FitchRatings

Fitch Affirms West Warwick, RI's IDR at 'BBB'; GO Bonds at 'A-'; Outlook Stable

Fitch Ratings-New York-27 June 2017: Fitch Ratings has affirmed the following ratings for the town of West Warwick, RI:

--Issuer Default Rating (IDR) at 'BBB';
--$2.75 million outstanding GO bonds, series 2007 at 'A-'.

The Rating Outlook is Stable.

The 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 'BBB' IDR reflects the town's minimal inherent budget flexibility as a result of limited independent revenue-raising authority, moderate expenditure flexibility and low reserves. Fitch expects future costs tied to salaries and pensions to pressure the budget but expectations for moderate tax base 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.

GO 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
Formerly an industrial and textile center, West Warwick's economic resource base is characterized by a tendency for unemployment rates above state levels, slow job growth, and moderate population declines. The town is 11 miles south of the state capital city of Providence. The estimated 2015 population was 28,852.

Revenue Framework: 'bbb' factor assessment
Property taxes make up the bulk of the town's revenues. 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 at 18% of government spending) are expected to remain relatively high, 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 slightly high 22% of personal income with unfunded pension liabilities making up more than 80% of the figure. Fitch expects the long-term liability factor assessment to remain in the current category due to manageable future debt plans and the town's commitment to fully fund its pension.

Operating Performance: 'bbb' factor assessment
The town implemented a five-year financial improvement plan effective fiscal 2015 that has helped stabilize both the town's and school fund's 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. However, reserves remain low; as such, the town's operating performance could be stressed in a future 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 properties that now house 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), net of exemptions, of $2.2 billion (as of Dec. 31, 2016) has improved by approximately 7% following a 9% decline in fiscal 2014 due to a triennial property revaluation that was effective Dec. 31, 2012. Housing values, as reported by Zillow.com, are projected to continue to improve and management reports a moderate amount of new projects on line which Fitch expects will contribute to moderate growth in AV.

Wealth levels are slightly below state and national averages and unemployment levels have improved notably this past year and are only slightly higher than state and national rates.

Revenue Framework
The town's primary revenue source is property taxes, which represented approximately 90% of fiscal 2016 general fund revenues. State and federal revenues provided to the town (exclusive of school aid) were only 4% of revenues in fiscal 2016 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 its tax base continues to grow reflective of increasing property values and completion of new projects. Fitch also expects that management will receive voter support to increase revenues as necessary to supplement expenditure growth, as has historically been the case.

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 4/5th's approval from the town's council, and in certain instances the state auditor general. Debt service costs are not restricted by this levy cap. However, as noted above, the town's budget and any increase in the tax levy or other local revenue sources is subject to voter approval.

The fiscal 2018 budget of $95 million was approved last month by residents and was up $2.8 million or 3% from the prior year's budget. The property tax levy increased by 2.5% over fiscal 2017. Expenditure increases were tied to employee benefits and a moderate increase in debt service. Management also lowered its tax collection rate assumption slightly. The school fund benefitted from a state aid increase of $1.4 million, the final year of state aid increases under the school funding formula.

Expenditure Framework
The town's largest general fund expenditure areas are related to education and employee salary and benefit costs, particularly in the area of public safety. The general fund provides support to the school fund annually through a transfer out representing approximately 46% of total fiscal 2016 general fund revenues of $67 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 (18% of government spending in fiscal 2016, with pension funding alone equaling 11% 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-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.

Long-Term Liability Burden
Total outstanding debt and net pension liabilities represent a slightly high 22% of personal income. Overall net debt levels of $42 million are low (3.5% of personal income and 1.9% of market value) and are not expected to materially change due to manageable plans for future debt and a rapid principal amortization rate of about 74% over 10 years.

The plan contributing the most to long-term liabilities 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 the June 30, 2016 measurement date at only about 16% (using Fitch's 6% rate of return) and the estimated Fitch-adjusted net pension liability is $157 million (18% of personal income and 7% of market value). Combined net pension liabilities for the town plan and state teachers' plan are an estimated $219 million, based on a 6% rate of return (18% of personal income and 10% 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 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 2018 for the town's plan is $9.3 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 one to five and 100.5% of the ADC in years six to 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 plan year ending June 30, 2034.

The town's unfunded OPEB liability as of July 1, 2015 was $54 million (4.5% of residents' personal income), an improvement from $58 million two years prior. Due to recent healthcare plan reforms and increases in employee contributions and newly required retiree contributions, the annual costs and overall liability declined from approximately $107 million in 2011. The town established an OPEB trust in fiscal 2015 and currently has a balance of $2 million according to management. The town and school fund continue to make annual contributions over and above pay-go to the trust.

Operating Performance
West Warwick's response to the prior downturn came from a combination of revenue increases and cost controls that helped stabilize its operating budget, but reserves remain low. 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. Fitch expects that during an economic downturn management would address the shortfall and maintain a stable 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 by management 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. The school fund has also rebounded and currently has a positive fund balance with fiscal 2017 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 2016, the town had a net operating deficit of $1 million or about 1.5% of spending. These results include $0.6 million for pay-as-you-go capital spending. The deficit reflects lower than anticipated tax revenues and a slight decline in state aid. The unrestricted fund balance at fiscal year-end of $1.5 million represents a low 2% of spending.

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 had surplus operations of $1.1 million for fiscal 2016, the third consecutive year of surplus results, and increased its committed fund balance to $4.1 million or 7.5% of school spending. Combined town and school fund unrestricted fund balances equal 6% of the combined town and school budget for fiscal 2017.

Management projects relatively flat general fund operations for fiscal 2017 depending on final tax collections, which are currently below budget. The school fund is projecting a $500,000 operating surplus due in part to lower salary related costs due to attrition and state aid coming in higher than budget. Fitch expects unrestricted general fund reserves to gradually be re-built over the next few years but to remain at relatively low levels as a proportion of general fund spending.

Contact:

Primary Analyst
Kevin Dolan
Director
+1-212-908-0538
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Secondary Analyst
Grace Wong
Director
+1-212-908-0652

Committee Chairperson
Michael Rinaldi
Senior Director
+1-212-908-0833

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

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria
U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017) (https://www.fitchratings.com/site/re/898466)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/site/dodd-frank-disclosure/1025736)
Solicitation Status (https://www.fitchratings.com/site/pr/1025736#solicitation)
Endorsement Policy (https://www.fitchratings.com/regulatory)

Solicitation Status

Fitch Ratings was paid to determine each credit rating announced in this Rating Action Commentary (RAC) by the obligatory being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated, except for the following:

Endorsement Policy - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures (https://www.fitchratings.com/regulatory) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.