

## Research

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### Summary:

# West Hartford, Connecticut; General Obligation

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## Summary:

# West Hartford, Connecticut; General Obligation

Credit Profile		
US\$17.0 mil GO bnds ser 2021A due 01/15/2036		
<i>Long Term Rating</i>	AAA/Stable	New
West Hartford Twn GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
West Hartford Twn GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed

## Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating to West Hartford, Conn.'s series 2021A general obligation (GO) bonds. At the same time, S&P Global Ratings affirmed its 'AAA' rating on the town's GO debt outstanding. The outlook is stable.

West Hartford's full faith and credit pledge, payable from the levy of an unlimited ad valorem tax on all taxable property in the town, secures the bonds and GO debt outstanding.

Proceeds from the series 2021 bonds will finance various capital projects.

## Credit overview

West Hartford has a very strong set of financial policies and controls that are institutionalized and embedded into its overall financial management, which, in our view, is a key factor contributing to its ability to sustain budgetary balance, even through a period of economic uncertainty due to the pandemic. Moreover, the town will likely maintain a steady pace of modest economic growth as construction-related development has been largely unaffected by the pandemic, and the level of economic deterioration in the county is less severe than the national base-case forecasts.

The rating and outlook incorporate the town's upcoming pension obligation bond (POB) issuance that will fully fund the unfunded actuarial accrued liability. Currently, West Hartford's debt burden is low but will increase by approximately \$365 million following the issuance of the POB. The town estimates that fully funding the actuarial accrued liability reduces cumulative pension contributions by over \$140 million on present value basis over the next 30 years. Initially, while the debt burden increases, the town's pension costs will substantially decrease, resulting in little to no budgetary effect in the beginning. In addition, management is reducing the discount rate of the pension plan to a more conservative 6.25% from the current 6.99% level and establishing a pension bond reserve fund. In terms of credit, we understand these actions likely limit the budgetary effects of future cost volatility to operations in the event of adverse investment returns.

The rating also factors the town's steady operations and proactive management team that has been able to navigate the challenges related to the pandemic. We anticipate management will continue and make budgetary adjustments to

preserve its current strong reserve position as it has demonstrated through various economic and business cycles.

West Hartford's GO debt is eligible to be rated above the sovereign because we believe the town can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings--Methodology And Assumptions," published Nov. 19, 2013, on RatingsDirect, West Hartford has a predominantly locally derived revenue source, with approximately 84% of general fund revenue coming from property taxes. The town also has independent taxing authority and independent treasury management from the federal government.

The rating further reflects our opinion of the following factors for West Hartford, specifically its:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with slight operating surpluses in the general fund and at the total governmental fund level in fiscal 2020;
- Strong budgetary flexibility, with an available fund balance in fiscal 2020 of 13.8% of operating expenditures;
- Very strong liquidity, with total government available cash at 18.0% of total governmental fund expenditures and 3.1x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 5.8% of expenditures and net direct debt that is 38.1% of total governmental fund revenue, and significant medium-term debt plans; and
- Strong institutional framework score.

### **Environmental, social, and governance factors**

We evaluated the town's environmental, social, and governance (ESG) factors relative to its economy, financial measures, management, and debt and long-term liability profile. We acknowledge that we consider its social risks, absent the implications of COVID-19 to health and safety, in line with those of the sector. Governance and environmental risks are also in line with the sector.

## **Stable Outlook**

### **Downside scenario**

Should the town's budgetary performance unexpectedly deteriorate--due to pressure from rising operating expenditures, shortfalls in key revenue sources, or otherwise--leading to a significant weakening of reserves or liquidity to a level we no longer view as commensurate with those of similarly rated peers, we could lower the rating.

Additionally, although we expect the town to address its substantial retirement liabilities in a meaningful way, over the long term, we could lower the rating should growth in fixed costs associated with debt, pension, and OPEBs crowd out other general fund expenditures or outpace revenue, leading to a deterioration in budgetary performance and weakened reserves.

## Credit Opinion

### Very strong economy

We consider West Hartford's economy very strong. The town, with a population of 63,360, is a largely developed and suburban residential community, bordering Hartford in Hartford County. It is in the Hartford-West Hartford-East Hartford MSA, which we consider to be broad and diverse. It has a projected per capita effective buying income of 160% of the national level and per capita market value of \$144,616. Overall, market value was stable over the past year at \$9.1 billion in 2021.

Interstate Highway 84 traverses the town, connecting residents with a diverse regional employment base. Although the tax base is primarily residential, West Hartford hosts a substantial local commercial base and is a retail and restaurant destination for the region. The local economy also features employers in government, health care, higher education, and manufacturing.

Prior to the pandemic, West Hartford experienced diversified residential and commercial development activity, contributing to a steady increase in building permit revenue and tax base growth. Additionally, due to the desirability of the community's service base, the town's real estate environment has been robust with steady appreciation in values.

The regional economy in Hartford County is well-diversified and has been slowly growing over the past few years, but the pandemic has stymied its momentum. The county unemployment rate was 3.9% in 2019, although it increased significantly because of the stay-at-home orders, peaking at 10.7% in July 2020. It declined to 7.7% in December 2020, although these levels remain above average compared with previous years. High unemployment for a prolonged period, particularly if it exceeds 10% on an annualized basis, is a risk we are monitoring and one that might prove a headwind for operations. IHS Markit forecasts Hartford County's real gross county product (GCP) will fall by 1.9% in calendar 2020, which we note is better than the state's 4.3% decline. The forecast suggests that economic activity will return to pre-pandemic levels in late 2021, increasing 3.9% in 2021 and 2.0% in 2022. This is a bit better than S&P Global Economics' U.S. base-case forecasts. (For more information on COVID-19's effect on the U.S. public finance sector, see "Potholes On The Road To Recovery," Sept. 29, 2020, and "Staying Home For The Holidays," Dec. 2, 2020.)

### Very strong management

We view the town's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Demonstrating the town's key budgeting practices is management's use of three-to-five years of historical data to forecast annual revenue and expenditure assumptions. In preparing its annual budget, management conducts a line-item review of each department's annual operation request; prioritizes operating expenditures, including future debt service and long-term liability costs; and incorporates changes in contractual obligations. Due to the uncertainty of state aid in recent years, finance officials conservatively estimate revenue from this source, and management solicits department input on local fees and charges for services.

During each fiscal year, management monitors the budget regularly, reporting budget-to-actual results to the town

council monthly. Furthermore, West Hartford adheres to its formal investment policy and reports earnings and holdings monthly to the town council. The town also has a comprehensive five-year financial forecast in its budget development process, which features analysis of key revenue and expenditure assumptions and tests budget performance under various conditions; this allows it to manage decisions and changes related to future operations, capital projects, and debt service.

West Hartford also maintains a strong focus on capital planning, as evidenced by its 12-year comprehensive capital improvement program (CIP) that identifies capital and nonrecurring capital expenditures. The town updates its CIP annually and details pay-as-you-go funding requirements, intergovernmental grants and reimbursements, and debt financing of all capital projects. Furthermore, management has historically met and sustained reserves in accordance with its fund balance policy. The formal policy calls for unassigned fund balance to stay between 7.5% and 15% of general fund expenditures to manage financial resources to maintain current service levels in the event of unexpected revenue shortfalls or unpredicted one-time expenditures. In accordance with the policy, should funds fall below 7.5%, the town will take necessary steps to restore unassigned fund balance to at or above the minimum target level.

West Hartford also sustains a formal debt management policy, which stipulates the use of certain debt instruments and reporting requirements. The policy formalizes measurable debt benchmarks and metrics, including annual debt service that will be no more than 10% of general fund expenditures and that debt amortization will not be less than 65% of principal being retired over 10 years. The town has historically monitored and sustained debt management practices in accordance with this policy and does acknowledge the policy will require some revisions following the issuance of the POB.

### **Strong budgetary performance**

The town had slight operating surpluses of 0.9% of expenditures in the general fund and 1.1% across all governmental funds in fiscal 2020. General fund operating results of the town have been stable over the last three years, with results of 0.3% in 2020 and 0.2% in 2018. Despite steady operating performance, we continue to factor in the potential downside risks stemming from the COVID-19 pandemic and its effects on economically sensitive revenues. Ultimately, in our view, the general fund performance should remain steady and in line with the budget, in large part due to the town's proactive budget monitoring and generally conservative budgeting practices.

The pandemic and state-mandated stay-at-home measures dampened fiscal 2020 revenues, primarily economically sensitive local receipts. However, a conservative budget and immediate expenditure-monitoring measures implemented following the onset of the pandemic allowed the town to post a general fund surplus.

West Hartford has a comprehensive budgeting development and monitoring framework, as well as its forward-looking expenditure and fixed-cost planning, which has allowed it to navigate the financial effects of COVID-19 without much deterioration. Changes in the tax rate have been consistent and timely to match West Hartford's expenditure needs. The town benefits from an overall stable and strong property tax base, which generated approximately 81% of general fund revenue in fiscal 2020. In addition, tax collections have remained strong, exceeding 99%. Notably, there was no significant disruption in tax collections in fiscal years 2020 and for 2021, current collections are in line with previous years.

Direct pandemic-related costs are reimbursable through FEMA and CARES Act funding, further limiting negative

pressure on the budget. For the fiscal 2021 budget, the town cut both revenues and certain expenditures to reflect any potential downside risks from COVID-19. The 2021 budget totals \$300.2 million, an increase of 1.2% over the prior year. With the potential for level funding of state aid in fiscal 2021, we believe risks for severe budgetary weakness is minimal in the current fiscal year. In the longer term, risks for budgetary performance remain mostly in the form of potential cuts to state aid, depending on the state's own revenue situation, and from rising fixed costs, especially from pension and OPEB contributions if actual investment performance does not match expectations.

### **Strong budgetary flexibility**

West Hartford's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2020 of 13.8% of operating expenditures, or \$44.9 million. The available fund balance includes \$29.8 million (9.2% of expenditures) in the general fund and \$15.1 million (4.6%) that is outside the general fund in the town internal service funds but legally available for operations. Operating activity in the internal service funds have been stable, and reserve balances have seen steady improvements.

While not included in our reserve ratios, the town has also traditionally committed recent surpluses as stabilization reserves to its capital nonrecurring expenditure fund (approximately \$5.1 million balance), and the debt service fund (about \$1.3 million). While designated for debt and capital, we generally view these as part of the overall reserve capacity of the town, which indirectly alleviates reliance on available general fund balance.

West Hartford will likely continue to budget for balanced operations annually, and it will make expenditure and revenue adjustments to try and outperform the budget at year-end. Based on the town's projections to finish fiscal 2021, we believe West Hartford will sustain reserves at strong levels over the next two years. As noted above, further enhancing our view of the stability of West Hartford's fund balance is the town's formal reserve policy that sets a minimum reserve level at 7.5% of expenditures, which are levels management is intent on maintaining.

### **Very strong liquidity**

In our opinion, West Hartford's liquidity is very strong, with total government available cash at 18.0% of total governmental fund expenditures and 3.1x governmental debt service in 2020. In our view, the town has strong access to external liquidity if necessary.

West Hartford is a regular market participant that has issued debt periodically over the past 20 years, including GO bonds. Furthermore, with the majority of cash invested in liquid money market funds, certificates of deposit, and the state investment pool, which maintain maturities of less than one year, we believe its investments are not aggressive.

In addition, we understand West Hartford has not entered into bank loans, direct-purchase debt, or contingent liquidity risks from financial instruments with payment provisions that change on the occurrence of certain events. Given its strong overall cash position and historically stable budgetary environment, we believe West Hartford's liquidity profile should remain very strong.

### **Weak debt and contingent liability profile**

This assessment factors this bond issue, as well as the anticipated \$365 million POB. Currently, total governmental fund debt service is 5.8% of total governmental fund expenditures, and net direct debt is 38.1% of total governmental fund revenue. Approximately 85.7% of the direct debt is payable within 10 years, which is, in our view, a positive credit

factor.

West Hartford has approximately \$134.1 million of total direct debt outstanding. Our assessment of the town's overall net debt includes its proportionate share of overlapping debt--totaling \$183 million--related to the Metropolitan District Commission, a special district in Hartford County to provide water and sanitary sewer services to eight member towns. As outlined in West Hartford's 12-year CIP, it expects to issue roughly \$20 million in bonds annually over the next several years for capital-related purposes.

With the upcoming \$365 million obligation bond, the net direct debt as a percentage of government revenues increases from approximately 38% to 141%. Moreover, the estimated near-term carrying charges for pensions and OPEBs will decrease from 12% to approximately 6.8%, while estimated debt service carrying charge increases from 5.8% to an estimated 12%. Expected budgetary savings in the near term are negligible.

### **Pension and other postemployment benefits**

- We currently view West Hartford's large pension and OPEB obligation a credit weakness, particularly given the pension system and OPEB trust low funded ratios. However, we acknowledge our view will likely change because of the POB issuance.
- While the use of an actuarially determined contribution (ADC) is a positive, we believe some of the assumptions previously used to build the pension ADC reflect what we view as slightly weak assumptions and methodologies, which increases the risk of unexpected contribution escalations.
- Although OPEB liabilities are reasonably well funded, and costs remain low, we believe there is a large liability and those will likely continue and increase.
- We view this a long-term challenge, but continually recognize management's efforts in reviewing the pension and OPEBs' underlying assumptions and making prudent changes to mitigate the town's exposure of these liabilities.

As of June 30, 2020, the town participates in the following pension plan:

- West Hartford Contributory Retirement System: 40.4% funded with a \$316 million net pension liability.

West Hartford's combined required pension and actual OPEB contributions totaled 11.9% of total governmental fund expenditures in 2020. Of that amount, 7.2% represented required contributions to pension obligations, and 4.6% represented OPEB payments. The town made its full annual required pension contribution in 2020. It funds 100% of pension ADCs, but we note that the town met our static funding metric in the most recent year but did not meet the minimum funding progress calculation, indicating that the system is addressing current costs but not fully making headway addressing its unfunded liabilities. Moreover, the plans' 26-year, closed amortization, and its level 2.5% of payroll amortization could result in slow funding progress. In our view, a discount rate at 6.9% could lead to contribution volatility.

The town also provides medical benefits to eligible retirees and covered dependents. West Hartford contributes the full normal cost for current employees hired since 2003 in addition to prefunding its OPEB liabilities in an OPEB trust fund; the total net position of the trust fund was \$9.6 million as of June 30, 2020. It also maintains a retiree health reserve, which had a balance of \$13.4 million as of June 30, 2020. The annual OPEB cost to amortize the liability over

30 years was \$14.8 million in fiscal 2020, of which the town contributed \$16.0 million or 108% of the required contribution.

As of June 30, 2020, its net OPEB liability totaled \$213 million and was 4% funded. We believe West Hartford continues to actively manage its pension and OPEB liabilities through comprehensive long-term planning, full funding of the ADC on an actuarial basis, and through its working relationship with collective-bargaining units.

While we expect long-term liability costs to remain manageable in the current budget environment, should investment returns fall short of assumptions that increase future contribution costs and stress its finances, we could modify our view of the town's debt and financial profiles.

### **Strong institutional framework**

The institutional framework score for Connecticut municipalities is strong.

## **Related Research**

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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