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 FCS12078, 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:
- Strong liquidity.
- Good budgetary performance.
- Evolving economy with fair prospects for growth and further diversification.

Weaknesses:
- Likelihood of increasing debt load to fund significant capital requirements.
• Constrained budgetary flexibility.

Rationale

Hamilton is perceived by Standard & Poor’s as having strong liquidity, good budgetary performance, and economic growth prospects which are partially offset by significant capital spending requirements and constrained budgetary flexibility.

In the fiscal year ended December 31, 2011, Hamilton had sufficient free cash and liquid assets to cover 56% of operating expenditures and almost 1,000% of the estimated debt service for 2012 (Standard & Poor’s adjusted). While it is expected, Hamilton may lose its creditor status with the next two years due to internal financing. Hamilton’s liquidity position will remain strong and be more than sufficient to meet all debt service requirements throughout the two year period.

The City has, over the past five years, produced operating surplus averaging 13% of operating revenues. However, after capital results have been volatile dipping into deficit in two of the past five years, Standard & Poor’s believes that Hamilton’s operating surplus will remain above 10% of operating revenues during the two year outlook horizon. High capital spending and lagging development related revenues will keep after-capital balances in a modest deficit relative to total revenue for the next several years.

The City is perceived to be concentrated in the manufacturing sector and posses advantages in a good transportation network and ease of access to both the United States and large domestic markets. The per capita GDP generated by the industrial base is believed to not materially vary from the provincial level of C$47,770 in 2011. Population growth has been slower than the provincial rate, but unemployment has moderated from recession levels and Hamilton has been making some headway in attracting new investment and expanding its economic base. The City has fair prospects for growth and further diversification.

Standard & Poor’s views a $2.0 billion infrastructure backlog leading to potentially increasing debt levels as a constraint on Hamilton’s credit rating. The full spending plan could push tax-supported debt levels to more than 60% of operating revenues by the end of 2014. However, management is expected to defer some capital projects and related debt issuance, constraining the debt level closer to 40% of operating revenues. This represents a sizeable increase from 27% at the end of 2011, but a debt level of 40% of operating revenues is considered manageable and in line with similarly rated peers.
Limited budgetary flexibility also partially mitigated Hamilton’s credit strengths. Hamilton and other Canadian municipalities are constrained in cutting expenditures due to Provincial mandated services, labour contracts, inflation, and political pressures. The ability to set property taxes, utility rates, and user fees supply 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 residents and a large infrastructure deficit.

**Outlook**

Hamilton’s stable outlook throughout the two year outlook horizon, depends on maintaining a strong liquidity position, budgetary performance will not deteriorate such that operating balances fall to below 5% of operating revenues, and tax-supported debt will not materially exceed 60% of operating revenue. The outlook could be revised to positive if the City generated strong after-capital surpluses and debt remained near current levels relative to operating revenue. Conversely, debt levels significantly higher than 60% of operating revenues, after-capital deficits of 10-15% of total revenue, or a notable deterioration in liquidity could lead Standard & Poor’s to revise the outlook to negative or lower the ratings.

**Hamilton’s Credit Rating History**

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<th>Rating (formerly Regional Municipality of Hamilton-Wentworth)</th>
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<td>AA+: 1994 to 1999</td>
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<td>AAA: 1989 to 1994</td>
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<td>Moody’s</td>
<td>Aa3: 1995 to 2001</td>
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<td>Aa2: 1988 to 1995</td>
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<td>Dominion Bond Rating Service</td>
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*Vision: To be the best place in Canada to raise a child, promote innovation, engage citizens and provide diverse economic opportunities.*

*Values: Honesty, Accountability, Innovation, Leadership, Respect, Excellence, Teamwork*
Peer Comparison Using Standard & Poor’s Rating

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<td>Toronto</td>
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<td>Windsor</td>
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</table>

Vision: To be the best place in Canada to raise a child, promote innovation, engage citizens and provide diverse economic opportunities.

Values: Honesty, Accountability, Innovation, Leadership, Respect, Excellence, Teamwork
City of Hamilton

Primary Credit Analyst:
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Legacy Defined Benefit Pension Plans Add To Contingent Liabilities
City of Hamilton

Major Rating Factors

Strengths:
• Strong liquidity
• Good budgetary performance
• Evolving economy with fair prospects for growth and further diversification

Weaknesses:
• Likelihood of increasing debt load to fund significant capital requirements
• Constrained budgetary flexibility

Rationale

The ratings on the City of Hamilton, in the Province of Ontario (AA-/Negative/A-1+), reflect Standard & Poor's Ratings Services' view of the city's strong liquidity, good budgetary performance, and economic growth prospects. In our opinion, rising debt levels spurred by significant capital spending requirements and constrained budgetary flexibility partially offset these strengths.

Hamilton has what we view as strong liquidity. We expect that free cash and liquid assets will fall from their current levels, which were sufficient to cover about 56% of operating expenditures in fiscal 2011 (ended Dec. 31, 2011) and almost 1,000% of the estimated debt service for 2012 (all figures Standard & Poor's-adjusted). We also believe that the city might lose its net creditor status within the next 18 months as it finances some capital projects internally. However, in our opinion, Hamilton's liquidity position will remain strong and will be more than sufficient to meet all debt service requirements throughout the two-year outlook horizon.

The city has consistently produced what we view as good budgetary performance. Operating surpluses have been robust, averaging 13% of operating revenue in the past five years, although after-capital results have been somewhat volatile, dipping into a deficit position in two of the past five years. We believe that operating surpluses will remain above 10% of operating revenues but that high capital spending and lagging development-related revenues will keep after-capital balances in a modest deficit relative to total revenue for the next several years.

Although Hamilton's economy remains concentrated in the manufacturing sector, particularly the steel industry, we believe it possesses some advantages given its good transportation network and ease of access to both the U.S. and large domestic markets. We also believe that the city's large industrial base likely generates nominal GDP per capita not materially different from the provincial level of C$47,770 in 2011. Although population growth has been slower than the provincial rate, unemployment has moderated from recession levels and Hamilton has been making some headway in attracting new investments and expanding its economic base. We believe that the city has fair prospects for growth and further diversification.

In our view, constraining the ratings is the likelihood of rising debt levels owing to the infrastructure deficit backlog,
which the city estimates at about C$2 billion. Although full spending of the capital plan could push tax-supported debt levels to more than 60% of operating revenue by the end of 2014, we believe that management is likely to defer some capital projects and related debt issuance and that the debt level will be closer to 40% of operating revenue. This represents a sizable increase from 27% at the end of 2011, but we believe this is still a very manageable debt burden and would remain in line with that of similarly rated peers.

Also partially mitigating the credit strengths is what we view as limited budgetary flexibility. Hamilton, 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.

**Outlook**

The stable outlook reflects our expectations 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 positive if the city reduced its capital spending to the point where it generated strong after-capital surpluses and debt remained near current levels relative to operating revenue. Conversely, debt levels significantly higher than 60% of operating revenues, after-capital deficits of 10%-15% of total revenue, or a notable deterioration in liquidity could lead us to revise the outlook to negative or lower the ratings.

**Comparative Analysis**

Hamilton's comparable peer group consists of the Canadian cities of Barrie (AA/Stable/--), Brantford (AA+/Stable/--), Guelph (AA/Stable/--), Kingston (AA-/Positive/--), and Regina (AA+/Stable/--), Windsor (AA/Stable/--); and Halifax Regional Municipality (AA-/Stable/--). All are in Ontario, except for Regina, which is in Saskatchewan (AAA/Stable/A-1+); and Halifax, which is in Nova Scotia (A+/Stable/A-1+). We tend to draw economic comparisons with peers at the local municipal level in Canada from demographic and labor market data, residential and nonresidential construction trends, and other indicators such as tourism activity. Hamilton's unemployment in 2011 was slightly below both the provincial rate and the median for 'AA' rated local and regional governments (LRGs), although it has historically been marginally higher than most of its domestic peers except for Windsor.

Comparisons of financial results show that Hamilton's operating balances have remained fairly robust and the five year average remains in line with the median for 'AA' rated LRGs. Hamilton's balances after capital revenues and expenditures have been more volatile but have been balanced during the past five years. Like most Canadian municipalities, the city maintains a strong liquidity position and its debt burden is in line with similarly rated Canadian LRGs but lower than that of many international peers.
Ontario Municipalities Benefit From A Well-Balanced And Predictable Institutional Framework

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.

Manufacturing Remains A Pillar Of Local Economy

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%. The population is tracking below the province's target of 660,000 by 2031 under its Places To Grow initiative. The average household income was an estimated C$77,200 in 2011 according to a recent municipal study; much less than the C$87,300 for the province-wide survey. Despite this, we believe that a large industrial base likely generates nominal GDP per capita similar to the provincial level of C$47,770.
The city is on major transportation corridors linking the nearby Greater Toronto Area (GTA) and the U.S., which are both within 50 miles. Hamilton's economy continues to be somewhat concentrated in the manufacturing sector, particularly the steel industry, which has not fully recovered from the drop in demand following the recession. The top private-sector employers include two steel companies, a manufacturer of rolling stock, an automotive parts manufacturer, and several food processing and production companies. The exposure to the manufacturing industry is partly mitigated by a sizable public sector presence encompassing health care, education (including a large university, college and local school boards), and the city itself as a top employer. The city has focused its economic development efforts on attracting new investment and expanding into sectors such as advanced manufacturing, food processing, clean technology, creative industries, life sciences, and logistics.

The unemployment rate within the Hamilton census metropolitan area (which includes the nearby cities of Burlington and Grimsby) has continued falling since peaking at 8.5% in 2009 and was 6.3% in 2011 and holding steady through July 2012. The total value of building permits in 2011 failed to top the record level of more than C$1 billion in the previous year, but data for 2012 shows strong year-over-year results, particularly in nonresidential development, and the city expects that the value could again top C$1 billion. Industrial vacancy rates were also down in 2011 and were lower than those of many surrounding municipalities. This also indicates continuing recovery in the industrial sector and demonstrates that Hamilton remains an attractive location for investment.

Hamilton will host some events at the 17th Pan American Games to be held around the GTA in July 2015 at a cost of about C$60 million. This represents the city's 30% commitment toward funding 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.

Stable Financial Management

In our view, Hamilton's 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, but lacks a debt management policy. The city is involved in several legal matters, none of which we expect to have a material financial or reputational impact.

Expenditure Pressures Constrain Budgetary Flexibility

We view the financial flexibility of Canadian municipalities as moderately constrained due to a high degree of municipal services that the provinces mandate and that leave local governments little discretion concerning the costs of delivering these services. Hamilton's largest operating expenses relate to protection services (mostly police and fire services), which consume 23% of all operating expenditures; while transportation and environmental services consume 15% and 13%, respectively (see charts 1 and 2). Wages and benefits account for almost half of all reported operating expenditures (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 operating revenue; 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 compared with those of other Canadian municipalities.

Hamilton, like many other municipalities in Canada, has generated lower development-related revenues in the years since the recession started and is dealing with declining capital affordability due to increasing debt service requirements, aging infrastructure, and inflation. The city has raised its water and sewer rates, and approved a 0.5% capital levy in principle for the next 10 years in an effort to address this. Total capital spending has increased in recent years as a proportion of total expenditures, reaching 25% in 2011. We expect similarly high levels of spending in the near term and although Hamilton maintains some ability to defer capital, in our view the high infrastructure renewal requirements place further limits on financial flexibility.

Chart 1

City of Hamilton - Adjusted Operating Revenues

- Tax revenue (54%)
- Provincial and federal grants (14%)
- Environmental services (12%)
- Transportation services (4%)
- General government (1%)
- Other user fees and service charges (4%)
- Investment and dividend income (4%)
- Other nontax revenue (7%)
Budgetary Performance Remains Healthy

Beginning in fiscal 2009, all Ontario municipalities were required to adopt full accrual accounting and reporting of tangible capital assets. 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.

Hamilton's operating surpluses have fluctuated in the past five years but have remained healthy, in our view, averaging about 13% of operating revenue over the past five years. This is in line with the city's peers and we do not expect that this ratio will drop below 10% during the two-year outlook horizon. After accounting for capital revenues and expenditures, the balances as a proportion of total revenues have been more volatile, ranging from a 9.3% surplus in 2008 and a 10.8% deficit the following year. Lower development activity and subsidized industrial development charges used as a development incentive have contributed to the capital revenue shortfall. In the next several years, we expect that fairly high capital spending and the likelihood of reduced capital grants from senior levels of government will result in modest after-capital deficits that do not substantially exceed 5% of total revenues.

The capital budget for 2012 includes about C$440 million of projects split about half for rate-supported water and wastewater projects and half for projects supported through the tax levy. The plan aims to support infrastructure renewal, specifically with regards to roads, social housing, and corporate and recreational facilities, while making
strategic investments in the new stadium for the Pan Am Games, downtown revitalization, the McMaster Health
Campus, and industrial land development. The 10-year forecast calls for more than C$3 billion of spending, including
significant spending on expanding water and wastewater capacity and roads. The city has indicated that lower water
use and conservation gains has lessened the pressure on the rate-supported capital budget and that it is likely to push
some projects well back.

Liquidity To Remain Very Healthy Despite Possible Loss Of Net Creditor Status

In our opinion, Hamilton's strong liquidity position bolsters its financial risk profile and remains a key credit strength.
Adjusted free cash and liquid assets at the end of 2011 were sufficient to cover the estimated debt service for 2012
about 10x. In addition, the city maintained a positive net debt position (defined as free cash and liquid assets minus
debt). Hamilton has access to a C$65 million line of credit which remains undrawn and we do not expect that it will
have any need to draw from this in the foreseeable future. Although we expect that internal financing of capital will
result in near-term liquidity declines and the possible loss of net creditor status, we believe that the city will maintain
very healthy levels of liquidity to meet debt service requirements.

Debt Burden Likely To Climb In The Next Few Years

Hamilton has what we view as a moderate tax-supported debt level of about C$354 million at the end of 2011, or
26.7% of operating revenue. This ratio is lower than those of most similarly rated international LRGs but in line with
the city's Canadian peers. Hamilton's capital budget indicates the need for large amounts of debt financing to complete
several large projects. If the city were to issue the full amount of budgeted debt, we believe that total debt could near
C$1 billion by the end of 2014, or more than 60% of forecasted operating revenue.

However, weak industrial activity and efficiency and conservation efforts in the past several years have had a
significant impact on water consumption in Hamilton. This has reduced the pressure on the city's infrastructure and
will likely push back some major water and wastewater expansion projects. As such, we believe that the actual debt
issuance will be much lower and will result in tax-supported debt being closer to 40% of operating revenues by 2014.

In 2012, we expect that Hamilton will issue close to C$100 million. 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 current ratings, all other factors being equal.

Legacy Defined Benefit Pension Plans Add To Contingent Liabilities

Hamilton has standard future employee benefits and obligations, and landfill postclosure costs that totaled about 25%
of fiscal 2011 operating revenue. While more than that of many domestic peers, we do not believe that this poses a
significant financial burden for the city, partly because it has reserves in place to cover about 20% of these liabilities.
However, it is also contingently liable for the principal and interest on more than C$14 million of loans to local school
boards, and has three defined benefit plans with a total liability estimated at close to C$72 million. All three are legacy
plans but one still has active workers and continues to accrue obligations.

Table 1

<table>
<thead>
<tr>
<th>City of Hamilton—Economic Statistics</th>
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<td>Population summary</td>
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<tr>
<td>Total population†</td>
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<tr>
<td>% aged 14 years or younger†</td>
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<td>% aged 65 years or older†</td>
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<td>Median age†</td>
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<td>Population*</td>
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<td>0.6</td>
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*Annualized Census results. §Includes both unit growth and market value changes. *Based on 2011 Census data from Statistics Canada.

Table 2

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*All figures Standard & Poor’s-adjusted.

Related Criteria And Research

Methodology For Rating International Local And Regional Governments, Sept. 20, 2010

Ratings Detail (As Of August 29, 2012)

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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.