INFORMATION REPORT

TO:	Mayor and Members General Issues Committee
COMMITTEE DATE:	August 14, 2017
SUBJECT/REPORT NO:	2016 S&P Global Ratings Credit Review (FCS17069) (City Wide)
WARD(S) AFFECTED:	City Wide
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SUBMITTED BY: **SIGNATURE:**	Mike Zegarac General Manager Finance and Corporate Services Department

Council Direction:

Not Applicable.

Information:

S&P Global Ratings (S&P) has reviewed the City of Hamilton's (Hamilton) credit rating and raised the rating to AA+ with a "Stable" Outlook from AA with a "Positive" Outlook. S&P's 2016 credit rating document, S&P's "Research Update" dated June 16, 2017, is attached as Appendix "A" to Report FCS17069.

Rationale:

On May 26, 2017, City staff met with S&P analysts and provided requested information which included operational reports, budget information, financial information reports, financial statements and an economic development review. The analysts reviewed the information supplied and performed an analysis of the City's current financial position and its projected financial position going forward. This analysis was presented to their credit committee and the City's credit rating was raised to AA+ (Stable Outlook) from AA (Positive Outlook) in the "Research Update" released on June 16, 2017. Beginning with the 2016 Credit Review, S&P provided a single press release only and discontinued the subsequent supplementary analysis release.

This credit review resulted in a change in outlook from stable to positive, reflecting at that time at least a one-in-three chance S&P could upgrade Hamilton by one level in the next two years if S&P saw an improvement in the City's budgetary performance such as after-capital deficits decreased to below 5% of adjusted operating revenue, on average, and tax-supported debt remained below 30% of consolidated operating revenues among other expectations.

Table 1 provides S&P's 2016 Ratings Score Snapshot as reported in the "Research Update". Compared with last year, all key rating factors remain unchanged with the exception of Budgetary Performance which was upgraded from Average to Strong.

TABLE 1: City of Hamilton 2016 Ratings Score Snapshot

Key Rating Factors	Assessment
1) Institutional Framework	Very Predictable and Well-Balanced
2) Economy	Very Strong
3) Financial Management	Strong
4) Budgetary Flexibility	Average
5) Budgetary Performance	Strong
6) Liquidity	Exceptional
7) Debt Burden	Very Low
8) Contingent Liabilities	Very Low

Explanations to Assessment of Key Rating Factors:

1) The City operates in a very predictable and well balanced local and regional government framework that has demonstrated a high degree of stability and where municipalities are legislated by the Province to pass balanced operating budgets.

2) S&P views the City's economy as slow but with steady economic growth and that it will continue to diversify in the next several years. The economy is less rooted in steel production and has moved into other sectors such as advanced manufacturing, agribusiness, food processing, life sciences, digital media and goods transport. The City's Gross Domestic Product (GDP) per capita is estimated to be in line with the provincial average in 2014-2016.

3) Financial Management is strong due to demonstrated fiscal prudence. Reflecting this are cost cuts of nearly $12 M to the City's 2017 budget or about 0.8% of expected 2017 operating revenues, including the elimination of some full-time positions. Disclosure is thorough and transparent. Policies are complemented by long-term financial sustainability plans, long-term operating and spending forecasts and robust policies for investments, debt and risk management.

4) Budgetary Flexibility is moderate and the City is constrained in its ability to meaningfully cut operating expenditures due to provincially mandated service levels, labour contracts, inflation and political pressures. In addition, capital spending, which is expected to average 22% of total spending from 2017-2019, will be difficult to significantly defer given the City's $3.5 B infrastructure deficit. Political and economic pressures limit the City's ability to implement significant increases in revenues which also impacts flexibility.

5) Budgetary Performance is rated as strong. Mild yet steady assessment growth and conservative spending policies will result in strong and stable operating surpluses averaging just over 13% of operating revenue in 2015-2019 which will partially finance the City's steadily increasing capital spending. It is believed that Hamilton's after-capital deficits will average approximately 3% of total revenues in 2015-2019.

6) Hamilton has exceptionally high internal liquidity levels it can draw on, complemented by very healthy internal cash flow generation reflected in its very high operating surpluses. Hamilton's average free cash and liquid assets will total approximately $874 M in 2017 and will represent nearly 10.9x the next 12 months debt service. The City also benefits from satisfactory access to external liquidity for refinancing needs.

7) Hamilton's debt burden is considered very low. The tax-supported debt level is expected to regress to just below 23% of consolidated operating revenues in 2019 from 31% in 2016 and interest costs are expected to remain very modest at much less than 5% of operating revenues throughout 2018 and 2019.

8) Contingent liabilities are modest and do not present significant risks to the City's debt burden or liquidity. The City owns Hamilton Utilities Corporation (HUC) whose primary business is electricity distribution. However, HUC is viewed as self-supporting and has a low likelihood of requiring material support. Hamilton's contingent liabilities stem largely from standard employee benefits and landfill post-closure liabilities and are considered low. They represent about 13.3% of consolidated operating revenues or 9% net of dedicated reserves as at the end of 2016 and do not have a significant impact on the City's credit profile.

In summary, S&P concluded that Hamilton scores very well in seven of eight rating factors with above average rankings up to and including an exceptional rating for liquidity. Budgetary flexibility is rated as average due to economic and political pressures as well as a large infrastructure deficit.

Financial Ratios:

S&P has concentrated on five ratios in evaluating the City's and other municipalities' score specifically for credit rating ranges of AA-, AA and AA+. Four of these ratios appear in Table 2 below and in Table 1 of S&P's Report in Appendix "A" to Report FCS17069. The fifth ratio appearing in Table 2 was developed by S&P to assess the capability of a municipality to meet the next 12 months debt service. The five ratios are shown in Table 2 with the City's 2016, 2015 and 2014 ratios and the 2015 average for the full range of AA+ municipalities rated by S&P.

TABLE 2: City of Hamilton Ratios with Comparators

Year	Operating Balance as a % Adjusted Operating Revenues	Balance After Capital Accounts as a % of Total Revenues	Capital Expenditures as a % of Total Expenditures	Tax-Supported Debt as a % of Consolidated Operating Revenues	Free Cash and Liquid Assets Plus Committed Facilities as a % of Next 12 Months Debt Service
Hamilton 2016	13.3%	2.0%	18.5%	31.0%	959%
Hamilton 2015	13.2%	(5.2%)	20.7%	26.0%	1107%
Hamilton 2014	12.9%	(1.9%)	22.8%	31.0%	1150%
Average of Canadian Municipal Comparators 2015 (AA+)	18.4%	3.3%	23.9%	59.1%	1060%

In 2016, the operating balance increased marginally to 13.3% from 13.2% in 2015. The balance after capital increased to a positive 2.0% versus (5.2%) in 2015. The capital expenditures decreased to 18.5% versus 20.7% in 2015 reflecting a decrease in capital expenditures. The tax supported debt rose to 31.0% from 26.0% in 2015. The free cash and liquid assets declined to 9.59x from 11.07x in 2015. As previously mentioned, S&P has developed this ratio to assess the capability of a municipality to meet the next 12 months debt service. S&P currently has eight Canadian municipalities or counties rated AA+ and all entities are considered "exceptional" with this ratio being greater than 1.0x.

Outlook:

The stable outlook reflects that Hamilton will maintain large operating surpluses through 2019 supported by a prudent spending policy. These surpluses, together with some cash drawdowns and debt issuance, will allow the City to increase capital spending and maintain modest after-capital deficits. These capital investments will be made in the context of steady, though mild, economic growth and will reinforce the ongoing diversification of Hamilton's economy.

The rating could be lowered over the next two years if lower-than-expected economic growth were to cause significant deterioration in the City's budgetary performance leading to after-capital account deficits of over 10% of total revenue. If such deterioration were to cause the City to rely more heavily on debt issuance causing the debt burden to rise significantly above 30% of operating revenue for a sustained period, then the rating could be lowered.

Although an upgrade is unlikely over the next two years, the rating could rise if the City's economy were to grow significantly, causing operating surpluses to rise such that they would fully and consistently finance the City's capital programs, leading to structural surpluses after capital spending. This, combined with improvements in management's long-term financial planning, including the introduction of realistic and detailed longer-term targets over a greater time horizon and a strengthened budgeting process with approvals before the start of the fiscal year and limited revisions, could lead S&P to strengthen their assessment of the City's financial management; providing that all other ratings factors are unchanged.

TABLE 3: Hamilton's Credit Rating History

Rating Agency	**Rating** (Note 1)	
S&P Global Ratings	AA+/Stable:	2016
	AA/Positive:	2015
	AA:	2008 to 2014
	AA/Positive:	2005 to 2007
	AA:	1999 to 2005
	AA+:	1994 to 1999
	AAA:	1989 to 1994
Moody's	Aa3:	1995 to 2001
	Aa2:	1988 to 1995
Dominion Bond Rating Service	AA:	2004 to 2009
	AA+:	1994 to 2004

Notes to Table 3:

Ratings for City of Hamilton from 2001 to 2016 and ratings for Regional Municipality of Hamilton-Wentworth from 1988 to 2000.

TABLE 4: Credit Rating Peer Comparison Using S&P's Rating

Municipality (Single Tier City or Regional Municipality)	**Rating** (Stable Outlook if not Stated Otherwise)
Durham	AAA
Halton	AAA
London[1]	Aaa
Peel	AAA
Waterloo[1]	Aaa
Hamilton	**AA+**
Guelph	AA+
Regina (Sask)	AA+
York	AA+
Barrie	AA
Kingston	AA
Niagara	AA
Ottawa	AA
Toronto	AA
Windsor	AA

Notes to Table 4:
[1] Moody's was used as S&P's rating was unavailable

Appendices and Schedules Attached

Appendix "A" – S&P Global Ratings, Ratings Direct Research Update

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