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CREDIT OPINION
11 July 2019

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New Haven (City of) CT

Update to credit analysis following revision of outlook to stable

Summary

New Haven, CT (Baa1 stable) continues to be challenged by a very narrow reserve position, limited revenue raising flexibility due to high tax rates and a significant amount of tax-exempt property, and elevated long-term liabilities. However, due to a tax rate increase in fiscal 2019, strengthened financial monitoring and expenditure controls, the city is projecting an operating surplus in fiscal 2019 and balanced operations in fiscal 2020. Fixed costs are currently manageable, but long-term liabilities are high and increased pension funding is required to prevent depletion of assets.

The local economy benefits from the institutional presence of Yale University (Aaa stable) and Yale New Haven Hospital (Yale New Haven Health, Aa3 stable), although resident income and wealth levels are low and poverty rates are high, due in part to the high student population.

On July 11, we affirmed the city's GO rating of Baa1 and revised to outlook to stable from negative.

Credit strengths

» Local economy benefits from significant institutional presence

» Projected surplus in fiscal 2019 will eliminate deficit fund balance position

» Reduction in fixed costs following several debt restructurings

Credit challenges

» High dependence on intergovernmental revenues

» Limited operating flexibility

» Elevated long-term liabilities

» Low funded ratios for pensions and notable treadwater gap leading to increased depletion risk

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Rating outlook

The stable outlook reflects the expectation that the city's financial position will improve slightly in fiscal 2019 and stabilize due to management's continued efforts to increase revenues and minimize expenditure growth. The outlook also reflects the ongoing growth in the city's tax base.

Factors that could lead to an upgrade

- Sustained trend of structural balance leading to increased fund balance position
- Improved pension funding leading to a reduced treadwater gap and higher funded ratios
- Reduction in long-term liabilities
- Tax base expansion and improved income and wealth levels

Factors that could lead to a downgrade

- Further reduction in reserves or ongoing structural imbalance
- Significant increase in long-term liabilities or fixed costs
- Tax base contraction

Key indicators

Exhibit 1

New Haven (City of) CT	2014	2015	2016	2017	2018
Economy/Tax Base					
Total Full Value ($000)	$9,330,122	$9,713,318	$9,723,396	$10,248,532	$9,408,562
Population	130,553	130,612	130,405	130,884	129,934
Full Value Per Capita	$71,466	$74,368	$74,563	$78,302	$72,410
Median Family Income (% of US Median)	70.4%	69.0%	67.0%	65.9%	65.9%
Finances					
Operating Revenue ($000)	$529,517	$548,595	$541,929	$582,957	$607,787
Fund Balance ($000)	$22	$1,726	$2,024	($3,764)	$4,620
Cash Balance ($000)	$25,160	$28,379	$32,572	$29,424	$49,096
Fund Balance as a % of Revenues	0.0%	0.3%	0.4%	-0.6%	0.8%
Cash Balance as a % of Revenues	4.8%	5.2%	6.0%	5.0%	8.1%
Debt/Pensions					
Net Direct Debt ($000)	$548,548	$551,620	$552,530	$548,728	$575,019
3-Year Average of Moody's ANPL ($000)	$1,138,198	$1,153,332	$1,250,307	$1,363,873	$1,475,444
Net Direct Debt / Full Value (%)	5.9%	5.7%	5.7%	5.4%	6.1%
Net Direct Debt / Operating Revenues (x)	1.0x	1.0x	1.0x	0.9x	0.9x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	12.2%	11.9%	12.9%	13.3%	15.7%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	2.1x	2.1x	2.3x	2.3x	2.4x

Source: Moody's Investors Service

Profile

New Haven is located on Long Island Sound in New Haven County, CT approximately 80 miles east of New York City. The city serves as a regional employment center and is home to a significant concentration of healthcare and higher education institutions including Yale University and Yale New Haven health. The city's population totals approximately 130,884.

Detailed credit considerations

Economy and Tax Base: Large tax base benefits from institutional presence

The city's economy will continue to benefit from Yale University's large academic and medical presence, much of which is not included in the city's taxable base, as well as ongoing development in the biotechnology and applied research sectors and mixed use developments. While Yale and the Yale New Haven Hospital helped stabilize the city in the aftermath of the recession, approximately 56% of the city's base is tax-exempt, limiting the city's ability to generate additional property tax revenues, the city's largest revenue source.

As of 2018, the city's equalized net grand list (ENGL) totaled a sizeable $9.4 billion. While net grand list, or assessed value, growth has been modest in recent years, a reassessment effective fiscal 2018 reflected a strong 8.5% increase. Officials report several mixed use developments, four hotels underway and in the pipeline. The city is also working on several road projects that are expected to improve access to certain areas of the city and spur new development in the future.

The city is favorably located in Southern Connecticut, benefitting from transportation options that will continue to improve through investment in the Tweed New Haven Airport and Union Station. The Second Court of Appeals recently ruled in favor of the airport in its proposed lengthening of its runway, which should lead to increased flight traffic, a positive for the regional economy. Highlighting Yale's strong presence in the city is the university's recent construction of two new residential colleges, the result of a $250 million donation. The expansion was the first since 1969, and is expected to increase enrollment by 15%. Additionally, Yale New Haven Hospital recently announced plans to build an $838 million neurosciences center in the city.

Partially reflective of the significant student population, with combined total enrollment exceeding 30,000, the city's per capita income remains below average, at 59.7% and 79.2% of state and national levels, respectively. One-quarter of the city's population is classified as below the poverty line. When considering only the taxable ENGL, the equalized value per capita is below the state median at $72,410. However, when including the nearly $4 billion in tax-exempt property full value per capita is over $100,000. Unemployment of 3.7% as of April 2019 is slightly above state and national levels of 3.3%.

Financial Operations and Reserves: Very limited reserve position expected to improve in fiscal 2019

The city's financial position will remain narrow given high fixed costs and limited revenue growth, but will improve in fiscal 2019 largely due to a tax rate increase. Due to general fund deficits in the last two years, fiscal 2018 general fund balance declined to negative $10.6 million, or -1.7% of revenues, the lowest amount in at least 10 years. The recent deficits were driven largely by reductions in intergovernmental revenues and expenditures over budget.

Positively, the city implemented a sizable tax rate increase in fiscal 2019, which, along with other revenue initiatives and debt restructuring, led to the adoption of a balanced budget. The 4.3 mills, or 11.1%, tax rate increase generated approximately $30 million in increased property tax revenues. Officials currently project upwards of a $14 million operating surplus due to property tax revenues over budget and expenditure savings, particularly related to medical expenses.

The adopted fiscal 2020 budget represents a 1.75% increase over the prior year budget and is balanced without a tax rate increase or the use of fund balance. The city continues to negotiation contributions from Yale University and Yale New Haven Hospital and will see a $3 million increase in fiscal 2020 due to recalculated fire service fees and Yale's voluntary PILOT payment.

While the city's general fund balance has remained very narrow in recent years, the city has eliminated the negative fund balance in its internal services fund from negative $18 million in fiscal 2014 and absorbed the fund into the general fund as of fiscal 2018. The city has also invested in technology upgrades that will better manage workers compensation claims and improve financial management. The city has partnered with Yale New Haven Hospital to develop a medical plan for city employees, which will reduce costs over the long-run. Lastly, officials have developed a five-year financial plan that includes a comprehensive review of operations, organizational structure and budget drivers, as well as 34 initiatives related to finances, capital and economic development.

The city will remain challenged to improve its reserve position to be in line with state peers given the potential for future state revenue cuts, which will compound relative stagnant revenue growth given limited tax base expansion, and high fixed costs. However, management's proactive approach to identification and implementation of cost saving measures, development of long-term financial plans and recent tax rate increase demonstrate an ongoing commitment to achieve structural balance.

LIQUIDITY

The city's liquidity position is adequate, with general fund cash totaling $33.9 million (5.6% of revenues) in fiscal 2018. The difference between fund balance and cash is driven by a significant amount of deferred and unearned revenues accounted for as liabilities.

Debt and Pensions: Manageable fixed costs; very elevated long-term liabilities and low funded pensions

The debt position will remain heavily leveraged for the foreseeable future, due to a currently high debt burden, additional future borrowing plans and an average retirement of principal. New Haven's direct debt burden, at 6.1% of ENGL, is well above the median level for similarly-sized cities. Debt service in fiscal 2018 represented 5.8% of operating expenditures but will increase in fiscal 2020 by approximately 50%.

The city's five-year capital plan reflects debt service escalating from $66 million per year in fiscal 2019 to $76 million in fiscal 2021, after which it levels off for four years. The five-year plan includes issuances in fiscal years 2018-2022, ranging from $45-56 million annually.

DEBT STRUCTURE

All of New Haven' debt is fixed rate and amortizes at a below average rate with 52.7% of principal scheduled to be retired over the next 10 years.

DEBT-RELATED DERIVATIVES

The city is not party to any derivative agreements.

PENSIONS AND OPEB

Pensions and OPEB are a significant credit pressure for New Haven as pensions are lowly funded and long-term liabilities are very high. The city maintains two single-employer defined benefits plans. The city's fiscal 2018 pension contributions amounted to 9.3% of revenues, but in order to “tread water” on its reported unfunded pension liabilities, the city would have had to dedicate 11.1% of its revenues to pensions. This “tread water gap” signals the magnitude to which the city is deferring its pension costs to future years under reported assumptions. Additionally, the city's plans have very low funded ratios of 38% and 44% (based on July 1, 2018 valuations), which signals a high level of asset depletion risk without higher contributions and strong investment performance.

New Haven's Moody's adjusted net pension liability, based on a 4.14% discount rate, was $1.5 billion in fiscal 2018. In comparison, the city reported a GASB net pension liability of $804 million for both plans, based on a weighted 7.75% discount rate.

For teachers, the city participates in the State of Connecticut Teachers' Retirement System (TRS). Employer contributions to the TRS, which are covered by on behalf payments made by the state, totaled $58.2 million in 2018.

The city funds OPEB on a pay-as-you-go basis, contributing $27.3 million in fiscal 2018. The city's GASB net pension liability totaled $616.7 million, based on a 3.87% discount rate, and the Moody's adjusted liability was $598.6 million, based on a 4.14% discount rate.

Including debt, pension and OPEB, the city's liabilities represent a significant 28.7% of ENGL or 4.4 times operating revenues. When the Moody's adjusted net pension liability for TRS is included, total long-term liabilities increase to a very high 42.5% of ENGL or 6.6 times operating revenues. Fixed costs (debt service, tread water indicator for pensions and OPEB contributions) in fiscal 2018 represented a moderate 19.6% of operating revenues, but will increase in fiscal 2020 to approximately 22% as debt service expenditures in fiscal 2018 and 2019 were unusually low due to refundings.

Exhibit 2

Elevated long-term liabilities with currently-manageable fixed costs

	($000)	% of Operating Revenues	Discount Rate
Reported Unfunded Pension Liability	804,230	132%	7.75%
Moody's Adjusted Net Pension Liability	1,525,281	251%	4.14%
Reported Net OPEB Liability	616,661	101%	3.87%
Moody's Adjusted Net OPEB Liability	598,617	98%	4.14%
Pension Contribution	56,314	9.3%	-
Pension Tread Water Gap	(10,878)	-1.8%	-
OPEB Contribution	27,431	4.5%	-
Debt Service	35,152	5.8%	-
Total Fixed Costs	108,019	17.8%	-

Source: Moody's Investors Service

Management and Governance

City management is in the process of developing a five-year financial plan with a focus on maintaining structural balance. in conjuction with the plan, officials have developed 34 initiatives related to revenue enhancements, expenditures, healthcare and capital that will support the goal of balanced operations over the next several years.

Connecticut cities have an institutional framework score of “Aa,” or strong. Revenues are highly predictable and stable, due to a large reliance on property taxes. Cities additionally benefit from high revenue-raising ability due to the absence of a state-wide property tax cap. Expenditures primarily consist of personnel costs as well as education costs for those cities that manage school operations, and are highly predictable due to state-mandated school spending guidelines and employee contracts that dictate costs. Expenditure reduction ability is moderate as it is somewhat constrained by union presence.

Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 3

New Haven (City of) CT

Rating Factors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$9,408,562	Aa
Full Value Per Capita	$71,813	Aa
Median Family Income (% of US Median)	65.9%	Baa
Notching Factors:[2]		
Institutional Presence		Up
Outsized Unemployment or Poverty Levels		Down
Finances (30%)		
Fund Balance as a % of Revenues	0.8%	Baa
5-Year Dollar Change in Fund Balance as % of Revenues	2.2%	A
Cash Balance as a % of Revenues	8.1%	A
5-Year Dollar Change in Cash Balance as % of Revenues	4.6%	A
Notching Factors:[2]		
Unusually volatile revenue structure		Down
Management (20%)		
Institutional Framework	Aa	Aa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	1.0x	A
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	6.1%	Baa
Net Direct Debt / Operating Revenues (x)	0.9x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	15.7%	Ba
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	2.4x	A
Notching Factors:[2]		
Other Analyst Adjustment to Debt and Pensions Factor (specify): Contingent risk associated with state pension support		Down
Other		
Credit Event/Trend Not Yet Reflected in Existing Data Sets: Elevated long-term liabilities with depletion risk for pensions		Down
	Scorecard-Indicated Outcome	Baa1
	Assigned Rating	Baa1

[1] Economy measures are based on data from the most recent year available.
[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology dated December 16, 2016.
[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs Updated for 2019 publication.
Source: US Census Bureau, Moody's Investors Service

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