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Ratings

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Summary:

Warwick, Rhode Island
Rhode Island Health & Educational Building Corp.; General Obligation

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Credit Profile		
US$6.72 mil rev bnds (Warwick) ser 2020C due 05/15/2040		
Long Term Rating	AA/Stable	New
Warwick GO		
Long Term Rating	AA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA' long-term rating to the Rhode Island Health & Educational Building Corp.'s series 2020C revenue bonds, issued for Warwick, and affirmed its 'AA' long-term rating on the corporation's existing debt also issued for the city. At the same time, we affirmed our 'AA' long-term rating on the city's general obligation (GO) debt. The outlook on all ratings is stable.

Subject to the master indenture agreement, Warwick's full-faith-and-credit-GO pledge secures the revenue bonds. The city's full-faith-and-credit-GO pledge also secures the outstanding GO bonds.

Officials intend to use series 2020C bond proceeds to fund school repairs and renovations.

Credit overview

Warwick has faced a challenging budgetary environment over the past few years due to expenditure pressures from the school department. The city increased its budget appropriation to the school and worked with officials to limit expenditure growth, resulting in improved variances for fiscal 2020, management reports. We believe management's work to resolve recent budgetary shortfalls leaves it in a better position to manage the current recessionary pressures. Our outlook is generally for two years, but we see some risks due to the COVID-19 pandemic and U.S. recession over the next six-to-12 months. There remains significant uncertainty stemming from the potential effects of the COVID-19 pandemic and the related economic recession, resulting in unknown and unquantifiable potential revenue and expenditure pressures. We have incorporated this uncertainty into our view of the city's budgetary performance and overall creditworthiness. We will continue to monitor any material adverse effects throughout the outlook period.

The city's very strong economy with direct access to the Providence metropolitan statistical area (MSA) helps support the economy and tax base. However, it continues to face high retirement costs associated with its large pension and other-postemployment-benefit (OPEB) obligations that could pressure future budgets, particularly if economic growth materially slows relative to recent years.

The long-term rating reflects our view of the following factors for the city:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Adequate management, with standard financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with slight operating surpluses in the general fund and at the total governmental fund level in fiscal 2019;
- Strong budgetary flexibility, with an available fund balance in fiscal 2019 of 9.3% of operating expenditures;
- Very strong liquidity, with total government available cash at 17.6% of total governmental fund expenditures and 8.3x governmental debt service, and access to external liquidity we consider strong;
- Very strong debt and contingent liability position, with debt service carrying charges at 2.1% of expenditures and net direct debt that is 16.2% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 81.1% of debt scheduled to be retired in 10 years, but a large pension and OPEB obligation and the lack of a plan to sufficiently address the obligation; and
- Strong institutional framework score.

Environmental, social, and governance risks

We analyzed the city's environmental, social, and governance (ESG) risks relative to its economy, management, financial measures, and debt and liability profile. Our rating incorporates our view regarding the indirect risks posed by the COVID-19 pandemic. Absent the implications of COVID-19, we consider the city's social risks in line with those of the sector. We believe its environmental and governance risks are in line with our view of the sector standard.

Stable Outlook

Downside scenario

We could lower the rating if the city's available reserves were to decline.

Upside scenario

If the city were to maintain consistent positive operating results, leading to increased reserves, while also making material progress in reducing both its retirement costs and the associated pension and OPEB liabilities, we could raise the rating.

Credit Opinion

Very strong economy

We consider Warwick's economy very strong. The city, with a population of 81,004, is in Kent County in the Providence-Warwick MSA, which we consider to be broad and diverse. It has a projected per capita effective buying income of 123% of the national level and per capita market value of $131,744. Overall, market value grew by 15.0% over the past year to $10.7 billion in 2020. The county unemployment rate was 3.2% in 2019.

We expect Warwick's underlying wealth and income metrics and broader tax base to remain stable. Assessed value (AV) increased by about 15% to roughly $10.7 billion for fiscal 2020 due to a revaluation. Officials indicate there have been no major tax appeals or delinquencies to date. We believe in the current economic environment, the city's tax collection rate could decline relative to actual collections in the recent fiscal year, something management is incorporating into its fiscal 2021 planning. At this time, we believe the short-term risk is from declining collections, while a longer-term recession could pressure valuations and new economic growth. We believe the city is accounting for the former in its budget planning, but the latter could pressure future budgets as the city relies on incremental economic growth to generate property tax revenue growth.

The city serves as one of Rhode Island's leading commercial and retail centers, benefiting from direct access to Providence, 12 miles away, and being in the state's approximate geographic center. It is on interstates 95 and 295, giving direct north-south access to Providence and the surrounding suburban communities. The recently completed Warwick Intermodal Train Station (Interlink) connects the station to the airport via an enclosed elevated walkway and provides residents and other commuters with direct access to Providence and Boston through Massachusetts Bay Transit Authority-operated commuter trains. In addition to two shopping malls, the city is home to T.F. Green Airport, the state's major commercial airport. While we believe the commercial/retail and airport sectors are pressured due to COVID-19, the city is not highly reliant on excise or airport-related revenues, and we believe management has taken steps in the fiscal 2021 budget to limit major shortfalls from these potentially volatile revenue streams.

Adequate management

We view the city's management as adequate, with standard financial policies and practices under our FMA methodology, indicating the finance department maintains adequate policies in some, but not all, key areas.

The city has a history of outperforming its budget in positive economic cycles. In fiscal 2020 and entering fiscal 2021, it made adjustments to its revenue and expenditure assumptions that we believe are likely to result in improved variances relative to past downward economic cycles. The administration also contracted with outside consultants and worked to hire experienced financial management professionals, which could lead to continued improvement in budgeting practices and financial results.

Warwick historically budgets for reserve use to balance the budget, which the current administration is working to phase out. Budgeting is comprehensive, involving discussions with department heads, five years of historical analysis, and forward planning. We understand that the administration is working to improve revenue and expenditure, particularly with the school department. At this time, reporting is not formally done on a regular schedule to the city council, although the school department sends a quarterly expenditure update to the management team.

The city also submits the required annual five-year forecasts to the state. It annually updates the five-year capital improvement plan that describes planned projects, annual costs, and potential funding. The city follows state investment guidelines and reports on holdings annually in the audit. It has a formal debt policy that limits general fund debt service to 10% of expenditures and requires 1.1x coverage for revenue bonds; otherwise, the city adheres to state limitations on debt. While Warwick does not have a reserve-balance policy, it strives to maintain sufficient reserves for unforeseen contingencies and cash flow.

Adequate budgetary performance

Warwick's budgetary performance is adequate, in our opinion. The city had slight operating surpluses of 0.7% of expenditures in the general fund and 1.0% across all governmental funds in fiscal 2019. General fund operating results of the city have been stable over the last three years, with results of negative 0.5% in 2018 and 2.3% in 2017.

Due to the sudden rapid economic deterioration, we incorporated the uncertain revenue and expenditure risk into our assessment of performance to account for these risks over the next one-to-two fiscal years. This assessment incorporates heightened near-term uncertainty that exists due to the recessionary pressures related to the COVID-19 pandemic and resulting financial pressures. We adjusted budgetary performance to account for recurring transfers, and incorporated the city's school operating fund into the general fund performance.

On a combined basis, the city finished fiscal 2019 with a modest surplus, despite a $1.9 million deficit result in the school fund. Improving school budgetary performance is a priority for the administration and management, through improved communication and oversight through regular meetings and updated financial systems. In fiscal 2020, management is expecting the school department to return a $2 million-$4 million surplus, due in part to COVID-19-related closures, resulting in savings in utilities, sports programs, and transportation. Due a drop in revenue, the city is expecting balanced results, with a combined $2 million-$4 million surplus.

For fiscal 2021, the city again increased school funding, while holding most expenditures constant with 2020. It permanently laid off 40 employees, while eliminating an additional 20 vacant positions for 2021. The budget reduces certain excise taxes, such as meals and hotel taxes, by 20%-30% from expected fiscal 2020 actuals as management expects a slow rebound to the economy. Budget officials examined tax collections in the last recession and budgeted collections near 2008-2009 collections. While the school department's budget is based on yet-to-be settled teacher contracts and the current assumptions, as well as January's school state aid projections, we expect management will continue to take a proactive approach to its budget. However, we believe there is significant revenue and expenditure uncertainty over the next two fiscal years, and we incorporated that into our forward-looking view of the city's budgetary performance.

Strong budgetary flexibility

Warwick's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2019 of 9.3% of operating expenditures, or $29.5 million.

We expect the fiscal 2020 audit to show a modest improvement in available reserves, based on management's current year-end projections. We also anticipate that, due to management's conservative approach for fiscal 2021, reserves are unlikely to materially deteriorate over the next year. While significant unknowns remain regarding direct school state aid, other revenues, and expenditures, we expect our view of budgetary flexibility will remain strong.

Very strong liquidity

In our opinion, Warwick's liquidity is very strong, with total government available cash at 17.6% of total governmental fund expenditures and 8.3x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary.

Warwick's frequent debt issuance, including GO bonds, demonstrates its strong access to external liquidity. Although the state allows for what we view as permissive investments, we believe the city does not currently have aggressive investments with most in highly rated and liquid mutual funds and fixed-income securities. It does not have any direct-purchase or variable-rate debt or unrated loans or bonds. The city entered into a number of direct-placement debt obligations with the state's infrastructure bank, but we do not believe they present a liquidity risk. We understand the city's collections remain stable. At this time, we do not expect a material change in the liquidity profile.

Very strong debt and contingent liability profile

In our view, Warwick's debt and contingent liability profile is very strong. Total governmental fund debt service is 2.1% of total governmental fund expenditures, and net direct debt is 16.2% of total governmental fund revenue. Overall net debt is low at 0.5% of market value, and approximately 81.1% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

Following this issuance, Warwick will have about $121 million of total direct debt, roughly $65 million of which is self-supported and revenue-secured enterprise debt. Residents authorized $40 million in debt for school capital projects, of which $25 remains authorized but unissued; we anticipate the city will issue the remaining debt over the next several years. The city expects to receive the state's minimum reimbursement of 35% of debt service for the school debt. At this time, we do not expect a material change in its debt ratios.

In our opinion, a credit weakness is Warwick's large pension and OPEB obligation, without a plan in place that we think will sufficiently address it. Warwick's combined required pension and actual OPEB contributions totaled 17.7% of total governmental fund expenditures in 2019. Of that amount, 13.8% represented required contributions to pension obligations, and 3.9% represented OPEB payments. The city made 103% of its annual required pension contribution in 2019. The funded ratio of the largest pension plan is 24.6%.

Pension and other postemployment benefits (OPEBs)

- In our opinion, a credit weakness is Warwick's large pension and OPEB obligation, without a plan in place that we think will sufficiently address it.
- While the city uses an actuarially determined contribution (ADC), we believe some of the underlying assumptions and methodologies heighten the risk of unexpected contribution escalations.
- Furthermore, OPEB liabilities are funded on a pay-as-you-go basis, which, given claims volatility as well as medical cost and demographic trends, is likely to lead to escalating costs.

The city participates in the following retirement plans:

- Police Pension I and Fire Pension I: 24.6% funded, $224.6 million net pension liability (NPL; 6.9% discount rate)
- Warwick Public School Teacher's Pension Plan: 52.8% funded, $140.2 million proportionate share of the NPL (7.0%)
- Warwick Public School Employees' Retirement Plan: 91.6% funded, $5.3 million NPL (7%)
- Police Pension II Plan: 81.9% funded, $45.9 million NPL (6.9%)
- City Employees' Pension Trust Fund: 73.3% funded, $49.6 million NPL (6.9%)
- Fire Pension II Plan: 79.8% funded, $19.5 million NPL (6.9%)
- City employees single-employer defined-benefit health care plan: $363.2 million net OPEB liability (NOL), measured using a 7.0% health care cost trend declining to 4.0%
- Warwick School Department single-employer defined-benefit health care plan: 27.1 million NOL (2.79%)

The city's aggregate NPL is $485 million total and aggregate NOL is $390 million. Warwick's combined required pension and actual OPEB contributions totaled 17.7% of total governmental fund expenditures in 2019. Of that amount, 13.8% represented required contributions to pension obligations, and 3.9% represented OPEB payments. The city made 103% of its annual required pension contribution in 2019. The funded ratio of the largest pension plan is 24.6%.

The Police Pension I and Fire Pension Plan are in critical status, as defined by the state's Retirement Security Act for Locally Administered Pension Funds; this designation requires cities and towns to enact a funding improvement plan to return the plan to, at least, 60% funding. As part of its adopted funding plan, the city will continue to contribute 100% of its annual required contribution. If actuarial assumptions hold true, it could reach 100% funding at the June 30, 2035, valuation. However, the plan has made little progress in improving the funded ratio over the past few years. In the most recent year, the plan did not meet either our static or minimum funding progress metrics. We also believe the discount rate, along with the discount rate in each of the pension plans, could lead to cost volatility. Given the underlying assumptions, we expect costs will rise.

The Warwick Public School Teachers' plan is a cost-sharing multiple-employer plan run by the state; the state assumes a portion of the Warwick school department's total liability ($244.8 million) and makes payments on behalf of the school department. The remaining plans are city administered. The city contributed at least the ADC in fiscal 2019 for each plan, and funded in excess of the ADC for the public school employees' plan. We anticipate it will continue to at least meet the ADC for each plan.

We understand that the fire fighters agreed to begin funding an OPEB trust fund, which over the long-term should lower the city's costs and liability. However, we expect the total liability and costs will continue to rise. We believe the city's retirement costs are pressuring its finances and could present an incrementally larger pressure as costs rise if overall budgetary growth does not keep pace.

Strong institutional framework

The institutional framework score for Rhode Island municipalities is strong.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of July 9, 2020)		
Warwick GO (AGM)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Ratings Detail (As Of July 9, 2020) (cont.)		
Warwick GO (AGM)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Rhode Island Hlth & Educl Bldg Corp, Rhode Island		
Warwick, Rhode Island		
Rhode Island Hlth & Educl Bldg Corp (Warwick) GO sch bnds		
Long Term Rating	AA/Stable	Affirmed
Rhode Island Hlth & Educl Bldg Corp (Warwick) GO (MAC)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.