Tax Supported
New Issue

# Meriden, Connecticut

## Ratings

### New Issue

General Obligation Bonds, 2006....... A–

### Outstanding Debt

General Obligation Bonds ................ A–
(Upgraded from 'BBB+' on 7/19/06)

Rating Outlook ................................ Stable

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## New Issue Details

$20,245,000 General Obligation Bonds, 2006, are scheduled for competitive sale on July 25 and mature serially Aug. 1, 2007–2016 with semiannual interest payments on Aug. 1 and Feb. 1, commencing Aug. 1, 2007.
**Security:** The bonds are general obligations of the city, with its full faith and credit pledged.
**Purpose:** Bond proceeds will be used to fund various general government and school capital improvement projects.

July 24, 2006

## ■ Outlook

The upgrade to 'A–' from 'BBB+' reflects the achievement of expected improvements to credit quality including a marginal improvement in liquidity and financial reserves, two years of unqualified audit opinions, maintenance of a moderate debt profile, and some success in economic development initiatives. Credit strengths include the city's continued willingness to raise recurring revenues, rapid debt amortization, and efforts to institutionalize formal financial management policies. Despite improvement, reserve levels are low, although some growth is likely over the near term. The Stable Rating Outlook reflects Fitch Ratings' expectation that overall financial flexibility will remain limited. Other credit concerns include a historically weak economic base, though the city's ongoing economic development plans should continue to produce modest employment and tax base growth.

## ■ Rating Considerations

With direct access to major highways, Meriden is situated 20 miles from both Hartford and New Haven. Its location bodes well for the city's ambitious economic development efforts, which continue to focus on attracting new businesses and reclaiming and rehabilitating existing land and properties for future development. Establishment of various enterprise zones continues to diversify the local economy and improve labor market conditions. Meriden's unemployment rate of 5.9% was above the state and national rates of 4.9% and 4.9%, respectively, but consistent with national trends, recent numbers show a decline over 2005 levels. Population has been relatively steady over the past three years and per capita income levels are below those of the county, state, and nation.

Fiscal 2005 reflected the second consecutive unqualified audit opinion, reversing years of inflated fund balances due to the misreporting of salary accruals. Consistent with fiscal 2004, the unreserved fund balance in fiscal 2005 totaled just 1.1% of general fund expenditures even with a $1.9 million operating surplus. Unaudited fiscal 2006 results are expected to yield an unreserved general fund balance equal to 2% of expenditures. The city is considering a formalized fund balance policy that would target a reserve level of 10% of expenditures. The city has improved collections of its primary revenue source, property taxes, and continues to demonstrate a willingness to raise recurring revenues. The next revaluation will occur later this year, effective fiscal 2008, and the city expects significant growth.

Meriden's moderate debt burden is one of its key credit strengths. Direct debt is $1,727 per capita and 3.0% of full market value. While the city's capital needs appear manageable, the multiyear capital improvement plan (CIP) only shows funding of projects in the first year. The city is currently developing a more detailed CIP with multiyear funding sources and maintains stringent debt affordability policies. The debt service burden on the budget remains affordable at

10% of spending despite a rapid debt amortization rate, with 89.5% of principal retired in 10 years.

## Strengths

- Moderate debt levels, with manageable future capital needs and rapid amortization.
- Willingness to raise revenues from recurring sources.
- Demonstrated progress toward institutionalization of fund balance and capital planning policies.

## Risks

- Limited financial flexibility underpinned by low fund balance levels.
- Historically weak economic base, somewhat offset by ongoing economic development projects that should improve tax and employment bases over the long term.

## Debt

Meriden's debt profile is its key credit strength. Direct debt levels are moderate at $1,727 per capita and 3.0% of full market value based on the equalized grand list estimated for fiscal 2006. The city has no overlapping debt. The debt burden is also affordable as debt service payments claim a moderate 10% of spending, despite a very rapid principal amortization rate of 89.5% in 10 years.

The adopted seven-year (fiscal years 2006–2012) CIP totals $349 million, of which approximately 54% is allocated for schools; 48% is for general government purposes, such as infrastructure needs, building maintenance, and public safety; and 8% is for the water and sewer system, which is self-supported by user fees and charges. Although the CIP currently spans seven years, projects are typically approved on an annual basis and the only funding sources identified are currently authorized bond issues. Costs included beyond the current year often consist of wishlist projects the approval of which is uncertain, thus overstating the total CIP cost. The city is currently enhancing its CIP process to more accurately calculate future capital costs and more clearly identify funding sources. The new CIP is expected this year.

Similar to other municipalities in Connecticut, Meriden receives proportional progress payments toward eligible school construction costs and, therefore, issues bonds only for the net share of project costs. The total amount for schools included in the CIP is $187 million, of which the city expects state participation of approximately 77%. While the projects have not yet been approved by the state, 77% is consistent with the historical rate. If the state does not approve the projects, the city will have to scale back the total scope of education capital projects significantly.

### Debt Statistics

($000)

| | |
|---|---|
| This Issue | 20,245 |
| General Purpose and Water and Sewer | 78,697 |
| Outstanding Debt | 98,942 |
| Less: Self-Supporting Debt | (13,954) |
| Direct Debt | 84,988 |

**Debt Ratios**

| | |
|---|---|
| Direct Debt per Capita ($)* | 1,727 |
| As % of Full Market Value** | 3.0 |

*Population: 59,136 (2004 estimate).
**Full market value: $3,458,070,392 (fiscal 2005 equalized grand list).

The state's statutory debt limit for municipalities is 7.0 times annual tax receipts but Meriden adheres to a more stringent self-imposed debt limit in the form of a city council resolution. The issuance of bonded debt for general government purposes (excluding those for schools and enterprise funds) is not to exceed 50% of the principal amount retired in the preceding fiscal year, unless approved by two-thirds of the city council. Although planned borrowings over the next few years will increase debt service payments, the claim on general fund expenditures is reportedly projected to remain at or below the currently affordable level of 10%, down from the peak of 13.4% of expenditures recorded for fiscal 1999. Debt service starts to decline in fiscal 2009. Given the very rapid principal amortization rate, the projected stable debt service burden should somewhat improve the city's financial flexibility by limiting the budgetary impact of planned new borrowings on the city's future financial resources.

In addition to the current issue, outstanding long-term debt of the city includes general obligation bonds and bonded debt related to the city's three enterprise funds: the water fund; the sewer authority; and the golf course fund. Outstanding at $8.2 million, the bonds are self-supported by the operations of the enterprises but carry the ultimate guarantee of the city's full faith and credit.

## Finances

The remedial action taken in fiscal 2004 to correct a legacy of qualified audit opinions marks Meriden's first step in rebuilding fund balance levels, liquidity levels, and overall financial flexibility and

**General Fund Summary**
($000, Audited Fiscal Years Ended June 30)

| | 1999* | 2000* | 2001* | 2002* | 2003* | 2004 | 2005 | 2006** |
|---|---|---|---|---|---|---|---|---|
| Property Taxes | 64,949 | 67,005 | 77,363 | 79,388 | 84,906 | 88,259 | 91,365 | 96,220 |
| Intergovernmental | 51,028 | 54,205 | 58,055 | 58,856 | 57,538 | 59,810 | 59,251 | 56,899 |
| Other | 5,191 | 5,393 | 5,828 | 5,523 | 9,903 | 12,269 | 11,874 | 11,031 |
| Total Revenues | 121,168 | 126,603 | 141,246 | 143,767 | 152,347 | 160,338 | 162,490 | 164,150 |
| General Government | 31,389 | 27,392 | 32,650 | 34,174 | 35,533 | 37,233 | 40,219 | 30,318 |
| Education | 58,729 | 62,027 | 64,468 | 69,584 | 73,737 | 75,327 | 78,349 | 89,713 |
| Public Safety | 13,088 | 13,962 | 14,741 | 15,265 | 16,148 | 16,944 | 17,441 | 17,237 |
| Debt Service | 17,072 | 14,890 | 17,316 | 14,800 | 14,409 | 17,400 | 15,867 | 17,959 |
| Other | 7,574 | 6,467 | 8,086 | 7,577 | 8,124 | 10,316 | 8,743 | 8,883 |
| Total Expenditures | 127,853 | 124,738 | 137,261 | 141,400 | 147,950 | 157,219 | 160,619 | 164,110 |
| Net Transfers and Other Uses | — | 536 | (663) | (681) | 245 | (100) | 4,750 | — |
| Operating Results | (6,684) | 2,401 | 3,322 | 1,686 | 4,642 | 3,019 | 6,622 | 40 |
| Total Fund Balance | (2,634) | 26 | 3,348 | 5,035 | 9,678 | 3,517 | 9,612 | — |
| As % of Total Expenditures and Other Uses | (2.1) | 0.0 | 2.4 | 3.5 | 6.3 | 2.2 | 6.0 | — |

*Overstated fund balance due to accrual misrepresentation. **Estimated.

creditworthiness. For many years, the city's financial reserves were inflated due to a prolonged omission of a liability for compensation associated with teachers' salaries earned at year end but paid subsequent to year end. As a result, negative general fund balances, the product of a legacy of unwillingness to raise recurring revenues, were misstated as positive. By the end of fiscal 2004, the accumulated salary liability ballooned to total $8.2 million. The full recognition of this liability in fiscal 2004 reduced the general fund balance from 6.3% of total expenditures and other uses to 2.2%.

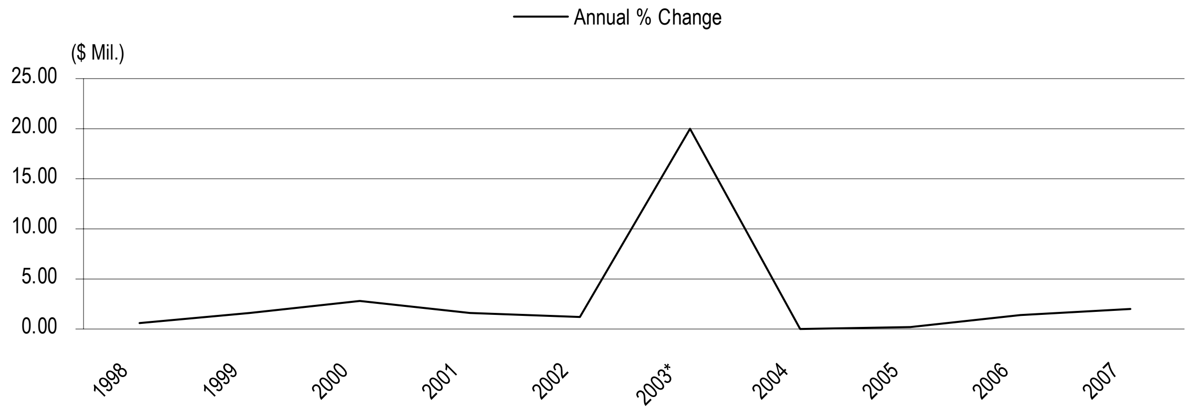
In fiscal 2005, unreserved fund balance remained low at 1.1% of spending despite a $1.9 million operating surplus. Total fund balance increased to 6% as a result of a one-time equity transfer to the general fund of $5 million from the bonded projects fund. The city plans to budget a portion of the reserve in each year to offset debt service costs but through conservative budgeting projects an increase in unreserved fund balance over time as reserves may not be needed. In fiscal 2006 the city budgeted $1.5 million of the reserve and with a total surplus of $1.54 million, expects to increase the unreserved fund balance to approximately 2% of expenditures. Property tax receipts typically contribute more than one-half of city revenues. Following five straight years of tax levy increases averaging 5.1% officials have demonstrated a renewed willingness to raise revenue from this reliable source. The most recent grand list revaluation was undertaken in October 2001, yielding a 20.0% increase in assessed valuation (AV) effective in fiscal 2003. Tax base growth since the revaluation has been slow, with fiscal years 2005 and 2006 at 1.5% and 2%, respectively. The next general revaluation is scheduled for fiscal 2006, and is expected to significantly boost assessed value. The revaluation will also reflect a shift toward residential property accounting for a greater share of AV, with residential values estimated to increase from 54%–61% of AV.

Because of more aggressive collection procedures, collections rates have improved, with 97% of the tax levy collected on a current basis for fiscal 2006, up from 93.3% recorded for fiscal 1999. On a total basis, collections rates ranged from a high 98.8% and 99.7% from fiscal 1996–2001. The city has recently changed its budgeting practices concerning tax collection rates. Previously, the city was using collection rate in the current budget year equal to the past three-years' average. Now the city is budgeting 100% of current tax collections but maintains a level of cushion as no tax receipts are budgeted for motor vehicles or delinquent taxes.

Meriden's budgetary dependence on intergovernmental aid, primarily state education assistance and payments-in-lieu-of-taxes, have lessened over the years, declining from 42.1% of general fund revenues in fiscal 1999 to 36.7% estimated for fiscal 2006. Despite reductions in federal and state aid, the improved property tax collections, conservative budgeting and the city's efforts in expanding its tax base should help restore fiscal stability.

The adopted budget for fiscal 2007 is balanced and includes the second year of budgeted fund balance from

**Fiscal Trends**
(Fiscal Years Ended June 30)




*Adjustments reflect salary accruals consistent with generally accepted accounting practices.

the aforementioned reserve. Revenues and expenditures increase approximately 5%. Expenditure pressure stems from increased school spending and rising health insurance costs, which will be funded by a prudent increase in the tax levy of approximately 5%. The city implemented a new automated budgetary process for the first time in fiscal 2005. The new computer software has enhanced monthly and quarterly reporting processes to the city council, the finance committee, the city manager, and the mayor.

With the problems of qualified audits overcome, the city is now looking ahead to restore financial flexibility by rebuilding fund balances. A draft fund balance policy, currently under consideration by the city council, targets reserves at 10% of spending. The draft policy contains strong compliance provisions, such as the requirement to budget 15% of the difference between the target and current fund balance until the target is reached and the restriction on spending fund balance except in the case of fiscal emergency as declared by a two-thirds vote of the city council. If approved in its current form, and adhered to, Fitch notes that in combination with other initiatives taken thus far, the city could achieve greater fiscal stability in coming years.

## ■ Economy

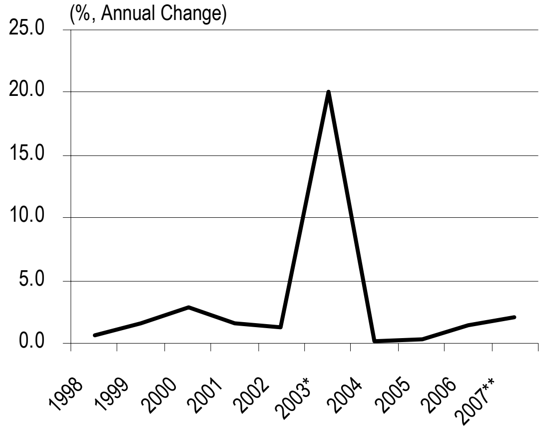
Situated halfway between the cities of Hartford and New Haven in New Haven County, Meriden is at the crossroads of major highways. The city's location bodes well for its ambitious economic development efforts, which continue to focus on attracting new business presence and reclaiming and rehabilitating existing land and properties for future development.

Meriden's somewhat limited economy is currently represented by telecommunications, health care, and automotive parts manufacturing. The city's largest taxpayers are primarily shopping center developers and utilities, accounting for 8.8% of the fiscal 2005 grand list. Consistent with a lack of economic diversity, the city's labor market conditions historically have compared unfavorably to those of the state and the nation. Meriden's unemployment rate of 6.3% in May 2004 was above that of the state and the nation at 4.8% and 5.6%, respectively.

Population exhibited nominal growth over the past three years, ranging from 0.3%–0.5% annually. Income levels, however, still remain below those of the county, state, and nation. Per capita income (2000 census) was $20,597, which was below the averages of the county, state, and nation, which were 16%, 29%, and 5% higher, respectively. The median household effective buying income was at par with the nation, at $38,396 in 2004, but 12.2% below that of the state. Market value per capita, based on the equalized grand list estimated for fiscal 2005, is average at $58,477.

In July 2002, the city established an information technology zone, which provides tax incentives for high-technology companies that relocate to the city.

**Assessed Valuation**
(Fiscal Years Ending June 30)




*Revaluation. **Projected.

Additionally, the city has a state-designated enterprise zone that provides significant tax incentives to manufacturers and warehousing and distribution companies locating into the zone, with one-half of the tax abatements reimbursed by the state. Furthermore, the city's comprehensive economic development strategy plan has been approved by the U.S. Economic Development Agency (EDA), a prerequisite for eligibility for EDA funding.

Commercial and retail development efforts undertaken so far should help diversify the city's economic and employment bases in the coming years. Aplicare Inc. (pharmaceuticals) recently opened a new operation that is projected to bring 180 new jobs to city and $2.6 million in renovations. Growth in retail development is also evident. Best Buy, Dick's Sporting Goods, Circuit City, and Saab Automobile USA have constructed facilities and opened for business since 2004.