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Ratings

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Summary:

Hartford, Connecticut
Hartford Stadium Authority; Appropriations; General Obligation

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Long Term Rating	BB/Positive	Outlook Revised

Rationale

S&P Global Ratings has revised its outlook to positive from stable on Hartford, Conn.'s long-term issuer credit rating (ICR), and at the same time, affirmed its 'BB+' ICR on the city.

S&P Global Ratings has also revised its outlook to positive from stable on the Hartford Stadium Authority's lease revenue bonds, which are financial obligations of the city and rated 'BB', one notch below the ICR.

The positive outlook reflects Hartford's improving management environment and financial controls, which have yielded balanced operations and greater operating flexibility to address capital and service delivery. The outlook factors in cost-saving measures taken by the city through labor contract agreements and tight expenditure controls, significant state oversight through the Municipal Accountability Review Board (MARB), and the Contract Assistance Agreement with the state of Connecticut. In our view, the city's underlying credit profile, despite its economic and taxing challenges, has improved and we believe there is a one-in three chance the rating could improve to investment grade in two years, provided it continues to produce balanced operating results in accordance with its financial recovery plan.

In December 2017, the city received a tier III MARB designation and in 2018 entered into a Contract Assistance Agreement with the state, where debt service for approximately $540 million of the city's general obligation (GO) debt would be paid through the state budget through maturity. Based on the agreement, the city's total direct debt lowered significantly, and eliminated its past structural imbalance, which was based on escalating debt service costs. In addition, the agreement provides considerable financial oversight to the city, and prohibits it from issuing any new debt through 2023. Although the state assumes the debt service on the city's GO debt, Hartford remains obligated to support its annual lease appropriation bonds--previously issued toward the construction of a minor-league baseball stadium--in the budget.

The 'BB' rating on the Hartford Stadium Authority series 2015 A and B and 2016 lease revenue bonds reflects the annual appropriation risk associated with the lease payment. The bonds are secured by lease-rental payments made by Hartford, as lessee, to the authority, as lessor.

Pursuant to our "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" criteria (published Jan. 22, 2018, on RatingsDirect), we rate these obligations one notch lower than Hartford's general creditworthiness (as reflected in the 'BB+' ICR) to account for the risk of non-appropriation related with the lease payment. Notably, under the lease agreement, Hartford cannot abate rental payments in the event of damage or destruction to the leased property. In addition, a debt service reserve fund (DSRF) is in place funded at 50% of maximum annual debt service (MADS), which we believe protects against late budget adoption.

In our review of the lease agreement, we have considered the affordability of the obligation to Hartford, and have reflected any risks associated with it supporting the lease to our view of the ICR. We consider the lease terms and features standard with no structural risks regarding timely payment of debt. Lease payments related to these obligations represent less than 1% of general fund revenues, and the city continues to show a commitment and plan in appropriating legally available monies annually in the budget.

Other factors considered in the rating and positive outlook include:

- An improvement to the financial management assessment (FMA) because of better budgeting, and better forecasting and planning due to the requirements set forth through the MARB and Contract Assistance Agreements;
- Very strong debt and contingent liability position following the financial assistance agreement, with debt service carrying charges projected to be less than 1% of expenditures and net direct debt that is 8.3% of total governmental fund revenue;
- Stronger budgetary performance projected in 2019 and 2020 as set forth in the city's recovery plan and budget; and
- A strong institutional framework score, despite past state budgetary challenges and the related predictability of intergovernmental aid.

The rating also factors these credit weaknesses, including Hartford's:

- Adequate economy that serves as the state capital and largest employment center in the state; however, it also maintains weak socio-economic demographics as shown from its projected per capita effective buying incomes (EBI) that are 55.4% of the nation, and a market value per capita of $47,154;
- Very weak budgetary flexibility, with an available fund balance in fiscal 2018 of 0.7% of operating expenditures, as well as limited capacity to reduce expenditures and limited capacity to raise revenues due to pronounced economic challenges and political resistance; and
- Adequate liquidity assessment with total government available cash at 13.8% of total governmental fund expenditures and 4.0x governmental debt service. While liquidity has stabilized, we believe access to external liquidity remains limited and challenging.

Weak management environment, although with improved financial controls and strong state oversight

Under MARB, the city--designated as a Tier III municipality—became eligible to receive municipal restructuring grants and was able to execute a financial assistance agreement with the state. As part of the agreement, Hartford must provide the state treasurer and the secretary of the Office of Policy and Management (OPM), along with MARB, ongoing financial reports, including cash-flow analysis, and a rolling three-year financial plan. The financial agreement also places limitations on the issuance of new debt such that total debt cannot exceed $100 million for a ten-year period after the city is no longer under MARB oversight.

While not likely given the city's progress to date, a Tier IV municipality designation would provide MARB greater approval powers over collective bargaining contracts and budgets. If MARB were no longer in operation, then the state treasurer and secretary of OPM would assume MARB authority over approval of the city budgets.

The financial assistance agreement also has additional covenants by which the city must abide, including the following events that would trigger a request for Tier IV municipality designation, e.g., if Hartford:

- Has a cumulative unassigned general fund balance deficit of 1.5% or more, as certified by an independent auditor;
- Has a general fund operating deficit or 1% or more for the most recently completed fiscal year, as certified by an independent auditor, and fails to take the necessary steps to achieve balance;
- Has an operating deficit of 1.5% or more of its average general fund revenues over two consecutive fiscal years; or
- Fails to make its actuarially required pension fund contribution.

Currently, we view the city as having good financial policies and practices under our FMA methodology, in part, reflecting adherence to these agreements, and also reflecting internal budgeting practices, oversight, and planning. Hartford city council receives monthly budget-to-actual reports and may amend the budget throughout the year through ordinances. The city has always prepared a five-year capital budget with identifies sources and uses. An investment policy is in place, and holdings are reviewed and reported to council at least annually by the city's treasurer. The city does not have any formal reserve and liquidity policies nor does it have any debt management policies aside from what is stipulated in the financial assistance contract.

Strong budgetary performance expected in 2019 and 2020

Hartford's budgetary performance should remain steady in 2019 and heading into fiscal 2020.

As noted, the financial assistance agreement significantly lowered the city's annual debt costs and, in turn, provided budgetary flexibility to invest in its capital stock. Indeed, the city intends on funding all significant infrastructure projects from grant funding and from general fund resources, with no additional bonding planned for the next few years.

For fiscal 2018, the city had balanced operating results, on a GAAP basis, in the general fund of 0.1% of expenditures, and surplus results across all governmental funds of 1.6%. Management reports that it expects an operating surplus at fiscal year-end 2019. As its key priorities, management will likely appropriate the surplus toward capital reserves and general fund reserves, and provide increased funding to other postemployment benefits (OPEBs).

In the past, Hartford has found it challenging reducing expenditures, particularly given the constraints imposed by public-sector unions and other budgetary limitations. However, the size of the city workforce remains 11% smaller, compared to fiscal 2015. In addition, the city did achieve concessions from its labor unions, which in prior years proved elusive. Hartford reached significant labor agreements with all of its municipal labor unions, collectively saving $12 million in the budget, and providing long-term structural changes that should aid in cost-containment in the future.

The fiscal 2020 budget is similar in service delivery to fiscal 2019 and adheres to the provisions set forth by MARB. The budget totals roughly $573.2 million, which is a 0.6% increase over the previous year. Property taxes account for 49% of revenues, and state aid (not including the contract assistance) totals about 45%. The revenue environment, while tight, is stable. The budget does not rely on any one-time revenues, asset sales, or deferments. Property tax collections and state aid collections have been strong recently, with little deviations from budget.

Very weak budgetary flexibility

Hartford's budgetary flexibility remains very weak with an available fund balance in fiscal 2018 of 0.7% of operating expenditures, or $4.8 million. Our assessment accounts for the city's limited capacity to reduce expenditures and raise revenues due to political and economic factors.

The high dependence on state aid is problematic given the state's political and budgetary environment. Moreover, the mill rate on property taxes has not increased in quite some time, from the rate set at 74.29 (a mill is equal to $1.00 of tax revenue for each $1,000 of assessed value). The current property tax burden is one of the highest in the state and, in our opinion, politically difficult to increase.

For fiscal 2019, we expect available general fund reserves will likely stay the same given the tight operating margins, and given management's commitment toward funding capital. As a key management priority, the city does intend on improving general fund balances over time, however. The goal is to achieve a general fund reserve balance equal to 7% of operating expenditures.

Adequate liquidity assessment

In our opinion, Hartford's liquidity remains weak, with total government available cash at 13.8% of total governmental fund expenditures and 4.0x governmental debt service in 2018. Factoring into our assessment is that although liquidity had been under pressure, concerns have eased. Nevertheless, despite stable liquidity, we believe the city remains challenged in its ability to access to external markets for liquidity if necessary.

Very strong debt and contingent liability profile

Factoring in the contract assistance from the state, we calculate the city's projected total governmental fund debt service to be less than 1% of total governmental fund expenditures, and the net direct debt to be 9.3% of total governmental fund revenue—which is significantly lower than in the past, and inherently a credit positive.

We calculate the city's total direct debt burden at roughly $78.5 million. That amount includes the series 2015 and 2016 lease-revenue bonds issued by the Hartford Stadium Authority and supported by the city through annual lease appropriations. The debt figure also includes outstanding capital leases and HUD Section 108 loans. As noted above, as part of the financial assistance agreement, the city is limited in how much debt it can issue to no more than $100 million. Given these limitations and restrictions, debt should remain low relative to its total governmental fund revenue. Another restriction outlined in the agreement is it must fully appropriate for pension costs without any deferrals.

Hartford's combined required pension and actual OPEB contributions totaled 7.3% of total governmental fund expenditures in 2018. Of that amount, 5.2% represented required contributions to pension obligations, and 2.2% represented OPEB payments. The city made its full annual required pension contribution in 2018.

There are four defined-benefit pension plans for employees of the city. Two are single-employer plans, one is a cost-sharing multiple-employer plan with the State of Connecticut, and one is a plan with the State of Connecticut for certified teachers.

The oldest existing single-employer plan is closed; the city pays retirement and survivor benefits to pensioners under an unfunded program basis, which covered city employees hired before the current City of Hartford Municipal Employees' Retirement Fund (City MERF) went into effect on May 1, 1947. There were 87 retirees covered by this plan as of the actuarial valuation dated July 1, 2014. The city's funding policy is to make contributions equal to the benefit payments for the year.

City MERF, the existing single-employer plan, had a plan fiduciary net position as a percentage of total pension liability of 72.7%, and a net pension liability estimated at $409 million for fiscal 2018. The city has contributed 100% of its actuarially determined contribution (ADC) for the past five years.

Hartford pays 100% of its required contribution to the State of Connecticut Municipal Employees' Retirement System (MERS). Its proportionate share reflects a plan fiduciary net position as a percentage of total pension liability of 91.68% for fiscal 2018. The city contributes 100% of the ADC as set by the state.

The city's net OPEB liability was $423 million as of 2018. It has established a trust with a balance of $21.2 million. The fiduciary net position as a percentage of the total OPEB liability was roughly 4.7%. The plan is generally funded on a pay-as-you-go basis, but the city is committed to increasing funding.

Adequate economy

We consider Hartford's economy assessment adequate. The city, with an estimated population of 124,438, is in Hartford County in the Hartford-West Hartford-East Hartford MSA, which we consider to be broad and diverse. It also benefits, in our view, from a stabilizing institutional influence. The city has a projected per capita EBI of 55.4% of the national level and per capita market value of $47,154. These figures are well below average in comparison with regional and national peers. Notably, market value has seen good growth over the past year to an estimated $5.8 billion in 2018, reflecting new developments and construction around the city. Nevertheless, the size and the make-up of the city's tax base are limiting factors in its ability to raise local-source tax revenues, and given the high tax rate, has also proven to be an impediment to economic growth.

Hartford is the state capital and the largest employment center in Connecticut, but despite the city being a major employment center, most of the region's wealth lies in outlying suburbs. The city benefits from the stabilizing presence of a large government workforce as it hosts over 53,000 government jobs. It is also home to several large higher education institutions. As the state capital and hub for many educational and cultural establishments, a considerable amount of property is considered exempt from real estate taxes. Recent reports suggest that roughly 51% of assessed real estate in the city is exempt from property taxes, which is a significant amount.

Aetna and The Hartford, which have provided stability to its employment base, maintain a strong community presence in the city. In addition, Eversource Energy, one of the nation's largest utilities, maintains a significant corporate presence there. We note, however, that despite the county's 4.8% unemployment rate, the city's unemployment has traditionally tracked higher—and is vulnerable to an adverse change in the economy or business environment.

Strong institutional framework

The institutional framework score for Connecticut municipalities is strong.

Outlook

A positive outlook signifies there is at least a one-in-three chance we could raise the rating over our two-year outlook period. Hartford is projecting a structurally balanced budget underpinned by significant state oversight. In our view, stronger revenue and expenditure assumptions, coupled with a significant deleveraging of annual debt obligations, have aligned recurring revenues and expenditures, eliminating what was a persistent multiyear budget gap. The outlook reflects the city's preliminary operating results in fiscal 2019 and projections for fiscal 2020.

Upside scenario

We could raise the rating should the city adhere to its financial recovery plan and continue to make progress in improving budgetary flexibility and reserves. Available reserve balances are currently at very weak levels. If the city were to exceed expectations and substantially build up reserves to stronger levels and demonstrate an ongoing commitment to maintaining structurally balance operations, we could raise the rating to investment grade over our two-year outlook horizon. We could revise the outlook to stable should the city revert to negative operating performance, or find it difficult to adhere to its financial recovery plan.