



## **RATING ACTION COMMENTARY**

# **Fitch Rates Hamden, CT's \$21MM Ser 2021 GO Bonds 'BBB'; Outlook Remains Negative**

Thu 29 Jul, 2021 - 12:56 PM ET

Fitch Ratings - New York - 29 Jul 2021: Fitch Ratings has assigned a 'BBB' rating to the following town of Hamden, CT general obligation (GO) bonds:

--\$20,880,000 GO bonds issue of 2021;

The bonds are scheduled to sell the week of Aug. 16 via negotiated sale. Proceeds will be used to fund various capital projects and refund certain outstanding GO bonds for savings.

In addition, Fitch has affirmed the town's Issuer Default Rating (IDR) and outstanding GO bonds at 'BBB'.

The Rating Outlook remains Negative.

## **SECURITY**

The bonds are a general obligation of Hamden backed by its full faith, credit, and unlimited taxing power.

## **ANALYTICAL CONCLUSION**

The Negative Outlook reflects issues regarding the town's ability to generate balanced operations that would preserve the current projected increases in its reserves, largely derived from a bond restructuring. Furthermore, the prospect of savings from an additional bond restructuring in fiscal 2022 are uncertain and could create pressure on the town's fiscal position if not fully realized. Although the continued use of property tax increases to support financial obligations is available, Fitch believes the ability to raise taxes from already high levels could be difficult to achieve from a political and economic standpoint.

The 'BBB' IDR and GO bond rating reflect Hamden's overall weak financial status and its reliance on savings from bond restructurings to help pay for future increases in scheduled debt service, while avoiding substantial property tax increases. Millage rates are considered high relative to other local governments in the state. Last year's planned bond restructuring resulted in budget savings that helped restore general funds to a positive position, reversing the negative \$2.3 million total fund balance as of fiscal end 2020.

The fiscal 2021 budget provided for full funding of the pension ADC for the first time in years, which Fitch views as a positive. Furthermore, Hamden's five-year statutorily required tax base revaluation resulted in a 7% yoy increase for fiscal 2022, providing much-needed new revenues for the current fiscal year's budget. The town's long-term liabilities are elevated in part due to a history of pension underfunding and are further pressured from a very high other post-employment benefit (OPEB) liability, despite the town's success in alleviating this pressure somewhat through negotiated concessions.

## **ECONOMIC RESOURCE BASE**

Hamden is located north of New Haven and about 35 miles southwest of Hartford. The town is primarily residential in nature and had a 2020 census population of 60,294, which is down slightly from 2010. The town is home to Quinnipiac University and is about five miles from Yale University, contributing to a notable presence in education. Employment and demographic indices largely reflect those of the state.

## KEY RATING DRIVERS

### Revenue Framework: 'a'

The town derives the bulk of its revenues from property taxes for which changes in the levy or millage rate are not restricted by law. The town's tax base experienced 7% growth for the current fiscal year based on the results of its five-year revaluation, reversing a trend of negative growth. Prior revaluation results reflected declines and very modest increases due to new development, necessitating millage rate increases to support spending.

### Expenditure Framework: 'bbb'

Spending pressures are evident in the town's escalating debt service structure and increasing pension contributions, given the low funded status of the town's single-employer pension plan and history of pension underfunding. The town has uncertain capacity to achieve cost savings without impacting service levels given the high proportion of debt service, retiree benefits, and critical education and public safety spending to the overall budget.

### Long-Term Liability Burden: 'a'

Fitch expects Hamden's long-term liability burden to remain moderately high in relation to personal income due to potential growth in outstanding net pension liabilities (NPL). Additionally, the town's unfunded OPEB liability is very high, although the town has made some progress to curb future benefits.

### Operating Performance: 'bb'

The town had maintained reserves at a very low 1%-2% of spending dating back to fiscal 2010; however, the pandemic-related impact on revenues contributed to a depletion of reserves and accumulated fund balance deficit in fiscal 2020. The town expects to restore

the general fund balance to a positive position in fiscal 2021, largely due to debt refunding and restructuring activity and use of fiscal stimulus moneys.

The combination of low reserves and limited spending flexibility contribute to a financial profile that could become distressed from future unexpected events or a cyclical downturn. Spending deferrals and use of non-recurring revenue sources have been utilized to support budget balance in the past, but Fitch would expect the application of these tools to become more challenging going forward.

## **RATING SENSITIVITIES**

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--The Rating Outlook could be revised to Stable if the town is able to demonstrate more balanced operations excluding one-time sources and an improved level of reserves which reflects a higher level of financial resilience.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A lack of progress in achieving budget stability including a lessened reliance on the use of non-recurring revenues and optimistic revenue assumptions to balance the budget.

--Inability to increase and maintain reserves to improve overall gap-closing capacity.

## **BEST/WORST CASE RATING SCENARIO**

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

## CURRENT DEVELOPMENTS

Hamden is projecting to end fiscal 2021 with an approximate \$4.3 million total general fund balance (2% of spending). This follows a \$4.3 million net operating deficit that occurred in fiscal 2020, due mostly to pandemic related declines in revenues, that had resulted in a negative \$3 million unrestricted fund balance position. Management raised the tax rate to support spending in the fiscal 2021 budget and reduced expenses following the negative fiscal 2020 operating results.

The positive expected result for fiscal 2021 reflects over \$6 million in unbudgeted savings derived from a bond refunding and restructuring and the use of \$6 million of American Rescue Plan Act (ARPA) moneys. Hamden has been allocated \$12 million of ARPA moneys plus an additional \$12 million as part of its county allocation. The Hamden schools, of which the town is a primary funding source, are also expecting to receive \$12 million in ARPA money which could alleviate funding pressure on the town.

The fiscal 2022 budget of \$262 million is a roughly 5% increase over the fiscal 2021 budget. The increase required a small rise in the mill rate. The increase in the tax base and mill rate resulted in a \$17 million increase in the tax levy to support mostly budget increases for public safety, employee salaries and benefits and debt service. State aid for the town and schools is up \$4.3 million, reflecting the state's effort to improve municipal and education funding.

Management budgeted an approximate \$2 million increase in debt service to \$23.9 million, which is approximately \$6.4 million above its fiscal 2022 scheduled debt service. The excess debt service appropriation should support surplus operations at year end if the town does not experience deficits in other areas, and is part of the town's plan to ramp up operating revenue to support the future increase in scheduled debt service in fiscal 2023.

Management plans to pursue a bond refunding and restructuring in 2022 that lowers annual debt service costs in fiscal 2023 by a projected \$10 million. The proposed restructuring pushes debt service costs to outer years when debt service declines. Without this restructuring pro-forma debt service for fiscal 2023 increases by \$5 million, or 21%, to \$28.9 million, before the realization of any savings from the current series 2021 refunding.

Fitch does not consider the continued practice and use of non-recurring revenue sources a reliable budget measure, as such actions rely on market conditions and access that may not be realized. An Outlook revision to Stable is predicated on the town's ability to present a

plausible plan that eliminates its dependence on one-shots and essential spending deferrals to balance the budget in addition to improvement of reserves.

## CREDIT PROFILE

Hamden's economic resource base largely reflects its position as a residential community. The median household income is slightly above those of the wealthy state. However, tax base performance has been somewhat weak prior to this most recent five-year property revaluation. The town's population has declined slightly over the past decade. Industry is clustered around healthcare, bioscience, and education, due to the town's proximity to a number of universities, including Yale University in nearby New Haven. Quinnipiac University is one of the town's largest employers and has roughly 7,400 undergraduate students.

## REVENUE FRAMEWORK

Hamden's primary source of revenues is the property tax, which typically approximates 75% of general fund revenues. Other key revenue sources for the town include state aid, the bulk of which is specifically dedicated for the operation of the town board of education (BOE).

Fitch expects the town's general fund revenues to remain fairly stagnant or to increase below the level of inflation in the foreseeable future absent policy action. The town's five-year tax base revaluation effective Oct. 1, 2020 (for fiscal year 2022) was up 7% at \$4.2 billion and follows the 5% decline based on the five-year revaluation effective for fiscal 2017. The tax base essentially remained flat for fiscal 2018, 2019 and 2020 reflecting limited new construction value being added to the tax base. Several new development projects could provide moderate growth depending on the pace of completion and housing values have experienced notable gains according to [Zillow.com](https://www.zillow.com) as housing sales activity has been robust.

The town's weak revenue performance was also impacted by prior years' contraction in state aid, the second largest component of general fund revenues, driven by the state's prior fiscal challenges. However, state aid revenues have improved moderately based on

the state's biennial budget for fiscal years 2022 and 2023. State aid for the town's BOE, which is designated as an Alliance Districts (or low performers), has experienced growth compared to non-Alliance Districts and will also see moderate increases based on the state's biennial budget.

General fund revenue growth has largely been supported by tax rate increases adopted by the town. The town has full legal control over its property tax levy and rate.

## **EXPENDITURE FRAMEWORK**

BOE spending, excluding state passthrough payments for teacher pension and medical insurance costs, consumes roughly 35% of the fiscal 2022 general fund budget. Medical and pension benefits for town and BOE employees account for another 31% of the budget followed by public safety expenditures at about 12%. Pro forma debt service after issuance of the series 2020 bonds and 2021 bonds grows from the budgeted \$23.9 million in fiscal 2022 to \$30 million by fiscal 2024.

Scheduled debt service payments have risen dramatically in the last several years, largely due to the issuance of \$125 million in GO pension obligation bonds (POBs) in 2015 and ongoing issuance of new money bonds to fund various governmental capital projects.

Fitch expects the town's overall spending needs will increase above the pace of the town's modest level of natural revenue growth. The combination of increased debt service and full funding of the ADC for the town-administered pension plan are key drivers of the town's rising costs. The fiscal 2021 budget included full funding of the pension ADC, a \$3 million increase from fiscal 2020; this increase equated to 1.2% of the fiscal 2021 budget. Full funding was budgeted also for fiscal 2022.

In fiscal 2020 the town's debt service (\$18 million) and OPEB payments together with the full pension ADC accounted for an elevated 21% of total governmental spending. As noted above, Fitch expects the town's annual debt service obligations to increase over the next few years before stabilizing in fiscal 2024.

The town has successfully negotiated several changes to its pension plan and medical coverage. Pension changes include a reduction in the COLA cap for some employees and an increase in the employee contribution. For medical coverage, all labor groups now participate in a high-deductible health plan. Management continues to look for savings in health insurance options, which could positively impact future OPEB costs.

Union contracts are subject to arbitration, but a decision may be rejected by a two-thirds vote by the town's legislative body. A new arbitration panel would then be appointed by the state and their subsequent decisions would be required to take into consideration the financial capability of the employer. The town made cuts to full-time positions over the previous recession through layoffs, combining positions and privatizing certain services and indicated additional expenditure flexibility above this remains should a downturn occur.

## **LONG-TERM LIABILITY BURDEN**

Long-term liabilities for debt and Fitch-adjusted net pension liabilities (NPLs) are estimated at a slightly elevated 20% of personal income. Fitch expects pension liability levels to increase gradually, while debt levels are expected to remain fairly level as management is currently anticipating only moderate future debt issuances. The 'a' assessment also reflects the town's very high, unfunded OPEB liability at \$627 million, or the equivalent of 18% of personal income.

The town maintains a single-employer pension plan that was closed to new hires July 1, 2007. All non-teacher hires since then participate in the state-operated Connecticut Municipal Employees Retirement System (CMERS). Teachers participate in the Connecticut State Teachers' Retirement System for which the town has no financial obligation. The town plan was severely underfunded due to a combination of poor investment results and years of underfunding of the ADC. To address this status the town issued \$125 million in POB's in 2015.

The combined NPL for the town plan and its proportionate share of CMERS was reported at \$335 million, with an asset to liabilities ratio of 44% measured as of June 30, 2020. The Fitch-adjusted NPL (based on Fitch's standard 6% discount rate) was approximately \$382 million or 11% of personal income with an asset to liabilities ratio of 41%. As long as the



POBs are outstanding the town must provide annual reporting to the state, including demonstrated funding of the pension ADC and an annual actuarial valuation of the pension plan.

## **OPERATING PERFORMANCE**

The town has relied upon one-time savings from bond refundings to help subsidize operations notwithstanding actions to control growth in certain recurring operating expenditures. Hamden's negative financial position for fiscal 2020 worsened due to optimistic budget assumptions and declines in revenues due to the pandemic. Management raised revenues and imposed expenditure cuts in the fiscal 2021 budget as discussed above and with use of federal grants and bond restructuring savings is projecting a fund balance of around \$4 million.

Inherent budget flexibility is assessed as midrange largely due to the town's unlimited legal authority to increase its property tax revenues; expenditure flexibility is viewed more cautiously given the extent of spending measures introduced by the town during the last recession (which included departmental consolidations, privatization of certain services, and staff reductions) and subsequent slow economic recovery. Outside of the general fund, the town continues to report moderate current fund deficits in its internal service funds on an aggregate basis.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

## **REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING**

The principal sources of information used in the analysis are described in the Applicable Criteria.

## **PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS**

None

## ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg).

## RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Hamden (CT) [General Government]	LT IDR	BBB Rating Outlook Negative	Affirmed	BBB Rating Outlook Negative
● Hamden (CT) /General Obligation - Unlimited Tax/1 LT	LT	BBB Rating Outlook Negative	Affirmed	BBB Rating Outlook Negative

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Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

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Hamden (CT)

EU Endorsed, UK Endorsed

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