S&P Global
Ratings

RatingsDirect®

Research Update:

City of Hamilton 'AA+' Ratings Affirmed; Outlook Is Stable

October 18, 2019

Overview

- We expect the City of Hamilton's fiscal performance to remain stable over the next two years, which, together with its high liquidity and low debt, will allow the city to fund its capital projects without impairing creditworthiness.
- We also believe that Hamilton's economic diversification will continue to mitigate the impact of volatility related to global trade disputes.
- As a result, S&P Global Ratings is affirming its 'AA+' long-term issuer credit and senior unsecured debt ratings on Hamilton and maintaining a stable outlook.

PRIMARY CREDIT ANALYST

Julia L Smith
Toronto
(1) 416-507-3236
Julia.Smith@spglobal.com

SECONDARY CONTACT

Dina Shillis, CFA
Toronto
+ 1 (416) 507 3214
dina.shillis@spglobal.com

RESEARCH CONTRIBUTOR

Deepanshu Goyal
CRISIL Global Analytical Center, an S&P Global Ratings affiliate, Mumbai

Rating Action

On Oct. 18, 2019, S&P Global Ratings affirmed its 'AA+' long-term issuer credit and senior unsecured debt ratings on the City of Hamilton, in the Province of Ontario. The outlook is stable.

Outlook

The stable outlook reflects our expectation that Hamilton's strong fiscal performance will continue over the next two years, supported by prudent policies. We believe that the city's high operating surpluses, together with some debt issuance, will allow Hamilton to maintain solid levels of capital spending and modest after-capital deficits. In our view, Hamilton will make these capital investments in the context of steady, although mild, economic growth; and these investments will reinforce the city's ongoing economic diversification.

Downside scenario

Over the next two years, lower-than-expected economic growth--due to trade disputes, an abrupt downturn in the housing market, or another external shock--could hurt Hamilton's revenue base. Although we view this scenario as unlikely in the next two years, this might stress the rating if after-capital deficits approach 10% of revenue. We could lower the ratings if such an outcome caused the city to rely more heavily on debt issuance, increasing the debt burden substantially above 30% of operating revenue for a sustained period; and if we did not believe that the debt burden was mitigated by high operating surpluses.

Upside scenario

Although we view the possibility of an upgrade as remote over the next two years, we could raise the ratings if Hamilton's economy were to grow significantly, causing operating surpluses to rise such that they would fully and consistently finance the city's capital program, leading to structural surpluses after capital spending. This, combined with substantial improvements in our assessment of financial management, supported by this stronger budget performance, and no deterioration in the other rating factors, could lead us to raise the ratings.

Rationale

We have updated our base-case scenario for Hamilton and extended our forecasting horizon to 2021. Although we expect weaker global demand and trade tensions to continue to lead to greater global economic volatility that might affect certain sectors in Hamilton, such as steel, the city's strong diversification will continue to make it resilient to such volatility, in our view. In this context, we believe the city's solid management will execute fiscally prudent policies, leading to high operating surpluses and modest deficits after capital accounts. This performance will allow Hamilton to sustain its large liquid assets and low debt levels.

Hamilton's economic diversification will continue to contribute to its steady economy, despite ongoing trade volatility.

We expect Hamilton to maintain its position as one of the most economically diversified cities in Canada over the next several years, as growth in diverse industry and manufacturing sectors surpasses that of many peers. We estimate that the city's GDP per capita would be in line with the national average of more than US$44,000 based on Hamilton's median household income and prosperous economy. Although historically rooted in steel production, the city's economy has moved into other sectors, including advanced manufacturing, aerospace, agribusiness, food processing, life sciences, digital media, and goods transport. In our view, this diversification, which The Conference Board of Canada scored at 0.95 in 2018, where a score of 1.00 is highly diverse, positions Hamilton well in the face of rising unpredictability on the timing and scope of global trade disruption and policy-related uncertainty. Nevertheless, we estimate that the steel industry continues to account for, directly and indirectly, just under 10% of Hamilton's labor force.

We expect broad policy continuity in the city's management under Fred Eisenberger, who is serving his third term as mayor of Hamilton. Management will prudently address infrastructure needs, in our view, particularly in transit and housing, facilitated by the four-year budget outlook and multiyear business plans. These plans complement Hamilton's thorough and transparent disclosure; long-term financial sustainability plans; long-term operating and spending forecasts; and robust policies for investments, debt, and risk management.

Hamilton's strong management operates in what we deem to be a very predictable and well-balanced local and regional government framework that has demonstrated a high degree of institutional stability. Although provincial governments mandate a significant portion 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.

Prudent budget execution will support low debt and high liquidity.

Hamilton's operating surpluses, averaging 13% of operating revenues from 2019-2021, will remain strong and steady over the forecast horizon, and should help, in part, to fund higher capital spending. At the same time, a 0.5% annual tax increase to the capital levy in the 2019 budget, in line with Hamilton's 10-year capital plan, along with an additional 0.34% increase annually, on average, from 2019-2021 to fund the city's share of provincial transit infrastructure funding, and for the West Harbour plan to make waterfront lands development-ready, will also help finance infrastructure projects. This higher capital spending, which we forecast will average 23% of total spending over the next three years, will contribute to moderate deficits after capital spending that average 3.8% of total revenues during the same period. In our view, Hamilton's capital spending level contributes to its average budgetary flexibility. We continue to expect the provincial government (through transit agency Metrolinx) to finance, construct, operate, maintain, and own one such investment--the light rail transit line for which property purchases have resumed following a short pause after the most recent provincial election. However, other projects will likely require Hamilton to issue debt. These projects include the West Harbour plan, which will make the waterfront ready to house about 1,600 new residential units; as well as transit investments, such as a transit maintenance and storage facility.

We expect that, to finance its capital plan, the city will issue about C$185 million from 2019-2021. This includes about C$45 million for City Housing Hamilton's housing projects. Nevertheless, we expect the city's debt burden to remain below 30% of consolidated operating revenues through 2021. In our view, the city's debt is also mitigated by its very high operating balances. Hamilton's debt consists of long-term debentures, mortgages on City Housing Hamilton properties, and a small amount related to capital leases. At the same time, we expect interest costs will remain very modest, at much less than 5% of operating revenues throughout the outlook horizon. We also believe the city's exposure to contingent liabilities is limited.

In addition to the city's very low debt burden, Hamilton has exceptionally high internal liquidity levels on which it can draw, complemented by very robust internal cash flow generation, as reflected in its very high operating surpluses. By our calculations, the city's average free cash and liquid assets are about C$463 million and will represent about 7x debt service. Beyond internal liquidity, Hamilton benefits from satisfactory access to external liquidity for refinancing needs, given its proven ability to issue debt into various markets, including that for public debt, and the presence of a secondary market for Canadian municipal debt instruments.

Key Statistics

Table 1

City of Hamilton -- Selected Indicators

	--Fiscal year ended Dec. 31--				
(Mil. C$)	**2017**	**2018**	**2019bc**	**2020bc**	**2021bc**
Operating revenues	1,575	1,641	1,701	1,760	1,828
Operating expenditures	1,340	1,431	1,476	1,533	1,599
Operating balance	234	210	224	227	229

Table 1

City of Hamilton -- Selected Indicators (cont.)

	--Fiscal year ended Dec. 31--				
(Mil. C$)	**2017**	**2018**	**2019bc**	**2020bc**	**2021bc**
Operating balance (% of operating revenues)	14.9	12.8	13.2	12.9	12.5
Capital revenues	97	210	140	176	166
Capital expenditures	351	408	403	505	476
Balance after capital accounts	(20)	12	(39)	(103)	(82)
Balance after capital accounts (% of total revenues)	(1.2)	0.6	(2.1)	(5.3)	(4.1)
Debt repaid	55	44	71	49	56
Gross borrowings	0	111	0	140	44
Balance after borrowings	(74)	78	(110)	(11)	(94)
Direct debt (outstanding at year-end)	418	485	414	505	493
Direct debt (% of operating revenues)	26.6	29.5	24.3	28.7	27.0
Tax-supported debt (outstanding at year-end)	418	485	414	505	493
Tax-supported debt (% of consolidated operating revenues)	26.6	29.5	24.3	28.7	27.0
Interest (% of operating revenues)	0.9	0.8	0.8	0.7	0.9
National GDP per capita (single units)	58,607	59,879	61,413	63,082	65,120

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. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. dc--Downside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with a downgrade. uc—Upside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with an upgrade. N/A--Not applicable. N.A.--Not available. N.M.--Not meaningful.

Ratings Score Snapshot

Table 2

City of Hamilton -- Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	2
Economy	1
Financial management	2
Budgetary performance	2
Liquidity	1
Debt burden	1
Stand-alone credit profile	aa+

Table 2

City of Hamilton -- Ratings Score Snapshot (cont.)

Key rating factors	Scores
Issuer credit rating	AA+

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "Methodology For Rating Local And Regional Governments Outside Of The U.S.," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

Key Sovereign Statistics

- Sovereign Risk Indicators, Oct 10, 2019. An interactive version is available at http://www.spratings.com/sri

Related Criteria

- Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- For Canada, Below-Potential Growth Is Likely In The Near Term, Oct. 7, 2019
- Credit Conditions North America: Rising Recession Risk Adds To Trade, Rate Uncertainty, Sept 30, 2019
- Guidance: Methodology For Rating Local and Regional Governments Outside of the U.S., July 15, 2019
- Institutional Framework Assessments For International Local and Regional Governments, July 4, 2019
- Public Finance System Overview: Canadian Municipalities, July 18, 2018

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	
Hamilton (City of)	
Issuer Credit Rating	AA+/Stable/--
Hamilton (City of)	
Senior Unsecured	AA+