MOODY'S
INVESTORS SERVICE

Ratings Report

Moody's downgrades Hartford, CT's GO to A2 from A1; outlook negative

Assigns A2 to $82M GO Bonds; MIG 2 to $50M GO BANs

Moody's Investors Service has downgraded to A2 from A1 the rating on the City of Hartford's (CT) outstanding general obligation bonds, affecting approximately $352 million of outstanding debt. The outlook is negative. Concurrently, Moody's has assigned an A2 rating to the city's $82 million of General Obligation Bonds, Series 2014 B. Moody's has also assigned a MIG 1 rating to $50 million General Obligation Bond Anticipation Notes (BANs), dated October 28, 2014 and due October 27, 2015.

The bonds are secured by the city's general obligation unlimited tax pledge. Proceeds from the bonds and notes will be used to finance various city and school capital projects.

SUMMARY RATINGS RATIONALE

The downgrade to A2 incorporates the weakened financial position, characterized by narrow reserve levels that are expected to decline further following a sizeable anticipated deficit in fiscal 2014. The downgrade also factors the expectation that the city will remain challenged to restore fiscal stability in the near term due to an ongoing reliance on one-time revenue sources for operations, limited revenue raising ability, and diminished flexibility for future expenditure reductions. The rating also incorporates the sizeable liabilities for pension, OPEB, and debt, as well as the city's standing as the state capital and an important regional economic center.

The negative outlook reflects the possibility for downward rating action should the city fail to stabilize and augment its slim reserve levels over the near term.

The MIG 2 rating is based on the city's long-term credit quality, as reflected in the rating and outlook. As per Moody's BAN methodology, note ratings are capped at MIG 2 for issuers rated A2 with a negative outlook and below.

STRENGTHS

-- State capital and regional employment center

CHALLENGES

-- Low wealth and high unemployment

-- Stagnant property values

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-- Narrow reserve levels, with anticipated operating deficit in fiscal 2014

-- Continuing revenue weakness and increasing expenditure demands, including pension contributions

DETAILED CREDIT DISCUSSION

NARROW FINANCIAL POSITION EXPECTED TO WEAKEN FURTHER

Following four consecutive years of surplus operations from fiscal 2010 through 2013, the city is anticipating a sizeable operating deficit in fiscal 2014. The deficit is expected to decrease General Fund balance as a percent of budget to the lowest point since fiscal 2009. The city's ability to restore structural balance and increase reserve levels over the near term will be a critical rating factor in future reviews. Any further decline in reserves will likely result in downward rating action.

The adopted fiscal 2013 budget was a $7 million reduction (1.3%) from the prior year, and was balanced with a 2.5 mill property tax increase, and the elimination of 14 full-time equivalent positions and 5 vacant positions. The city did not appropriate any reserves during the fiscal 2013 budget formulation. The city restructured a portion of its outstanding debt during the fiscal year, which provided $5.9 million in cash flow savings. Inclusive of this one-time revenue source, the city finished with balanced operations. At year end, total General Fund balance increased to $30.4 million, or 5.4% of revenues. Unassigned fund balance grew to $27.5 million, or 4.7% of revenues, representing the city's strongest reserve position since 2008. At this level, reserves remain below the city's goal to maintain Unassigned General Fund balance at a minimum of 7% of revenues.

The fiscal 2014 budget was a $1.5 million reduction (0.3%) from the prior year, and was balanced with an $8.3 million draw on fund balance, and no increase to the tax rate. The budget included a $13 million contribution to the retirement system from unidentified revenue sources, which never fully materialized. At year end, the city is expecting a total reduction of fund balance of approximately $13.8 million, which includes the budgeted $8.3 million. This would lower total General fund balance to $16.5 million, or 3.1% of revenues which is the lowest level since 2009.

The fiscal 2015 adopted budget includes a 2.5% increase in spending and was balanced without the use of fund balance or any increase to the tax rate. The budget does include $13.7 million in non-recurring revenue related to the sale of city owned property. In addition, the city elected to extend its pension funding schedule by 10 years in order to create near term budgetary relief, which Moody's believes is indicative of significant fiscal strain. Additional expenditure savings were achieved through the reduction of 52 positions, which equates to roughly 3.5% of the total workforce. We believe that the use of non-recurring revenues is an unsustainable budgetary practice and could lead to credit weakening in the future.

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EMPLOYMENT BASE ANCHORED BY STATE GOVERNMENT; UNEMPLOYMENT REMAINS HIGH & WEALTH LEVELS LOW

The tax base remains strained by declining or stagnant property values, low wealth levels and a very high level of unemployment, which stood at 13.3% as of July 2014, compared to state and national levels of 6.8% and 6.5% respectively. While the city benefits from the stabilizing presence of a large government workforce, new job and grand list growth is expected to remain slow over the medium term.

The city's most recent October 1, 2011 (effective fiscal 2013) revaluation resulted in a 9.7% reduction in the city's grand list, with the largest value declines occurring in the city's commercial sector. The tax base remains concentrated, with the top ten taxpayers representing a sizable 20.8% of total value, consisting mainly of insurers and office buildings. The insurance industry remains an important part of the local economy including three of the top ten taxpayers and three of the top five employers. These include The Hartford Financial Services Group, Inc. (Baa3 positive), Aetna Inc. (Baa2 stable) and The Travelers Companies, Inc. (A2 stable). The economy also benefits from its role as a regional health care center, with several hospitals located in the city.

Hartford has struggled in recent years with elevated office vacancy rates in the city. During the fourth quarter of 2013, vacancy rates in the central business district stood at 20% which although high, is a significant improvement from 26.6% last year. Wealth indices remain very low as reflected in the city's 2012 median family income, which is just 40% and 59% of the state and nation, respectively. In addition, the city's $52,256 full value per capita is just 59% of the national average, partially reflecting the large amount of tax exempt government property.

MANAGEABLE DEBT PROFILE

Hartford's net direct debt burden remains well above average at 8.1% of equalized net grand list (ENGL), skewed somewhat by the city's sizable tax-exempt sector. Debt service in fiscal 2013 represented a manageable 7.7% of General Fund expenditures and payout of existing principal is slow with 57% retired within 10 years. Looking ahead, the city anticipates issuing approximately $50 million of bonds and notes annually, to support the 5-year capital improvement plan. The debt profile consists entirely of fixed rate borrowing and is not a party to any derivative agreements.

PENSION AND OPEB LIABILITIES REMAIN SIZEABLE

Hartford has a history of strong pension funding practices. Due largely to market losses, the funded ratio of the City Municipal Employee Retirement Fund (MERF) dropped as of July 2012 to a still strong 79% from 88% in 2010, and 96.6% in 2009. The city has consistently funded its full annual required contribution (ARC) and expects to continue that practice moving forward. The fiscal 2013 ARC for the MERF plan was $34.3 million, or 6.1% of General Fund expenditures. Increasing contributions to the plan will likely be a source of financial stress for the city, although a recent extension of the amortization schedule will provide near term relief. The city's 2013 adjusted net pension liability, under Moody's methodology for adjusting reported pension data, is a sizeable $1 billion, or a well above average 15.6% of ENGL, or 1.82 times General Fund revenues. Moody's uses the adjusted net pension liability to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities.

The city has a large $273 million other post-employment benefits liability (OPEB), with a $10.9 million ARC which was funded at 58% in 2013. The plan is funded on a pay-as-you-go basis. We do not anticipate the city will be able to make material progress in reducing the size of the unfunded OPEB liability over the medium term due to significant competing expenditure needs and ongoing revenue weaknesses.

WHAT COULD MAKE THE RATING GO UP

-- Rebuilding of reserves to levels consistent with higher rating categories

-- Established trend of structurally balanced operations

-- Significant improvement in socioeconomic indices

-- Sizeable tax base growth

WHAT COULD MAKE THE RATING GO DOWN

-- Continued reliance on one-time revenue sources

-- Protracted structural budget imbalance

-- Reduction of General Fund balance

-- Deterioration of the city's tax base and demographic profile

KEY STATISTICS

2013 Equalized Valuation: $6.5 billion

2013 Equalized Value Per Capita: $52,256

Median Family Income as % of US Median: 52.1%

Fiscal 2013 Operating Fund balance (General Fund and School Fund) as a % of Revenues: 5.4%

5-Year Dollar Change in Operating Fund Balance as % of Revenues (2009-2013): 0.44%

Fiscal 2013 Operating Cash Balance (General Fund and School Fund) as % of Revenues: 12.8%

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5-Year Dollar Change in Operating Cash Balance as % of Revenues, adjusted (2009-2013): 5.22%

Institutional Framework: "Aa"

5-Year Average Operating Revenues / Operating Expenditures (2009-2013): 1.00x

Net Direct Debt as % of Full Value: 5.55%

Net Direct Debt / Operating Revenues: 0.64

3-Year Average of Moody's ANPL as % of Full Value: 18.07%

3-Year Average of Moody's ANPL / Operating Revenues: 2.1x

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