STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:
New Haven, Connecticut; General Obligation

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Credit Profile		
US$46.7 mil GO bnds iss ser 2015 A due 08/01/2035		
Long Term Rating	A-/Stable	New
New Haven GO		
Long Term Rating	A-/Stable	Upgraded

Rationale

Standard & Poor's Ratings Services raised its long-term rating and underlying rating (SPUR) on New Haven, Conn.'s outstanding general obligation (GO) bonds to 'A-' from 'BBB+'. At the same time, Standard & Poor's assigned its 'A-' rating to the city's series 2015 GO bonds. The outlook is stable.

The upgrade is based on the city's consistently balanced budgets and strong operating performance, a trend we anticipate will continue. The trend has resulted in an improvement in the nominal value of the city's available reserves.

The city's full-faith-and-credit pledge secures the bonds. Officials intend to use bond proceeds for public improvements, urban renewal, and school construction projects.

The rating reflects our opinion of the following favorable factors for the city, specifically its:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA) and a local stabilizing institutional influence;
- Strong budgetary performance, with balanced operating results in the general fund but a slight operating deficit at the total governmental fund level;
- Strong liquidity, with total government available cash of 6.9% of total governmental fund expenditures and 89.3% of governmental debt service, and access to external liquidity we consider strong; and
- Very strong institutional framework score.

Offsetting these strengthening factors are the city's:

- Very weak budgetary flexibility, with an available fund balance in fiscal 2014 of 0% of operating expenditures that is also low on a nominal basis at $22,000;
- Weak management, with "standard" financial policies and practices under our Financial Management Assessment methodology; and
- Weak debt and contingent liability position, with debt service carrying charges of 7.8% of expenditures and net direct debt that is 75.7% of total governmental fund revenue, and a large pension and other postemployment benefit (OPEB) liability and the lack of a plan to sufficiently address the obligation, but rapid amortization with 90.1% of debt scheduled to be retired in 10 years.

Strong economy

We consider New Haven's economy strong. The city, with an estimated population of 130,542, is located in New Haven County in the New Haven-Milford MSA, which we consider to be broad and diverse. The city also benefits, in our view, from a stabilizing institutional influence. The city has a projected per capita effective buying income of 78.0% of the national level and per capita market value of $66,923. Overall, the city's market value fell by 2.6% over the past year to $8.7 billion in 2015. The county unemployment rate was 7.2% in 2014.

Located midway between New York City and Boston, New Haven is home to Yale University and three other educational institutions that stabilize the regional economy, although the large student population depresses income indicators. Yale University is planning or has recently finished $1 billion in capital additions to its campus, including two new colleges for 800 undergraduates, a 15% increase in students. There are a number of economic developments underway that we expect may positively affect the city's tax base over the long term. Ongoing upgrades to the Tweed New Haven Airport and Union Station should likely improve access to the city. Further, Alexion Bio-Tech's relocation of its headquarters to downtown New Haven is expected to bring 500 jobs. The city is also formulating a strategic plan to develop widespread broadband access to foster economic activity throughout the region. Finally, there are 1,500 new market-rate apartments under construction or in the zoning approval phase that would results in spending of about $400 million. Overall, New Haven's assessed value (AV) has grown nearly 2% over the past three years, to $6.12 billion in 2015. We consider the city's tax base to be very diverse, with the top 10 comprising 16.4% of AV.

Strong budgetary performance

New Haven's budgetary performance is strong in our opinion. The city had balanced operating results in the general fund of 0.2% of expenditures, but a slight deficit across all governmental funds of 0.6% in fiscal 2014.

The 2014 revenues and expenditures were adjusted to include the spending in the internal service fund. We also adjusted general fund expenditures for transfers out of the general fund and governmental fund expenditures for capital outlay paid from bond proceeds. Management attributes the city's strong performance in 2014 to unbudgeted debt service savings from refunding. For 2015, we understand the city estimates ending the year with a $1.7 million general fund operating surplus. The city attributes its improved results to reduced overtime costs following the hiring of 68 police officers and 87 firefighters as well as favorable revenue variances in building permit fees and licenses due largely to $7.5 million in fees for the new residential college at Yale University.

The 2016 budget of $507.875 million represents a 0.9% decrease from the 2015 budget. The budget does not include a tax rate increase and incorporates new funding levels required for recent changes in the underlying assumptions for the city's pension funds. Four of the city's collective bargaining unit contracts are currently in negotiation although the city has settled its contracts with the police, firefighters', and public works unions.

Very weak budgetary flexibility

New Haven's budgetary flexibility is very weak, in our view, with an available fund balance in fiscal 2014 of 0% of operating expenditures. In addition, reserves are low on a nominal basis at $22,000, which we view as vulnerably low and a negative credit factor.

The city's available general fund reserves turned negative in 2013 following years of structurally imbalanced budgets. Fiscal 2014 results, however, reversed this trend with a budget that did not include one-time revenue or significant projected expenditure savings contingent on labor group concessions. As a result, available reserves in 2014 grew to $22,000, which we still consider to be nominally very low. The internal service funds had a cumulative deficit of $18.2 million in 2014. According to the 2014 audit, subsequent events in 2015 include $14.5 million of debt refunding savings that were applied to the internal service funds to reduce the deficit significantly. Further, 2015 general fund results are expected to add about $1.7 million to general fund reserves although we would still consider these levels to be very weak. It is management's intention to eliminate the deficit fund balances in the general and internal service funds. Should the city realize consistent and sizable positive operating results, available reserves should improve in the medium term.

Strong liquidity

In our opinion, New Haven's liquidity is strong, with total government available cash of 6.9% of total governmental fund expenditures and 89.3% governmental debt service in 2014. In our view, the city has strong access to external liquidity if necessary.

Since last year, underlying liquidity has improved to adequate from weak following a continued increase in tax collections. The city's strong external liquidity stems from its issuance of GO debt and bond anticipation notes in the past 15 years. As there are no pending claims on liquidity, we expect no change in the city's liquidity ratios.

The city has a revolving loan agreement with Bank of America N.A. that can accommodate the issuance of up to $70 million of grant anticipation notes to finance school construction projects. The agreement contains certain events of default that we consider to be permissive. However, there is no immediate acceleration or termination of the loan as a remedy.

The Parking Authority, a component unit of the city, has a $6.8 million direct purchase revenue bond secured bythe pledged income from parking revenue. New Haven, acting on behalf of the authority, has an interest-rate swap agreement--which terminates Jan. 1, 2022--to effectively change the variable interest rate on the bonds to a fixed rate. We believe that given the relatively small size of the direct purchase debt and related swap agreement in relation to the city's cash position, the city has sufficient liquidity for any potential event of default or remedy associated with the direct purchase and swap agreements.

Weak management

We view the city's management as weak, with "standard" financial policies and practices under our Financial Management Assessment methodology, indicating the finance department maintains adequate policies in some but not all key areas.

During the audited three-year period when the city was rebounding from a structural imbalance, we considered the initial management score as weak. We otherwise believe that management is adequate and maintains "standard" financial policies and practices. Management uses typically three years of historic trend analysis to create a line-item budget. Management also consults with outside sources to understand revenue and expenditure trends when formulating the budget. Management monitors budget-to-actual results regularly and presents monthly reports to the Board of Aldermen. While the city does not have a formal long-term financial plan or forecast, it does maintain a five-year capital improvement plan--with funding sources identified--that is incorporated into the budget annually. The city does not have a formal debt management policy but does have an investment policy and reports holdings and returns to the board monthly. New Haven lacks a formal fund balance policy but will likely target to maintain reserves at 5% of expenditures should management be successful in building up available reserves.

Weak debt and contingent liability profile

In our view, New Haven's debt and contingent liability profile is weak. Total governmental fund debt service is 7.8% of total governmental fund expenditures, and net direct debt is 75.7% of total governmental fund revenue. Approximately 90.1% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

Over the next two years, the city will likely issue up to $72 million in debt for various capital improvements. Given the city's above-average amortization, we do not expect the additional debt to adversely affect the city's overall debt profile.

In our opinion, a credit weakness is New Haven's large pension and OPEB liability and the lack of a plan that will sufficiently address the obligation. New Haven's combined pension and OPEB contributions totaled 8.5% of total governmental fund expenditures in 2015. Of that amount, 5.3% represented contributions to pension obligations and 3.2% represented OPEB payments. The city made its full annual required pension contribution in 2015.

The city maintains two single employer contributory, defined benefit pension plans: The City Employees' Retirement Fund (CERF) and the Policemen's and Firemen's Retirement Fund. The CERF had an unfunded liability of $266.98 million as of its June 30, 2014, valuation and was just 39.3% funded, while the Police and Fire plan had an unfunded liability of $335.95 million and was just 50.13% funded. The city also provides OPEBs to its employees on a pay-as-you-go basis. As of the latest valuation date of July 1, 2013, the city's OPEB unfunded actuarial accrued liability was $441.06 million and was 0.1% funded.

Management has taken a number of steps to reduce the city's future pension and OPEB liability. However, the liability is sizable and will remain a credit weakness for many years. Management recently lowered the investment rate assumption to 8% from 8.25% for both pension funds. Further, the city lowered it payroll growth assumptions to 3.0% for the police and fire pension and 2% for CERF. Finally, the city is negotiating with its unions to reform postemployment health care benefits in their new contracts.

Very strong institutional framework

The institutional framework score for Connecticut municipalities is very strong.

Outlook

The stable outlook reflects our view that the city's adoption of more realistic budget assumptions since 2014 has resulted in strong operating performance that should continue into 2015. Further, the 2016 budget is balanced with no use of one-time revenues or cuts in expenditures. Despite our expectation of continued strong operating performance--which we believe should boost reserves--we do not anticipate changing the rating within our two-year horizon as available reserves will likely remain very weak and that the city will continue to face challenges associated with its pension and OPEB obligations. Upward movement would likely follow sustainable positive operations resulting in higher available reserves as well as an improvement in the debt profile. Conversely, should the city return to structural imbalance, resulting in a weakening of reserves or liquidity, we could lower the rating.

Related Criteria And Research

Related Criteria

- USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- USPF Criteria: Financial Management Assessment, June 27, 2006
- USPF Criteria: Debt Statement Analysis, Aug. 22, 2006
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013

Ratings Detail (As Of July 30, 2015)		
New Haven GO (wrap of insured) (AMBAC & AGM) (SEC MKT)		
Unenhanced Rating	A-(SPUR)/Stable	Upgraded
New Haven GO (FGIC)		
Unenhanced Rating	A-(SPUR)/Stable	Upgraded
New Haven (BAM)		
Unenhanced Rating	A-(SPUR)/Stable	Upgraded
New Haven GO		
Unenhanced Rating	A-(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

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