

Research Update:

City of Hamilton 'AAA' Ratings Affirmed; Outlook Remains Stable

October 15, 2024

Overview

- Driven by infrastructure and maintenance requirements, the City of Hamilton will undertake a larger-than-historical level of capital spending in the next several years, as well as some related debt issuance.
- However, we expect that operating results will remain strong and stable, and that liquidity will remain more than sufficient to cover debt service.
- Therefore, S&P Global Ratings affirmed its 'AAA' long-term issuer credit and senior unsecured debt ratings on Hamilton.
- The stable outlook reflects our view that, although we expect larger after-capital deficits, its credit fundamentals will allow the city to execute a higher level of spending while maintaining robust overall results.

Rating Action

On Oct. 15, 2024, S&P Global Ratings affirmed its 'AAA' 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 S&P Global Ratings' expectations that, in the next two years, the city will maintain its prudent long-term financial planning and risk management policies such that its budgetary performance remains strong, while generating after-capital deficits in the service of its large capital plan. We expect the debt burden will remain relatively stable and that the city's liquidity position will remain very high.

Downside scenario

We could take a negative rating action in the next two years if a slow response by the city to

PRIMARY CREDIT ANALYST

Sabrina J Rivers

New York
+ 1 (212) 438 1437
sabrina.rivers
@spglobal.com

SECONDARY CONTACT

Hector Cedano, CFA

Toronto
+ 1 (416) 507 2536
hector.cedano
@spglobal.com

RESEARCH CONTRIBUTOR

Akul Patel

CRISIL Global Analytical Center, an
S&P affiliate, Mumbai

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changing operating conditions led to capital spending beyond expectations such that deficits rose above 10% on average, or additional borrowing increased the debt burden to more than 30% of operating revenues during the outlook horizon.

Rationale

To support its expanding economy, Hamilton is set to undertake a large capital plan focusing on key water and wastewater infrastructure upgrades, transit service improvements, and cyber security investments. As a result, we expect this plan will drive after-capital deficits of greater than 5% over the outlook horizon and a moderate increase in the city's debt burden. At the same time, we expect that Hamilton's economy will remain broad and diversified, allowing the city to generate continuous high operating balances and maintain liquidity more than sufficient to cover 12 months of debt service.

Supportive institutions and prudent financial management practices will bolster Hamilton's creditworthiness.

We believe Hamilton demonstrates characteristics of a resilient economy, including thorough diversification. Although historically rooted in steel production, the economy has expanded into other sectors, including advanced manufacturing, aerospace, agribusinesses, food processing, life sciences, digital media, and goods transport. The city's accessible location on the edge of the Greater Toronto Area supports its ability to attract business and investment. Although municipal GDP data are unavailable, we believe that Hamilton's GDP per capita is in line with the national level, which we estimate will be about US\$53,400 in 2024.

In our view, Hamilton demonstrates prudent financial management policies. Its planning is facilitated by a four-year budget outlook and multiyear business plans. These plans complement the city'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.

On Feb. 25, 2024, Hamilton was subject to a ransomware attack that affected the vast majority of its systems. The city was able to quickly contain the attack without paying the ransom nor was any personal identifying information compromised. Since containing the attack, Hamilton has been rebuilding its operations from extensive backups, taking the opportunity provided by the attack to reinforce its cyber preparedness initiatives through additional capital spending. At the same time, the full cost of responding to and recovering from the attack is unknown although regular costing updates to-date have been provided. As a result of the attack, the city has seen delays in the release of year-end financial statements. However, we view management's nimble response as commensurate with our assessment of its prudent financial management and assume a timely return to regular financial reporting.

As do other Canadian municipalities, Hamilton benefits from an extremely predictable and supportive local and regional government framework that has demonstrated high institutional stability and evidence of systemic extraordinary support in times of financial distress. Most recently through the pandemic, senior levels of government provided operating and transit-related grants to municipalities, in addition to direct support to individuals and businesses. 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

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intensive. Any operating surpluses typically fund capital expenditures and future liabilities (such as postemployment obligations) through reserve contributions. Municipalities have demonstrated a track record of strong budget results and, therefore, debt burdens, on average, are low relative to those of global peers and growth over time has been modest.

Elevated capital spending will require some moderate debt issuance over the outlook horizon, though both will remain manageable.

Given the key capital expenditures planned to enable growth, we expect that Hamilton's spending on these projects will increase notably from prior years. In our base-case scenario for 2022-2026, we expect the city to generate after-capital deficits averaging just above 6% and spend an average of C\$800 million in the forecast years. This spending will be primarily for investments in water and wastewater treatment facilities across the city, as well as infrastructure developments and transit services. Apart from these, the city's planned C\$3.4 billion light-rail transit project is expected to continue largely apace, with funding wholly the responsibility of senior levels of government. At the same time, we expect that its stable property tax base will allow Hamilton to generate operating balances averaging 13% over the base-case period.

In 2024-2026, Hamilton plans to issue about C\$212 million of debt, consisting of both mortgages and debentures, to fund part of its capital projects. Nevertheless, we expect tax-supported debt will remain relatively stable and will represent about 18% of operating revenues by year-end 2026, as debt repayment helps to offset new debt issuance. Beyond the outlook horizon, we expect the city will issue additional debt to fund its capital plan. We expect its interest burden will remain low through the outlook horizon despite planned issuances, representing less than 1% of adjusted operating revenues in all years. We also believe the city's exposure to contingent liabilities is limited.

In our view, Hamilton's liquidity is a key credit strength. We estimate total free cash in the next 12 months will be enough to cover over 8x the estimated debt service for the period. We expect this ratio will remain well above 100% during the outlook horizon.

City of Hamilton – Selected Indicators

Table 1

City of Hamilton--Selected indicators

(Mil. C\$)	--Fiscal year ended Dec. 31--					
	2021	2022	2023bc	2024bc	2025bc	2026bc
Operating revenues	1,826	1,892	1,972	2,047	2,135	2,227
Operating expenditures	1,585	1,648	1,715	1,790	1,850	1,919
Operating balance	241	244	257	257	285	308
Operating balance (% of operating revenues)	13.2	12.9	13.0	12.6	13.3	13.8
Capital revenues	139	123	209	282	327	272
Capital expenditures	447	320	571	770	892	741
Balance after capital accounts	(67)	46	(105)	(231)	(281)	(161)
Balance after capital accounts (% of total revenues)	(3.4)	2.3	(4.8)	(9.9)	(11.4)	(6.5)

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Table 1

City of Hamilton--Selected indicators (cont.)

(Mil. C\$)	--Fiscal year ended Dec. 31--					
	2021	2022	2023bc	2024bc	2025bc	2026bc
Debt repaid	52	52	41	38	43	39
Gross borrowings	17	4	2	4	148	60
Balance after borrowings	(102)	(2)	(143)	(266)	(176)	(140)
Direct debt (outstanding at year-end)	401	353	315	280	385	406
Direct debt (% of operating revenues)	22.0	18.7	16.0	13.7	18.0	18.3
Tax-supported debt (outstanding at year-end)	401	353	315	280	385	406
Tax-supported debt (% of consolidated operating revenues)	22.0	18.7	16.0	13.7	18.0	18.3
Interest (% of operating revenues)	0.6	0.5	0.4	0.4	0.6	0.6
National GDP per capita (single units)	65,825	72,249	72,127	72,553	74,508	76,835

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.

Ratings Score Snapshot

Table 2

City of Hamilton -- Rating component scores

Key rating factors	Scores
Institutional framework	1
Economy	1
Financial management	2
Budgetary performance	3
Liquidity	1
Debt burden	1
Stand-alone credit profile	aaa
Issuer credit rating	AAA

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. 7, 2024. An interactive version is available at <http://www.spratings.com/sri>

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Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Economic Outlook Canada Q4 2024: Further Rate Cuts Will Accelerate Growth, Sept. 24, 2024
- Risk Indicators For Canadian Local And Regional Governments: Strong Fiscal Management Is Key To Withstand Population Pressures, Sept. 19, 2024
- Canadian Municipalities Employ Flexibilities Within Fiscal Framework To Temper Cost Pressures, April 2, 2024
- Sector And Industry Variables | Criteria | Governments | Sovereigns: Sovereign Rating Methodology, March 26, 2024
- S&P Global Ratings Definitions, June 9, 2023

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 AAA/Stable/--

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Ratings Affirmed

Hamilton (City of)

Senior Unsecured AAA

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.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.

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