

S&P Global
Ratings

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Research Update:

**City of Hamilton Outlook Revised To
Positive On Expected Very Low Debt
Burden And Exceptional Liquidity**

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Research Update:**City of Hamilton Outlook Revised To Positive On Expected Very Low Debt Burden And Exceptional Liquidity****Overview**

- We are revising our outlook on the City of Hamilton to positive from stable.
- We are also affirming our 'AA' long-term issuer credit and senior unsecured debt ratings on the city.
- The outlook revision reflects our opinion that, in the next two years, the city will continue to demonstrate a very low debt burden, healthy operating balances, and exceptional liquidity.
- In part, the ratings on Hamilton reflect our view of the city's exceptional liquidity, very strong economy, very low debt burden, and strong financial management.

Rating Action

On June 24, 2016, S&P Global Ratings revised its outlook on the City of Hamilton, in the Province of Ontario, to positive from stable. At the same time, S&P Global Ratings affirmed its 'AA' long-term issuer credit and senior unsecured debt ratings on Hamilton.

Rationale

The outlook revision reflects our opinion that the city's tax-supported debt will remain below 30% of consolidated operating revenues in the next two years, despite the temporary increase in debt expected in 2016; and that Hamilton will continue to demonstrate healthy operating balances, and exceptional liquidity.

Hamilton has indicated it will not issue any debt in 2017 and 2018, which, coupled with significant repayments scheduled on its housing mortgages, would result in the tax-supported debt burden decreasing to about 23% of consolidated operating revenues in fiscal 2018. This is despite an estimated increase in the ratio in fiscal 2016, when the city intends to issue C\$130 million of new debt to finance its capital needs. Moreover, we expect that interest costs will remain very modest at much less than 5% of operating revenue throughout the outlook horizon.

In our opinion, Hamilton demonstrates strong financial management. Disclosure and transparency are very good, annual financial statements are audited and

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unqualified, and the city prepares robust annual operating and capital budget documents. Well-defined financial policies also guide debt and liquidity management.

Hamilton's economy is what we view as very strong. We estimate that the city's GDP per capita is in line with the provincial average in 2013-2015 of about US\$45,500, given its broad base and continuing diversification into sectors such as health care, construction, and educational services, which has counterbalanced a gradual decline in its traditional manufacturing base. Although population growth has been slower than that of Ontario, unemployment remains lower than the provincial level and we believe that the city has fair prospects for growth and further diversification.

We expect Hamilton's budgetary performance to be average in the 2014-2018 base-case forecast period, with strong operating balances averaging almost 12% of operating revenues (all figures S&P Global Ratings-adjusted) and after-capital deficits averaging about 5% of total revenues. We believe that high capital expenditures in the next several years could stress these ratios, resulting in higher after-capital account deficits; however, we expect them to stay below 10% of total revenues.

Constraining the ratings on Hamilton partially is what we view as average budgetary flexibility relative to that of its domestic peers. While modifiable revenues are high, averaging about 87% of operating revenues, the city, like other Canadian municipalities, is constrained in its ability to meaningfully cut expenditures due to several factors, including high capital requirements, provincially mandated service levels, labor contracts, inflation, and political pressures. Although the ability to set property taxes, utility rates, and user fees gives municipalities significant revenue-raising tools, political and economic pressures also limit the degree to which a city will employ these. This is particularly true in Hamilton's case, given its residents' lower average household income and a large infrastructure deficit that limits the city's ability to materially defer capital spending, which will account for about 22% of total expenditures over the forecast period.

The city owns one large holding company, Hamilton Utilities Corp. (HUC), whose primary business activity, through its subsidiaries, is electricity distribution. We view this entity as self-supporting; it pays the city annual dividends of about C\$10 million. We estimate the city's exposure to HUC at less than 20% of adjusted operating revenues. Our assessment of the likelihood of extraordinary support from the city is low and we believe HUC provides a service that another private entity could readily assume and its potential as a source of cash through an asset sale is substantial. We believe the city's other contingent liabilities, stemming largely from standard employee benefits and landfill postclosure liabilities, are very low. They represent about 13% of consolidated operating revenues at year-end 2015 (or 10% net of dedicated reserves), and do not have a significant impact on the credit profile.

In our view, Canadian municipalities benefit from a very predictable and well-balanced local and regional government framework that has demonstrated a

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high degree of institutional stability. Although provincial governments mandate a significant proportion of municipal spending, they also provide operating fund transfers and impose fiscal restraint through legislative requirements to pass balanced operating budgets. Municipalities generally have the ability to match expenditures well with revenues, except for capital spending, which can be intensive. Any operating surpluses typically fund capital expenditures and future liabilities (such as postemployment obligations and landfill closure costs) through reserve contributions.

Liquidity

Hamilton has an exceptional liquidity profile. At the end of fiscal 2015, the city had cash and temporary investments of about C\$883.7 million, down from C\$1.0 billion at the end of the previous fiscal year, as it used previously amassed reserves to finance some capital projects and interest and principal payments increases. It holds cash equivalents and marketable securities in investment-grade government bonds and money market instruments, and manages them internally. By our liquidity calculations, Hamilton's average free cash and liquid assets total about C\$824 million in fiscal 2016. We estimate that they will represent about 11x the next 12 months' debt service. In addition, we believe the city's history of strong operating balances points to robust cash flow generation capability and bolsters its liquidity profile.

In our view, the city has satisfactory access to external liquidity, given its proven ability to issue into various markets, including that for public debt, and the presence of a secondary market for Canadian municipal debt instruments.

Outlook

The positive outlook reflects that there is at least a one-in-three chance we could upgrade Hamilton by one notch in the next two years if we saw an improvement in the city's budgetary performance such as after-capital deficits decreased to below 5% of adjusted operating revenues, on average, and tax-supported debt remained below 30% of consolidated operating revenues. It also reflects our expectation that Hamilton will preserve exceptional liquidity balances, and that operating performance will remain fairly stable. We could revise the outlook to stable should the city's capital plan require additional debt issuance resulting in a tax-supported ratio exceeding 30%, or if higher-than-expected spending forced the city to run after-capital account deficits of more than 10% of total revenue.

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Key Statistics

Table 1

City of Hamilton -- Economic Statistics					
	--Fiscal year ended Dec. 31--				
(%)	2011	2012	2013	2014	2015
Population	519,949	524,038	540,000	545,850	550,700
Population growth	0.7	0.8	3.0	1.1	0.9
Unemployment rate	6.4	6.5	6.4	5.8	5.5

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. Sources typically include national statistical offices.

Table 2

City of Hamilton -- Financial Statistics									
	--Fiscal year ended Dec. 31--								
(Mil. C\$)	2013	2014	2015	2016bc	2017bc	2018bc	2016uc	2017uc	2018uc
Operating revenues	1,360	1,414	1,504	1,535	1,577	1,620	1,560	1,622	1,686
Operating expenditures	1,181	1,231	1,306	1,350	1,394	1,438	1,343	1,382	1,419
Operating balance	179	183	199	185	183	182	217	240	267
Operating balance (% of operating revenues)	13.2	12.9	13.2	12.1	11.6	11.2	13.9	14.8	15.8
Capital revenues	68	151	62	97	105	114	85	93	114
Capital expenditures	272	364	342	350	380	411	309	335	411
Balance after capital accounts	(24)	(30)	(81)	(68)	(92)	(115)	(6)	(3)	(31)
Balance after capital accounts (% of total revenues)	(1.7)	(1.9)	(5.2)	(4.2)	(5.5)	(6.6)	(0.4)	(0.2)	(1.7)
Debt repaid	40	40	47	55	60	41	55	60	41
Balance after debt repayment and onlending	(64)	(70)	(128)	(123)	(152)	(156)	(61)	(63)	(72)
Balance after debt repayment and onlending (% of total revenues)	(4.5)	(4.5)	(8.2)	(7.5)	(9.0)	(9.0)	(3.7)	(3.7)	(4.0)
Gross borrowings	0	99	0	130	0	0	130	0	0
Balance after borrowings	(64)	29	(128)	7	(152)	(156)	69	(63)	(72)
Operating revenue growth (%)	3.6	4.0	6.4	2.0	2.7	2.7	3.7	3.9	3.9
Operating expenditure growth (%)	2.1	4.3	6.1	3.4	3.3	3.1	2.9	2.8	2.7
Modifiable revenues (% of operating revenues)	86.4	86.8	86.5	86.7	87.0	87.2	86.7	86.9	87.0
Capital expenditures (% of total expenditures)	18.7	22.8	20.7	20.6	21.4	22.2	18.7	19.5	22.5
Direct debt (outstanding at year-end)	380	438	391	466	406	365	466	406	365
Direct debt (% of operating revenues)	27.9	31.0	26.0	30.4	25.8	22.6	29.9	25.1	21.7
Tax-supported debt (% of consolidated operating revenues)	27.9	31.0	26.0	30.4	25.8	22.6	29.9	25.1	21.7
Interest (% of operating revenues)	1.1	0.9	1.0	1.1	1.1	0.9	1.1	1.1	0.9

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Table 2

City of Hamilton -- Financial Statistics (cont.)

	--Fiscal year ended Dec. 31--								
(Mil. C\$)	2013	2014	2015	2016bc	2017bc	2018bc	2016uc	2017uc	2018uc
Debt service (% of operating revenues)	4.0	3.8	4.1	4.7	4.9	3.5	4.6	4.8	3.3

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. Base case reflects S&P Global Ratings' expectations of the most likely scenario. Downside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with a downgrade. Upside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with an upgrade.

Ratings Score Snapshot

Table 3

City of Hamilton -- Rating Score Snapshot

Key Rating Factors	Assessment
Institutional Framework	Very predictable and well-balanced
Economy	Very strong
Financial Management	Strong
Budgetary Flexibility	Average
Budgetary Performance	Average
Liquidity	Exceptional
Debt Burden	Very low
Contingent Liabilities	Very low

*S&P Global Ratings' ratings on local and regional governments are based on eight main rating factors listed in the table above. Section A of S&P Global Ratings' "Methodology For Rating Non-U.S. Local And Regional Governments," published on June 30, 2014, summarizes how the eight factors are combined to derive the government's foreign currency rating.

Key Sovereign Statistics

Sovereign Risk Indicators, May 3, 2016. Interactive version available at <http://www.spratings.com/sri>

Related Criteria And Research

Related Criteria

- Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014
- Methodology And Assumptions For Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs, Oct. 15, 2009
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Institutional Framework Assessments For Non-U.S. Local And Regional Governments, April 21, 2016

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- Global Credit Conditions Weaken Broadly Amid Increasing Market Volatility,
April 19, 2016

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Hamilton (City of)		
Issuer Credit Rating	AA/Positive/--	AA/Stable/--

Ratings Affirmed

Hamilton (City of)	
Senior Unsecured	AA

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings

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