Council Direction:
Not Applicable

Information:

Standard & Poor’s Rating Service (S&P) has reviewed the City of Hamilton’s (Hamilton) credit rating and affirmed the rating at AA with a “stable” outlook.

Attached, as Appendix “A” to Report FCS13072, is S&P’s credit rating report for Hamilton. S&P’s report highlights financial management and points to three strengths and two weaknesses as follows:

Major Rating Factors

Strengths:
- Predictable and well-balanced local government framework.
- Strong liquidity.
- An economy that continues to diversify.

Weaknesses:
- Constrained budgetary flexibility.
• A moderate debt load that is expected to increase in medium term.

Rationale

Hamilton’s major strengths are perceived by Standard and Poor’s as having a predictable and well-balanced local government framework, strong liquidity, and an economy that continues to diversify. Hamilton’s constrained budgetary flexibility as it tackles significant capital investment requirements and the associated increase in its debt burden over the medium term, partially mitigate the City’s strengths.

In the fiscal year ended December 31, 2012, Hamilton had sufficient cash and liquid assets to cover 1,200% of the estimated debt service costs for 2013 (Standard & Poor’s adjusted). While it is expected Hamilton may reduce its liquidity position in the next two years due to internal financing, Hamilton's liquidity position will be more than sufficient to meet debt service requirements throughout the two-year period with a strong debt service coverage of 5x–8x.

As at fiscal year-end 2012, the City’s operating surplus declined to 11.9% of operating revenues due to declining revenue. This compares to 13.6% in 2012 and 18.8% in 2011. However, Standard and Poor’s believes that the City will maintain an operating surplus of about 10% throughout the outlook horizon of two years. A move below 5% of operating revenue could be negative for the City’s rating. After accounting for capital revenue and expenditure, both of which were lower in 2012, the balance was a modest deficit of 4.2% in 2012 versus a deficit of 1.2% in 2011 of total revenue. A deficit of 15-20% and a tax supported debt level exceeding 60% of operating revenues during the outlook horizon could be negative for the City’s rating.

The City is perceived to be diversifying away from its manufacturing base and demonstrating growth in other sectors such as, health care, educational services, finance and food processing. The City’s population increased 3.1% since the 2006 census which is below the Provincial average of 5.7%. The median family income for the Hamilton census metropolitan area (CMA) was $76,700 in 2011 compared with the Provincial median of almost $69,900. The City is estimated to generate a per capital GDP in line with the Provincial median of $49,865. While the labour force growth was modest in 2012 at 0.7%, the unemployment rate was 6.5%, which is lower than the Provincial rate of 7.8%. The City issued a record $1.5 billion in building permits in 2012 topping the record $1.1 billion in 2010. Residential permits account for 44% while institutional permits increased substantially due to the construction of a large regional mental health centre which is expected to add 13,000 jobs.
Hamilton had $419 million of tax supported debt outstanding at the end of 2012. This equalled 32% of operating revenue which is viewed as moderate compared to its peers. However, due to Hamilton’s estimated $2 billion infrastructure deficit, the City’s planned debt burden is projected to reach 45% of operating revenue by the end of 2015 and could surpass 60% by 2017. Although this level of leverage would weaken the City’s credit profile somewhat, the City’s credit rating could remain stable, all other factors being equal. At the end of 2012, the City had three defined benefit plans with a total liability of $73 million. These are legacy plans and the deficit represents about 6% of operating revenue. However, the annual service cost for these plans has no meaningful impact on the City’s credit profile.

The City’s capital budget for 2013 is $435 million and focuses largely on roads and water and wastewater projects funded by reserves, the operating levy and developer contributions. Other strategic investments are included in the capital budget such as the new PanAm Games stadium and waterfront redevelopment. The ten-year capital forecast is about $3.2 billion, directing significant spending to sustaining infrastructure, expanding water and wastewater capacity, and roads. This capital plan with estimated spending of $400 million in projects annually is expected to be $300 million annually with deferrals of capital spending.

Hamilton’s largely stable and prudent financial management has a positive impact on its credit profile. However, the City’s budgetary flexibility is constrained by the estimated infrastructure deficit of $2 billion, mandated municipal services, reduced senior government support, collective agreements, and a fairly high tax levy relative to household income as compared to other Canadian municipalities.

Outlook

Hamilton’s stable outlook through the next two years depends on a strong liquidity position, budgetary performance that will not deteriorate such that operating balances fall to below 5% of operating revenues, and that tax-supported debt will not materially exceed 60% of operating revenue. The outlook could be revised to negative or the ratings could be lowered if materially weaker budgetary performance resulted in operating balances of less than 5% of operating revenues and after capital deficits exceeding 15%-20%, and that higher than expected borrowing pushed tax-supported debt to over 60% of operating revenues during the outlook horizon. Alternatively, the outlook could be revised to positive or the ratings could be raised if strong revenue growth, effective cost containment, and substantial deferral of capital spending and associated debt issuance resulted in significantly stronger operating balances, after-capital surpluses, and tax-supported debt not materially exceeding 30% of operating revenues.

OUR Vision: To be the best place in Canada to raise a child, promote innovation, engage citizens and provide diverse economic opportunities.
OUR Mission: WE provide quality public service that contribute to a healthy, safe and prosperous community, in a sustainable manner.
OUR Values: Accountability, Cost Consciousness, Equity, Excellence, Honesty, Innovation, Leadership, Respect and Teamwork.
### Hamilton’s Credit Rating History

<table>
<thead>
<tr>
<th>Rating Agency</th>
<th>Rating (formerly Regional Municipality of Hamilton-Wentworth)</th>
</tr>
</thead>
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| Standard & Poor's (formerly CBRS)      | AA: 2008 - 2012  
                                  | AA/Positive: 2005 - 2007  
                                  | AA: 1999 to 2005  
                                  | AA +: 1994 to 1999  
                                  | AAA: 1989 to 1994 |
| Moody’s                                | Aa3: 1995 to 2001  
                                  | Aa2: 1988 to 1995 |
| Dominion Bond Rating Service           | AA: 2004 to 2009  
                                  | AA+: 1994 to 2004 |

### Peer Comparison Using Standard & Poor’s Rating

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<thead>
<tr>
<th>Municipality (or Regional Municipality)</th>
<th>Rating (Stable outlook if not stated otherwise)</th>
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<tr>
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<td>AAA</td>
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<tr>
<td>Halton</td>
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<td>London</td>
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<td>Peel</td>
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<td>Waterloo</td>
<td>AAA</td>
</tr>
<tr>
<td>York</td>
<td>AAA (Negative)</td>
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<td>Brantford</td>
<td>AA+</td>
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<td>Guelph</td>
<td>AA+</td>
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<td>Ottawa</td>
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<td>Regina (Sask)</td>
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<td>Barrie</td>
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<td>Windsor</td>
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City of Hamilton

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City of Hamilton

Major Rating Factors

Strengths:
- Predictable and well-balanced local government framework
- Strong liquidity
- An economy that continues to diversify

Weaknesses:
- Constrained budgetary flexibility
- A moderate debt load that we expect to increase in medium term

Rationale

The ratings on the City of Hamilton, in the Province of Ontario, reflect Standard & Poor's Ratings Services' view of the city's strong liquidity, its economy (which continues to increase and diversify away from its industrial manufacturing roots), and the predictable and well-balanced local government framework. In our opinion, Hamilton's constrained budgetary flexibility as it tackles significant capital investment requirements, and the associated increase in its debt burden expected over the medium term, partially mitigate these strengths.

We believe Canadian municipalities benefit from a predictable and well-balanced local and regional government framework that has demonstrated a high degree of institutional stability. Although provincial governments mandate a significant proportion of municipal spending, they also provide operating fund transfers and impose fiscal restraint through legislative requirements to pass balanced operating budgets. Municipalities generally have the ability to match expenditures well with revenues, except for capital spending, which can be intensive. Any operating surpluses typically fund capital expenditures and future liabilities (such as postemployment obligations and landfill closure costs) through reserve contributions.

Hamilton's economy has continued to diversify and has experienced solid growth in sectors such as health care, construction, and educational services, which have counterbalanced the decline in its traditional manufacturing base. We believe the city is advantageously located near U.S. and large domestic markets, and that it has a good transportation network to access them. We also believe that Hamilton's large, stable public sector and still-sizeable industrial base likely generates nominal GDP per capita not materially different from the provincial level of C$49,865 in 2012. Although population growth has been slower than that of Ontario, unemployment remains lower than the provincial rate and we believe that the city has fair prospects for growth and further diversification.

Constraining the ratings on Hamilton partially is what we view as limited budgetary flexibility relative to that of its domestic peers. The city, like other Canadian municipalities, is constrained in its ability to meaningfully cut expenditures due to several factors, including provincially mandated service levels, labor contracts, inflation, and political pressures. While the ability to set property taxes, utility rates, and user fees give municipalities significant revenue-raising tools, political and economic pressures also limit the degree to which a city will employ these. This is
particularly true in Hamilton’s case, given the lower average household income of its residents and a large infrastructure deficit that limits the city’s ability to defer capital spending.

At the end of 2012, the city’s had C$419 million of tax-supported debt outstanding. This equaled 32% of operating revenue (all figures Standard & Poor’s-adjusted) generated during the year, a level we view as moderate compared to peers. We expect that Hamilton’s debt burden will continue to increase in the medium term as it debt finances parts of its capital program and that tax-supported debt could reach 45% of operating revenue by the end of 2015 and could surpass 60% by 2017 if the city borrows according to its current plan. Although this level of leverage would weaken the city’s credit profile somewhat, we do not believe that it would be inconsistent with the ratings, all other factors being equal.

**Liquidity**

Hamilton’s strong liquidity has a positive impact on its credit profile, in our opinion. Adjusted free cash and liquid assets of about C$680 million at fiscal year-end 2012 (Dec. 31) were sufficient to cover about 1,200% of debt service costs expected for 2013. We expect that internal financing of some capital projects, together with rising principal and interest payments, will reduce liquidity levels in the medium term but that during our two-year outlook horizon, debt service coverage will continue to be strong at 5x-8x.

In our view, the city has satisfactory access to external liquidity given its proven ability to issue into public debt markets and the active secondary market for Canadian municipal debt instruments.

**Outlook**

The stable outlook reflects our expectation that, throughout the two-year outlook horizon, Hamilton will maintain a strong liquidity position, budgetary performance will not deteriorate such that operating balances fall to below 5% of operating revenues, and that tax-supported debt will not materially exceed 60% of operating revenue. We could revise the outlook to negative or lower the ratings if materially weaker budgetary performance resulted in operating balances of less than 5% of operating revenue and after-capital deficits exceeding 15%-20%, and that higher-than-expected borrowing pushed tax-supported debt to over 60% of operating revenues during the outlook horizon. We could revise the outlook to positive or raise the ratings in the next two years if strong revenue growth, effective cost containment, and substantial deferrals of capital spending and associated debt issuance resulted in significantly stronger operating balances, after-capital surpluses, and tax-supported debt not materially exceeding 30% of operating revenue.

**Institutional Framework: Predictable And Well-Balanced for Ontario Municipalities**

We view the Canadian provincial-municipal intergovernmental system as being "well-balanced and predictable" because of its maturity and stability, low-to-moderate degree of mismatching of revenues and expenditures, moderate levels of transparency and accountability, and strong likelihood of extraordinary support from provincial governments.

Provincial-municipal relationships have proven to be more dynamic than the federal-provincial one, largely because the municipal governments are established through provincial statute and not the constitution. Historically, the
provinces have taken a more active role in municipal affairs than the federal government in provincial matters. Although there have been long periods of relative stability, provincially imposed large-scale changes to municipal revenue powers and expenditure responsibilities have occurred.

Provinces mandate a significant proportion of municipal spending and, through legislation, require municipalities to pass balanced operating budgets (although they also provide operating fund transfers). Nevertheless, municipalities generally have the ability to match expenditures well with revenues, except for capital spending, which can be intensive for some. Many have been limited in their ability to renew their infrastructure, roads, water, and wastewater, due to constraints on fee and property tax increases. Property taxes are the primary source of own-source revenues for Canadian municipalities, followed by fees and transfers from both the provincial and federal governments. Chief expenditure categories of Canadian municipalities are transportation services, which include roads and transit; environmental services, which include water distribution and treatment and wastewater collection; protection services such as fire and police; and recreation and cultural services. Small and rural municipalities generally receive higher provincial transfers, for both operating and capital programs, compared with those of their more urban counterparts, but there are no formal equalization schemes.

We believe financial information is quite timely. National accounting standards are strong and improving, in our view, although adoption can vary somewhat. Statutes require audited statements. While there are no national standards that apply to budgeting practices, a five-year capital budgeting process is usually the minimum. In addition, only current-year budgeting is required generally for operations.

The provinces have an established history assisting their distressed municipalities through grants.

**Economy: Diversifying Away From Manufacturing Roots**

Hamilton is in southern Ontario, on the western edge of the Golden Horseshoe, and has a population of about 520,000 according to the 2011 Census. The population has increased 3.1% since the 2006 Census; this is below the provincial growth rate of 5.7%. According to data from the national statistics organization, the median family income for the Hamilton census metropolitan area (CMA; which includes an additional 200,000 people in outlying municipalities) was about C$76,700 in 2011, compared with the provincial median of almost C$69,900. We believe that the city likely generates GDP per capita in line with the provincial level of C$49,865 recorded in 2012 given its established industrial base and growth in other sectors, such as health care and educational services.

Hamilton is on major transportation corridors linking the nearby Greater Toronto Area (GTA) and the U.S., which are both within 50 miles. Its economy has gradually diversified away from its manufacturing roots, steel in particular. Although the sector still employs almost 13% of the CMA’s workforce, employment in the sector has dropped by 16% since 2007. On the other hand, sectors such as construction; retail and wholesale trade; finance, real estate, and insurance; educational services; and health care have experienced solid growth. The top employers include many stable public sector entities such as hospitals, McMaster University, the city itself, and local school boards; while large private employers include manufacturers of steel, rolling stock, and auto parts, as well as several food processing and production companies. Although the CMA labor force growth was very modest in 2012 at 0.7%, the unemployment
rate was 6.5%, lower than the provincial rate of 7.8%.

The total value of building permits in 2012 reached C$1.5 billion, topping the record of C$1.1 billion in 2010. Although residential permits continued to account for the largest share (44%), institutional permit values were higher than usual due to a very large permit issued for the construction of a large regional mental health center that we expect will add about 1,300 jobs. For 2013, we expect that permit values will be more in line with historical averages and not exceed C$1 billion. Industrial vacancy rates have declined in the past three years and the city has established a long-term plan to develop 2,500 acres of land near its international airport into employment lands.

Hamilton will host the soccer competition at the 17th Pan American Games to be held around the GTA in July 2015 at a cost to the city of about C$40 million. This represents the city's commitment toward the building of a new multipurpose stadium. While this represents a significant investment, Hamilton intends to fully fund this through its reserves, and we believe the games themselves could bring further attention and economic spin-off to the city.

**Financial Management: Positive Impact On Credit Profile**

In our view, Hamilton's largely stable and prudent financial management has a positive impact on its credit profile. The city prepares detailed tax-supported and rate-supported operating budgets annually and the rate-supported budget also contains a three- and 10-year operating forecast. It also prepares capital budgets annually, and those include updated 10-year spending and funding forecasts. Hamilton provides thorough and transparent disclosure and has a robust set of financial policies in place, including ones for reserves and investments, and is developing a debt management policy which we expect council will receive sometime in the fall of 2013. The city is involved in several legal matters and has recently uncovered an isolated incident of financial fraud as well as a series of occurrences related to time theft; however, we do not expect these to have a material financial or reputational impact.

The city council consists of the mayor, elected citywide; and 15 councilors, elected individually by ward. The current mayor is the third in as many elections, although overall, the council was mostly unchanged during the previous election. The next election is scheduled for Oct. 27, 2014. Unlike Canada's members of federal or provincial parliaments, municipal councilors do not operate under a political party system.

**Budgetary Flexibility: Constrained By Infrastructure Requirements**

We view the financial flexibility of Canadian municipalities as moderately constrained on the expenditure side due to a high degree of municipal services, which the province mandates and provide municipal governments little discretion over the costs of delivering these services.

Hamilton's largest operating expenses by function relate to protection services (mostly police and fire services), while transportation, social and family services, environmental services, and recreational and cultural services combined consume half of all adjusted operating expenses (see charts 1 and 2). Wages and benefits account for more than half of all adjusted operating expenditures by type (net of amortization) and can exert a significant pressure on operating budgets. These expenses are often subject to collective agreements, which can further limiting budgetary flexibility.
Canadian municipalities have more flexibility on the revenue side. Property taxes are the largest source of modifiable revenue, accounting for 54% of Hamilton's adjusted operating revenue in 2012; water and wastewater rates contribute another 12%. Although the city has passed very modest tax increases in recent years, its rates are already fairly high relative to household income and compared with those of other Canadian municipalities, which has resulted in some pressure to keep tax rate increases down. In addition, subsidies from other levels of government have decreased significantly in the past several years, further highlighting the pressures on revenue. Although this is largely due to the uploading of certain services back to the province (thus also saving on the expenditure side), the overall effect has been a decrease in total adjusted operating revenue of 1.2% in 2012 and 5.4% in 2011, while adjusted operating expenses have increased 0.8% and 0.7%, respectively.

Hamilton typically allocates more than 20% of its total expenditures to capital and we expect that this trend will continue throughout the outlook horizon. In our view, the city's ability to defer a significant portion of its capital plan to preserve financial flexibility under a stress scenario is somewhat hindered by its significant infrastructure deficit, which Hamilton estimates to be about C$2 billion with an annual gap in funding of C$195 million. The city must balance the need to repair and replace its existing infrastructure and fund new growth capital projects to increase the tax base but its own sources of funding are insufficient to fund both. Increasing debt service costs, inflation, and slow revenue growth from developer contributions (DCs) have resulted in declining capital affordability. Actions Hamilton has taken to contain this issue include raising its water and sewer rates annually, and the introduction of a 0.5% capital levy into the operating budget, which was approved in principle for 10 years.
Chart 1

City of Hamilton - Adjusted Operating Revenues

- Property tax (54%)
- Provincial and federal grants (12%)
- Other non-tax revenue (10%
- Other user fee and service charges (4%)
- Recreational and cultural services (2%)
- Transportation services (4%)
- Environmental services (13%)
- Payments-in-lieu (1%)

© Standard & Poor's 2013.
Budgetary Performance: Weakened Slightly Over Past Two Years

To improve comparability across local and regional governments globally, Standard & Poor's adjusts the published figures of all municipalities to reflect their budgetary balances on a cash basis. This includes adjusting for major accruals, restating capital spending to a cash basis by removing the influence of capital amortization and net income of certain government business enterprises, and adjusting for one-time revenues.

Operating and after-capital balances weakening following lower revenue generation

Hamilton's operating balances have declined in the past several years as operating revenue declined, reaching 11.9% of operating revenues in 2012 from 13.6% in 2011 and 18.8% in 2010. However, we view these surpluses as healthy and we believe that the city will maintain operating surpluses of about 10% throughout the outlook horizon through prudent expenditure control and modest growth in tax and user rate revenue. After accounting for capital revenue and expenditure, both of which were lower in 2012, the balance was a moderate deficit of 4.2% of total revenue in 2012; this is greater than the 1.2% deficit in 2011. In the next several years, we expect that the likelihood of reduced capital grants from senior levels of government will result in continuing after-capital deficits of 5%-10% of total revenues. These deficits could be greater if there is a slowdown in new development and its related capital revenues, but could
be lower if the city were to defer significantly larger portions of its capital plan than currently expected.

**Capital plan continues investments in core infrastructure**

Hamilton's 2013 capital budget is C$435 million and focuses largely on roads and water and wastewater projects with a large proportion of funding to come from reserves, the operating levy, and DCs. It also includes strategic investments in the new stadium for the Pan Am Games and waterfront redevelopment. The 10-year capital forecast is about C$3.2 billion and directs significant spending toward sustaining existing infrastructure, expanding water and wastewater capacity, and roads. Although the capital plan contains more than C$400 million in projects annually, given the likelihood of some capital deferrals as in past years (particularly in the rate-supported capital budget), we expect that actual spending will closer to C$300 million per year.

**Liquidity: Strong Cash And Liquid Asset Balances**

In our opinion, Hamilton's strong liquidity position bolsters its financial risk profile and remains a key to its credit strength. Adjusted free cash and liquid assets totaled almost C$680 million at the end of 2012, sufficient to cover about 12x the estimated debt service for 2013. In addition, the city maintained a positive net debt position (defined as free cash and liquid assets minus debt). Although we expect that the internal financing of some capital projects will chip away at liquidity levels and Hamilton's increasing debt burden will increase principal and interest expenses, we believe liquidity will remain strong overall and sufficient to cover at least 5x-8x debt service in the next two years.

In our view, the city has satisfactory access to external liquidity given its proven ability to issue into public debt markets and the active secondary market for Canadian municipal debt instruments.

**Debt Burden: Moderate But Increasing**

Hamilton had about C$419 million of debt outstanding at the end of 2012, consisting of long-term debentures, mortgages on social housing properties, and a small amount relating to capital leases. This equaled 31.9% of operating revenue generated during the year, a level which we view as moderate and is lower than that of many similarly rated domestic peers. Changes to the city's capital plan, specifically the expected deferral of significant expansions to the city water and wastewater treatment facilities, have resulted in lower forecast borrowing during the outlook horizon such that we do not expect that tax-supported will exceed 60% of operating revenues before 2016.

Hamilton does not expect to issue any additional debt in 2013 but intends to issue C$138 million in 2014 and up to C$788 million by 2017. In conjunction with this, we expect annual debt service costs to rise to more than C$100 million by 2014 from C$66 million in 2012. Despite the rising debt load, we believe that interest costs will remain below 5% of operating revenue throughout the outlook horizon and that the debt burden will remain consistent with the ratings, all other factors being equal.

Hamilton has three defined benefit plans with a total liability at the end of 2012 of C$73 million, which represents almost 6% of operating revenue. All three are legacy plans, but one still has active workers and continues to accrue obligations. However, the annual service cost for these plans has no meaningful impact on the city's credit profile, in
Contingent Liabilities: Modest And Partially Covered By Reserves

Hamilton has standard employee benefits and obligations and landfill postclosure costs that totaled about 27% of fiscal 2012 operating revenue. While more than that of many domestic peers, we do not believe that this poses a significant financial burden for the city, in part because it has reserves in place to cover about a third of these liabilities. However, it is also contingently liable for the principal and interest on about C$12 million of loans to local school boards.

Key Statistics

Table 1

<table>
<thead>
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<th>City of Hamilton -- Economic Statistics</th>
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<tbody>
<tr>
<td>Population summary</td>
</tr>
<tr>
<td>Total population</td>
</tr>
<tr>
<td>% aged 14 years or younger</td>
</tr>
<tr>
<td>% aged 65 years or older</td>
</tr>
<tr>
<td>Median age</td>
</tr>
<tr>
<td>Economic statistics (% change)</td>
</tr>
<tr>
<td>Population*</td>
</tr>
<tr>
<td>Unemployment rate (%)</td>
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<td>Assessment base§</td>
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*2012 estimate based on Census growth rate. §Includes both unit growth and market value changes.

Table 2

<table>
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<th>City of Hamilton -- Financial Statistics</th>
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<tr>
<td>(%)</td>
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<tr>
<td>Capital expenditure/total expenditure</td>
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<tr>
<td>Modifiable revenue/adjusted operating revenue</td>
</tr>
<tr>
<td>Operating balance/adjusted operating revenue</td>
</tr>
<tr>
<td>After-capital balance/adjusted total revenue</td>
</tr>
<tr>
<td>Free cash and liquid assets/debt service</td>
</tr>
<tr>
<td>Tax-supported debt/consolidated operating revenue</td>
</tr>
<tr>
<td>Interest/operating revenue</td>
</tr>
</tbody>
</table>

Related Criteria And Research

- International Local And Regional Governments Default And Transition Study: 2012 Saw Defaults Spike, March 28, 2013
- Methodology For Rating International Local And Regional Governments, Sept. 20, 2010

Ratings Detail (As Of August 30, 2013)

<p>| Hamilton (City of) |
| Issuer Credit Rating | AA/Stable/-- |</p>
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<th>Issuer Credit Ratings History</th>
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*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.*