STANDARD & POOR'S
RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:

Derby, Connecticut; General Obligation; Note

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Summary:

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Credit Profile		
US$7.575 mil GO bnds iss ser 2015 B due 09/01/2035		
Long Term Rating	AA/Stable	New
US$5.9 mil GO BANs dtd 09/03/2015 due 03/15/2016		
Short Term Rating	SP-1+	New
US$3.85 mil GO rfdg bnds iss ser 2015 A due 09/01/2026		
Long Term Rating	AA/Stable	New
Derby GO bnds ser 2009		
Long Term Rating	AA/Stable	Upgraded

Rationale

Standard & Poor's Ratings Services raised its long-term rating to 'AA' from 'AA-' on Derby, Conn.'s existing general obligation (GO) debt due to the city's strong budgetary performance in the past five years, demonstrating stronger budgetary planning and overall management practices. The outlook is stable.

At the same time, Standard & Poor' assigned its 'AA' long-term rating to Derby's series 2015 A and B GO bonds. We also assigned our 'SP-1+' short-term rating to the city's bond anticipation notes (BANs).

Derby's full faith and credit GO pledge secures the bonds.

The 'SP-1+' short-term rating reflects our view that the city maintains a very strong capacity to pay principal and interest when the notes come due. Derby has a low market-risk profile because of its strong legal authority to issue long-term debt to take out the notes. In addition, it is a frequent issuer that regularly provides disclosure to market participants.

Officials will use the bond and BAN proceeds for various capital purposes.

The ratings reflect our assessment of the city's:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with "good" financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with a slight operating surplus in the general fund and balanced operating results at the total governmental fund level;
- Adequate budgetary flexibility, with an available fund balance in fiscal 2014 of 6.3% of operating expenditures;
- Very strong liquidity, with total government available cash of 8.1% of total governmental fund expenditures and 2.8x governmental debt service, and access to external liquidity we consider strong;
- Very strong debt and contingent liability position, with debt service carrying charges of 2.9% of expenditures and net direct debt that is 45.5% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of

market value; and
- Very strong institutional framework score.

Strong economy

We consider Derby's economy strong. The city, with an estimated population of 12,921, is located in New Haven County in the New Haven-Milford MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 104.4% of the national level and per capita market value of $82,546. Overall, the city's market value fell by 0.7% over the past year to $1.1 billion in 2014. The county unemployment rate was 7.2% in 2014.

Based on our regional forecasts, we expect modest employment growth through 2016 and for unemployment to improve only slightly. In our view, the regional and state economy will remain stable but with slow growth relative to its peers. Derby has seen a recent uptick in economic development, and we note building permit activity has improved since the recession. In addition, recent data indicate that median home prices are stable or improving in the region. The city has benefited from a stable tax rate catering to new development. Businesses have opened over the past several years, creating new jobs and also improving taxable values. Additionally, housing starts remain positive. We believe all these factors are important because the city, along with other local governments in the region, largely relies on property taxes to meet rising expenditure demands.

However, despite these positive signs, we do not expect substantial improvements to local source revenues to remain sustainable in the near term. Rather, we believe revenue growth will remain in line with previous years, between 1% and 2%. This will require management to remain diligent in its budgetary planning.

Strong management

We view the city's management as strong, with "good" financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

This is a revision from our previous assessment because we believe the city has demonstrated prudent budgetary planning. The city's revenue and expenditure assumptions are realistic and well-grounded from both a long-term and recent trend perspective. The city has monthly meetings with the Board of Apportionment and Taxation, and has procedures in place for reviewing and amending the budget based on updated information and actual performance. The city also maintains a five-year capital improvement plan that it updates annually and which is linked to the operating budget. Derby's investments adhere to state guidelines, and the city maintains a basic debt management policy that the board adopted. The city also maintains an adopted fund balance policy to keep reserves between 5% and 10% of expenditures.

Strong budgetary performance

Derby's budgetary performance is strong in our opinion. The city had slight surplus operating results in the general fund of 1.4% of expenditures, and balanced results across all governmental funds of 0.5% in fiscal 2014. General fund operating results of the city have been stable over the last three years, with a result of 0.6% in 2013 and a result of negative 0.3% in 2012.

For analytical consistency, we have adjusted out any capital spent with bond proceeds across all governmental funds. In addition, in our calculations we have factored out any deferred pension payment on a cash basis that otherwise would have negatively affected operations.

Despite a challenging budgetary environment, in our view the city has favorably produced balanced general fund results between 1% and negative 1% of expenditures during the past several years. The city's operating revenue base is strong and stable. Property taxes generate about 59% of Derby's general fund revenues while state aid contributes about 31%. Strong tax collections, at an average of 96%, provide what we view as good financial stability, while state aid has been generally stable for the city.

The city expects a surplus at the close of fiscal 2015, which will make it the third consecutive general fund surplus (after transfers). The fiscal 2016 adopted budget totals $39 million, and the city has not appropriated any reserves to balance operations. Although the city has been deferring pension payments several years, the annual amounts have been relatively small. In addition, we understand the city plans to phase in contribution increases and be fully funding its annual required contribution (ARC) in three years.

Adequate budgetary flexibility

Derby's budgetary flexibility is adequate, in our view, with an available fund balance in fiscal 2014 of 6.3% of operating expenditures, or $2.7 million.

We expect Derby's reserves to improve to roughly $3.2 million in fiscal 2015. The city maintains a reserve policy that limits reserves between 5% and 10% of expenditures, and it has historically adhered to these targets; therefore, we do not expect flexibility will deteriorate to weaker levels. Moreover, given the current budgetary environment, Derby should maintain available reserves level because management has demonstrated its ability to adjust spending as needed.

Very strong liquidity

In our opinion, Derby's liquidity is very strong, with total government available cash of 8.1% of total governmental fund expenditures and 2.8x governmental debt service in 2014. In our view, the city has strong access to external liquidity if necessary.

The city has demonstrated strong market access by issuing GO bonds within the past several years. Therefore, we believe liquidity will remain very strong since there is no significant deterioration of cash balances planned or expected. Furthermore, we note the city does not have any contingent liquidity risk from financial instruments with payment provisions that change on the occurrence of certain events. In addition, management is not aggressive in its use of investments.

Very strong debt and contingent liability profile

In our view, Derby's debt and contingent liability profile is very strong. Total governmental fund debt service is 2.9% of total governmental fund expenditures, and net direct debt is 45.5% of total governmental fund revenue. Overall net debt is low at 1.9% of market value, which is, in our view, a positive credit factor.

Including this issue, the city has about $20.9 million of total direct debt--of that amount, $5.3 million are BANs. Furthermore, we have adjusted out about $698,000 of enterprise-related GO debt from our direct debt calculations,

based on three years of evidence that user charges have provided at minimum 1x coverage.

Derby's combined pension and other postemployment benefits (OPEB) contributions totaled 4.6% of total governmental fund expenditures in fiscal 2014. Of that amount, 3.0% represented contributions to pension obligations and 1.6% represented OPEB payments.

Although we acknowledge the city has not been fully funding its ARC, we note the pension plan is reasonably well funded at 77% and costs remain manageable. However, we could view these factors negatively in the future if funding substantially decreases, costs begin to accelerate as a percent of expenditures, and management continues to defer pension payments.

Very strong institutional framework

The institutional framework score for Connecticut municipalities is very strong.

Outlook

The stable outlook reflects our view of Derby's stable budgetary performance and adequate financial flexibility. We believe the city's ongoing developments should provide stability to its local tax base, which contributes a significant portion of tax revenue, and should allow the city to maintain a stable financial position during the two-year outlook period.

We do not expect to change the rating during the outlook period because we expect Derby will maintain adequate reserves and continue to make progress funding its long-term liabilities. Although we view Derby's debt and contingent liability profile as very strong, we note that its unfunded OPEB and pension costs will likely continue to increase. For now, budgetary performance and flexibility remain unaffected by those long-term liabilities largely due to Derby's good management practices. However, those increasing costs will continue to test management. Nonetheless, any negative pressure that may arise is well beyond our outlook horizon.

Related Criteria and Research

Related Criteria

- USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- USPF Criteria: Financial Management Assessment, June 27, 2006
- USPF Criteria: Debt Statement Analysis, Aug. 22, 2006
- USPF Criteria: Bond Anticipation Note Rating Methodology, Aug. 31, 2011
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Institutional Framework Overview: Connecticut Local Governments

Ratings Detail (As Of August 10, 2015)

Derby GO

Ratings Detail (As Of August 10, 2015) (cont.)		
Unenhanced Rating	AA(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

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