

FITCH AFFIRMS WEST WARWICK, RI'S GOS AT 'BBB-'; OUTLOOK REVISED TO POSITIVE

Fitch Ratings-New York-05 June 2015: Fitch Ratings affirms the 'BBB-' rating on the following town of West Warwick, RI (the town) outstanding general obligation (GO) bonds:

--\$3.3 million GO bonds, series 2007;

--\$1 million GO Bonds, series 2005.

The Rating Outlook is revised to Positive from Stable.

SECURITY

The bonds are general obligations of the town secured by its full faith and credit and unlimited taxing authority.

KEY RATING DRIVERS

POSITIVE OUTLOOK REFLECTS STABILIZED OPERATIONS: Moderate tax revenue increases, significant pension reform efforts and improved oversight and expenditure controls in the school fund have helped management achieve a more structured and stable financial profile. Such efforts should provide for continued stabilized operating performance and improved financial flexibility.

POORLY FUNDED PENSION: The town's pension plan is severely underfunded and recent pension reform efforts have reduced annual required contributions (ARC) to more manageable levels. After years of underfunding, management has begun making full ARC payments at the reduced level, although Fitch expects a very poorly funded pension plan for some time.

MODERATE RESERVE LEVELS: Fiscal 2014 results reflect a decline in general fund balance to still-moderate levels. Surplus operations in the school fund have resulted in a moderate fund balance after prior years of deficit balances.

WEAK DEMOGRAPHICS: Demographics are weak with a relatively declining population, low wealth levels, and high unemployment. After a notable decline during the recession, assessed values have begun to stabilize.

LOW DEBT RATIOS: The town's overall debt levels are low with rapid amortization.

RATING SENSITIVITIES

PRUDENT FINANCIAL MANAGEMENT: Management's ability to consistently achieve balanced operations and adequate reserve levels is key to the rating remaining at the investment-grade level. These actions, combined with an increase in revenue flexibility driven by a strengthening economy and tax base growth, could support a positive change in the rating.

CREDIT PROFILE

West Warwick is 11 miles south of the state capital city of Providence. The 2013 population of 28,893 represents a 2.3% decline over the 2000 census figure.

PRUDENT MANAGEMENT ACTIONS LEAD TO BETTER FINANCIAL STABILITY

Management was successful in negotiating pension reform measures with its labor groups and retirees resulting in substantial budget relief for the five-year period of fiscal 2015 to 2019. Additionally, it has made broad changes to its health plans and negotiated higher employee and future retiree contributions. The sought-after pension and health care reforms were part of the town's plan to reduce its long-term liabilities and achieve full funding of the ARC of its town-administered employee pension plan. The town began making 100% ARC payments in fiscal 2015 and has budgeted for 100% pension and other post-employment benefit (OPEB) contributions in fiscal 2016.

The pension and OPEB changes were part of five-year employment contracts with its labor groups, effective July 1, 2014. Employees agreed to no salary increases over this period. The contracts contain a wage-opener clause in years four and five in the event the town meets certain financial improvement thresholds.

FISCAL 2015 PROJECTIONS REFLECT STABLE RESULTS

Voters approved the fiscal 2015 budget via referendum last year, capping off a collaborative effort among all affected parties to restore financial stability within the town. The budget included a 3.79% tax levy increase, slightly below the state-wide 4% annual levy cap. Property taxes make up 69% of the overall \$86 million budget followed by state aid (28%).

Management reports the general fund is expecting balanced operations even though severe winter weather resulted in snow removal costs exceeding budget. The school fund has shown some medical and dental expense savings and with continued expenditure controls in place, management is projecting balanced operations.

FISCAL 2016 BUDGET REFLECTS MODERATE TAX RATE INCREASE

The fiscal 2016 budget of \$89.5 million was approved last month by residents and was up \$3.2 million or 3.7% from the prior year's budget. The budget includes a 3.24% tax levy increase of \$1.9 million and appropriations of \$505,000 for capital projects and \$200,000 surplus to fund balance.

West Warwick's charter requires its budget (including any tax levy over the cap) 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.

FISCAL 2014 RESULTS MIXED

The town's fiscal 2014 budget of \$83 million was a 4.3% increase over fiscal 2013. The budget included a \$1.9 million (3.9%) tax levy increase. Incorporated in the tax increase was approximately \$750,000 in additional revenue generated from the decrease in the motor vehicle value exemption to \$1,000 from \$2,500 for the motor vehicle tax.

The town had a net operating deficit of \$889,000 (1.38% of spending) due to higher than anticipated legal costs associated with the labor negotiations, and higher overtime, insurance and utility costs. Capital spending accounted for \$634,255 of general fund spending. The unrestricted general fund totaled \$3.4 million or a moderate 5.3% of spending.

The school fund posted surplus results due to a combination of lower than anticipated medical and dental insurance expenses, and lower than budgeted salary and capital spending. Additionally, the school fund continues to receive increases in annual state aid in accordance with the state's fair funding formula. The school fund ended the fiscal year with a \$2.7 million (5.4% of spending) operating surplus increasing its fund balance to \$2.71 million.

PENSION REFORM EFFORTS LOWER ANNUAL PENSION COSTS

The town-administered employee pension plan is severely underfunded at only 19% as of July 1, 2014 due to years of continuous under-funding. The funded level declines to an estimated 18% using

Fitch's 7% investment rate of return. The unfunded liability is \$117 million, or a high 5.6% of assessed value (AV).

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 ARC from \$10.7 million to \$8 million for fiscal 2015 and lowered the future annual rate of growth in the ARC. The reduction will allow the city to achieve 100% funding of the ARC commencing fiscal 2015 rather than the partial payments that have been made over the last several years. The town contributed \$6 million in fiscal 2014.

The town is required to fully fund its pension ARC in accordance with the court-approved plan of reform. The ARC 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 ARC in years 1-5 and 100.5% of the ARC in years 6-20. The purpose of the higher ARC 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.

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.

The town fully funds the ARC to the state's Employee Retirement System (ERS) for its teachers. However, Fitch considers the state teachers' plan to be weakly funded at an estimated 57% at June 30, 2014 using Fitch's 7% rate of return assumption.

FUTURE OPEB LIABILITIES REDUCED WITH REFORMS

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 paid \$3.5 million towards its fiscal 2014 ARC of \$4.8 million (or 73%). An increase in the town's annual funding of OPEB costs above pay-as-you-go was budgeted for in fiscal 2016 with plans to establish a dedicated investment trust.

LOW DEBT RATIOS; MODERATELY HIGH CARRYING COSTS

Overall debt levels are very low at 1.2% of fiscal 2016 AV and \$848 per capita. Debt amortization is above-average with 78% of par maturing in 10 years. Last month voters approved the authorization of \$25 million in new debt for various projects. Of the authorization \$18 million has been earmarked for the financing of the purchase of wind turbines anticipated to be paid for from current costs associated with energy usage and \$5 million has been designated for road improvements. Even with this new debt, which is about equal to the currently outstanding amount, debt levels should remain low.

Total carrying costs for the full town pension plan ARC (prior to reform), ERS contributions, OPEB contributions and debt service represents a moderately high 22% of fiscal 2014 total governmental spending. Fitch expects carrying costs to decrease moderately due to the decline in the pension and OPEB ARCs beginning in fiscal 2015. Carrying costs will grow moderately thereafter to meet the pension funding goals and accommodate the new debt.

BELOW-AVERAGE ECONOMIC INDICATORS

Wealth levels are slightly below state and national averages. Unemployment remains improved to 7.6% in March 2015 from 9.7% the prior year as employment grew 2.3% over the period.

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.

AV had 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 is showing modest signs of improvement. Taxable values have improved by 1.1% and 0.87% for fiscals 2015 and 2016, respectively as new projects come on line. Housing values increased 2.4% year over year through April 30 according to Zillow Group but are still substantially below peak levels.

New development projects underway, and planned, are anticipated by management to increase AV and help offset some of the future anticipated tax increases. Fitch believes this to be reasonable due to the reports of activity underway and the increase in building permits. Fitch will evaluate the impact of any change in the current weak economic trend once it starts to materialize.

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In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial Associates, S&P/Case-Shiller Home Price Index, IHS Global Insight, Zillow.com, and the National Association of Realtors.

Applicable Criteria

Tax-Supported Rating Criteria (pub. 14 Aug 2012)

https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015

U.S. Local Government Tax-Supported Rating Criteria (pub. 14 Aug 2012)

https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314

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