FitchRatings

Fitch Upgrades West Warwick, RI's Long-Term IDR to 'BBB' & GO Bonds to 'A-'

Fitch Ratings-New York-30 June 2016: Fitch Ratings upgrades the following ratings on the town of West Warwick, RI:

--Long-Term Issuer Default Rating (IDR) to 'BBB' from 'BBB-';
--$3 million GO bonds, series 2007 to 'A-' from 'BBB-'.

The Rating Outlook has been revised to Stable from Positive.

The Long-Term IDR reflects the town's unsecured general credit quality; the security rating on the GO bonds, two notches above the IDR, reflects the enhanced recovery prospects provided by the statutory lien granted under state law.

SECURITY
The bonds are general obligations of the town backed by its full faith and credit and unlimited taxing authority. The Rhode Island State General Assembly enacted amendments to Section 45-12-1 of the General Laws to provide GO bondholders with a statutory lien on ad valorem taxes and general fund revenues of cities and towns with priority over creditors in the event of a bankruptcy of the issuer. Fitch believes that this provides bondholders a substantial preferential right in a bankruptcy proceeding.

KEY RATING DRIVERS

ISSUER DEFAULT RATING: The upgrade of the town's Long-Term IDR to 'BBB' from 'BBB-' reflects the stabilization of operations through pension and OPEB reforms and long-term employee contracts. These actions, combined with a five year operating plan, have provided budget relief, a reduced burden on the tax base, and a lowering of the long-term liabilities associated with retiree benefits. Fitch expects future costs tied to salaries and pensions to pressure the budget but expectations for moderate revenue growth combined with future revenue increases should support such growth. School fund operating performance has been positive resulting in excess reserves available for school operations alleviating general fund pressure.

GENERAL OBLIGATION BOND RATING: West Warwick's 'A-' rating is two notches above the town's IDR reflecting the statutory lien security attached to GO bonds issued in Rhode Island and the resulting enhanced recovery considerations.

Economic Resource Base
West Warwick is 11 miles south of the state capital city of Providence. The estimated 2015 population of 28,852 represents a 1.2% decline over the 2010 census figure.

Revenue Framework: 'bbb' factor assessment
Property taxes make up the bulk of the city's revenues, providing for predictability and stability. Fitch expects future revenue growth to be generally in line with inflation without revenue-raising measures. Although the state statutory tax levy restrictions that limit annual tax levy increases to 4%, with some exceptions, provide a reasonable amount of tax raising flexibility, West Warwick does not have the independent legal ability to raise revenues because its charter requires its budget to be approved by voter referendum.

Expenditure Framework: 'a' factor assessment
Expenses have been recently controlled due to local pension reform efforts, implementation of long-term employee contracts, and stabilization of the town's school fund, but Fitch expects that the town's overall spending needs will increase in the future at a pace above natural revenue growth due to the demands of weakly funded pensions and pent-up labor costs. Carrying costs related to long-term liabilities (currently about 20% of government spending) are expected to remain elevated, but manageable. Town control over headcount, wages, benefits and work rules is limited by staffing and labor contracts requirements.

Long-Term Liability Burden: 'a' factor assessment
Unfunded pension liabilities are elevated but somewhat offset by low debt levels. These combined liabilities represent a moderate 18% of personal income. Fitch does not expect debt levels to materially change over the next few years and the town fully funds its pension and has begun making 100% contributions toward OPEB; however, the fact that more than 80% of the total liability figure is in the form of unfunded pension liabilities makes the figure more variable.

Operating Performance: 'bbb' factor assessment
The town implemented a five-year financial improvement plan effective fiscal 2015 that has helped stabilize its fiscal condition. The plan followed a period of financial pressure related to large cuts in state aid, compounding pension liabilities as a result of a history of underfunding annual pension contributions, and exposure to school fund operating deficits. Operating performance could be stressed in a future potential economic downturn although Fitch expects the town would recover financial flexibility.

RATING SENSITIVITIES
PRUDENT FINANCIAL MANAGEMENT: Management's ability to manage costs and retain financial flexibility, including through reserve funding, is key to maintaining the rating. A material improvement in Fitch's expectations for the economy and tax base growth as well as reserve funding could support a positive change in the rating.

CREDIT PROFILE

The town was formerly an industrial and textile center and progress has been made in industrial diversification with several larger former textile mills converted to multiple tenancy by smaller, newer businesses. Management reports a notable increase in the number of building permits compared to last year reflecting both residential and commercial improvements and expansion.

Assessed value (AV) declined by 8.7% in fiscal 2014 due to a triennial property revaluation effective Dec. 31, 2012. The decline reflects a housing market that was struggling but has since shown signs of improvement. AV net of exemptions has steadily improved since fiscal 2015 as new projects come on line. Housing values increased 11% year over year through May 2016 according to Zillow Group but are still notably below peak levels.

Wealth levels are slightly below state and national averages and unemployment levels are consistently above state and national rates.

Revenue Framework
The town's primary revenue source is property taxes, which represented about 92% of fiscal 2015 general fund revenues. State and federal revenues provided to the town (exclusive of school aid) were only 4.5% of revenues in fiscal 2015 and can vary each year depending on grant programs that are offered.

West Warwick's charter requires its budget (including any tax levy increase) to be approved by voter referendum. If approval is not received, the town can operate under the previous year's budget until the succeeding budget is approved.

Fitch expects West Warwick's revenues to be in line with inflation or better going forward absent policy action as its economy improves and tax base growth continues as new projects are completed. Fitch also expects that management will increase revenues as necessary to supplement expenditure growth.

State statute limits annual increases in the tax levy to 4% above the prior year's levy while insulating the town from loss of revenues from decreases in the property tax base. Certain exceptions exist in the law to exceed the 4% limit but require a 4/5ths approval from the town's council, and in certain instances, the state auditor general. Debt service costs are not restricted by this levy cap.

The fiscal 2017 budget was approved last month by residents and was up $2.6 million or 3% from the prior year's budget. The tax base increased by 4.4% or $90.3 million and the property tax levy increased by $2.4 million, or 4% over fiscal 2016. Expenditure increases were tied to full pension and OPEB funding, as well as a $1 million increase in school funding and $0.6 million increase in debt service. The general government budget was $4 million less than in fiscal 2016 due to a reallocation of payroll taxes and benefit costs to the respective departmental budgets.

Expenditure Framework
The town's largest general fund expenditure areas are related to education and employee salary and benefit costs associated with public safety. The general fund provides support to the school fund annually through a transfer out representing approximately 48% of total fiscal 2015 general fund revenues of $65 million.

The town's natural pace of spending is expected to remain above natural revenue growth due primarily to the weakly funded pension plan and pent up labor costs. Expenditure growth has been recently controlled due to the local pension and OPEB reform efforts, implementation of long-term employee contracts expiring in fiscal 2019, and stabilization of the town's school fund. Employees agreed to no salary increases over the five-year contract period, but the contracts contain a wage opener clause in years four and five depending on the financial position of the town.

Carrying costs related to debt and unfunded retiree benefit liabilities (19% of government spending in fiscal 2015, with pension funding alone equaling 12% of spending) are expected to remain elevated, but manageable. Pensions are expected to be a continued spending pressure due to low funded levels for both the town operated plan and the state teachers' plan. Town control over headcount, wages, benefits and work rules is limited by staffing and labor contract requirements, including minimum staffing requirements for police and firefighters, but management can reduce non-public safety staff if necessary.

The town's five five-year plan to improve pension funding assumes additional annual tax levy increases. Changes in the tax base, either positive or negative, will influence the level of these tax increases.

West Warwick teachers participate in the state operated Employees' Retirement System for teachers. Costs associated with the state teachers' plan are expected to grow as the plan is considered weakly funded by Fitch.

The town's unfunded OPEB liability as of June 30, 2014 was $58 million, a large improvement from the $107 million valuation for June 30, 2011. Due to recent healthcare plan reforms and increases in employee contributions and newly required retiree contributions, the annual costs and overall liability declined. The town established an OPEB trust in fiscal 2015 with an initial investment of $240,000. It then deposited $920,000 (1.4% of general fund spending) in fiscal 2016 and budgeted $743,000 as a deposit to the trust for fiscal 2017.

After a period of contention and maintenance of a deficit position, school fund performance continues to be positive due to better internal spending controls and an increase in state school funding. The school fund experienced net operating surpluses in fiscal 2014 and 2015 and had $3.2 million in reserves (equal to 6% of school spending) available for future school spending.

Long-Term Liability Burden

Total outstanding debt and unfunded pension liabilities represent a moderate 18% of personal income. Overall net debt levels of $41 million are low (3.4% of personal income and 1.9% of market value) and levels are not expected to materially change due to manageable plans for future debt and a rapid principal amortization rate of about 80% over 10 years

The plan contributing the most to this liability is the town's defined benefit pension plan offered to all employees excluding teachers. Management has made significant efforts to address its compounding pension costs by successfully negotiating and implementing court-approved reforms to the plan effective fiscal year 2015. Even with these reforms, the pension plan is still severely underfunded as of July 1, 2015 at only about 20% (using Fitch's 7% rate of return) and the estimated Fitch-adjusted net pension liability is $130 million (11% of personal income and 6% of market value). The combined unfunded pension liabilities for the town plan and state teachers' plan is an estimated $170 million, based on a 7% rate of return (14.4% of personal income and 8% of market value).

The agreed upon reforms that were made with the town's labor groups and retirees were court approved in July 2014 and include suspension of cost-of-living-adjustments (COLAs) for the next five fiscal years and increased contribution rates for employees. The reforms resulted in a reduction of the actuarially determined contribution (ADC) from $10.7 million to $8.1 million for fiscal 2015 and lowered the future annual rate of growth in the ADC. The ADC for fiscal 2017 for the town's plan is $8.7 million.

The town is required to fully fund its pension ADC in accordance with the court approved plan of reform. The ADC is projected to increase by an average 3.5% annually over the next 20 years. The system is projected to reach a still-weak 60% funded status by 2033 assuming the town's 7.5% investment rate and payment of 100% of the ADC in years 1-5 and 100.5% of the ADC in years 6-20. The purpose of the higher ADC percentage in these years is to meet the state's requirement of emerging from critical pension status (less than 60% funded) by fiscal year ending 2033.

Operating Performance

West Warwick's response to downturns comes from a combination of revenue increases and cost controls that have resulted in a stabilization of its operating budget and maintenance of moderate reserves. The impact of a moderate economic decline scenario on revenues is likely to be limited due to the fact that the town's primary revenue source is property taxes. The town has the legal ability to maintain (or increase by up to 4%) its tax levy even with a decline in taxable values and it has historically demonstrated a history of maintaining its tax levy. The "minimal" inherent budget flexibility assessment reflects the fact that all budgets are subject to voter referendum, meaning that the town does not have independent revenue raising flexibility. However, Fitch expects that during an economic downturn management would address the shortfall and maintain a moderate level of reserves through an increase in revenues and expenditure management based on past performance and the fundamental changes they have made to improve the town's financial condition.

The town's financial operations were projected to become severely strained following the downturn as a result of compounding pension liabilities and growing OPEB costs. In addition, the town and school department had an ongoing dispute over the town's funding of school operations resulting in an accumulated operating deficit for the school fund. Management was successful in implementing both pension and OPEB reforms for existing and retired employees helping to control the growth in these costs and achieve stabilization of the budget. As indicated above, the school fund has also rebounded and currently has a positive fund balance with fiscal 2016 projections indicating another operating surplus. Fitch would expect management to again take appropriate action to maintain its financial resilience consistent with the current rating level.

For fiscal 2015, the town had a net operating deficit of $766,356 net of pay-as-you-go capital spending. Results reflect mostly a decrease in expected delinquent tax collections. The unrestricted fund balance of $2.5 million represents a modest 3.7% of spending. Other available funds of $2.05 million are available for budget flexibility and consist primarily of capital funds that the town will spend down over time, and unassigned special revenue funds.

Management projects relatively flat general fund operations for fiscal 2016 with a $200,000 budgeted surplus. The school fund is projecting a $500,000 operating surplus due primarily to lower salary related costs and lower than anticipated medical costs. Fitch expects unrestricted general fund reserves to gradually be re-built over the course of the five-year plan to a 5% of spending level.

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

Applicable Criteria
U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016)
(https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?
rpt_id=879478&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOjE0NjczNTY3MTAsInNlc3Npb25LZXkiOiJNRDJYT0M1WVVXUFlDV1I4Qk9UOFFZUU8zRjJMT01HSDRWR0pEUjZJIn0.MF7s3kg2HufwhTpswkcrdtPUNbjxk23G7PMGc6z17rk)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form

(https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?pr_id=1008304&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOjE0NjczNTY3MTAsInNlc3Npb25LZXkiOiJNRDJYT0M1WVVXUFIDV1I4Qk9UOFFZUU8zRjJMT01HSDRWR0pEUjZJIn0.MF7s3kg2HufwhTpswkcrdtPUNbjxk23G7PMGc6z17rk)
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