To: Chair and Members
   Audit and Administration Committee

From: Joseph L. Rinaldo
      General Manager
      Finance and Corporate Services

   Telephone: (905) 540-6150
   Facsimile: (905) 546-2584
   E-mail: jrinaldo@hamilton.ca

Date: November 29, 2007

Re: 2007 Standard and Poor's Credit Rating (FCS08002) (City Wide)

Council Direction:
N/A.

Information:
Standard & Poor’s Rating Service (S&P) has maintained Hamilton’s credit rating of stable with a positive outlook.

The rating agency’s press release and credit rating report are attached as Appendix A to report FCS08002. The release points out three strengths and one challenge as follows:

Strengths:
1) Strong liquidity support. The City improved its’ net creditor position modestly in 2006, continuing the trend of the past four years. As at December 31, 2006, cash balances represented 63.3% of operating expenses. In addition, reserves have increased notably by 6.2% on a year-over-year basis, ending the year with about $428 million.

2) Solid financial performance. Hamilton’s operating balance, as a percentage of operating revenue, was a moderate 12.6% in 2006. This was a result of operating expenses rising at a modestly higher pace than operating revenues, the year-end fiscal 2006 (Dec. 31). The year-end 2005 percentage was 15.4% due to a one time $18.2 million dividend from Hamilton Utilities Corp. Nevertheless, Hamilton’s operating surplus, as a percentage of revenues, is low compared with the median for similarly rated domestic and international peers.
3) Moderately diversified economy. Hamilton’s economy continues to benefit from its’ proximity to the Greater Toronto Area and access to the U.S. market. However, much like other municipalities across Canada, the City’s economy continues to be affected by the rising value of the Canadian dollar and the sharp increase in energy prices. Despite these challenges, the City’s steel sector is still doing well. Hamilton is focusing its’ economic development strategy on diversifying further into key high growth sectors, such as biotechnology and health care, in an effort to move away from more traditional, manufacturing-based industries. Hamilton’s success can be seen in robust non-residential permits, employment and assessment growth in recent years.

Challenges:

1) Rising debt levels, in the medium term, as a result of an aggressive capital plan. The City’s capital expenditure was approximately $276 million in 2006, moderately higher than the five-year average of $223 million. With a $3.1 billion 10-year capital program, expenditures should increase notably in the next three to five years. The vast majority of this spending will go to Hamilton’s water and waste-water infrastructure; some will also go to roads and waste management. This projected capital budget is considered manageable, given the City’s liquidity position, revenue sources, such as, development charges, federal and provincial gas taxes, pay-as-you-go, debt issuance and the level of rate supported debt. The overall direct debt level is expected to peak out at 45-50% of operating revenues in the next five years. A level of less than 50% is in the range of Hamilton’s domestic and international peers.

Hamilton’s AA positive outlook would revert to AA stable if debt levels rise above, and/or liquidity declines substantially more than forecast, as a result of an acceleration of the City’s capital plan.

The long-term credit history of the City of Hamilton is as follows:

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Rating History (formerly Region of Hamilton-Wentworth)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standard and Poor’s (formerly CBRS)</td>
<td>AA (positive): 2005 - Current</td>
</tr>
<tr>
<td></td>
<td>AA: 1999 to 2005</td>
</tr>
<tr>
<td></td>
<td>AA+: 1994 to 1999</td>
</tr>
<tr>
<td></td>
<td>AAA: 1989 to 1994</td>
</tr>
<tr>
<td>Moody’s</td>
<td>Aa3: since 1995</td>
</tr>
<tr>
<td></td>
<td>Aa2: 1988 to 1995</td>
</tr>
<tr>
<td>Dominion Bond Rating Service</td>
<td>AA: since 2004</td>
</tr>
<tr>
<td></td>
<td>AA+: 1994 to 2004</td>
</tr>
</tbody>
</table>
Long-term Peer comparison (using Dominion Bond Rating Services equivalent scale):

<table>
<thead>
<tr>
<th>Municipality (or Regional Municipality)</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hamilton</td>
<td>AA (positive)</td>
</tr>
<tr>
<td>Toronto</td>
<td>AA</td>
</tr>
<tr>
<td>Halton</td>
<td>AAA</td>
</tr>
<tr>
<td>Niagara</td>
<td>AA</td>
</tr>
<tr>
<td>Peel</td>
<td>AAA</td>
</tr>
<tr>
<td>York</td>
<td>AAA (negative)</td>
</tr>
</tbody>
</table>

Joseph L. Rinaldo
General Manager
Finance and Corporate Services
City of Hamilton ‘AA’ Rating Affirmed on Strong Liquidity; Outlook Positive

Rationale

On Nov. 20, 2007, Standard & Poor’s Ratings Services affirmed its ‘AA’ long-term issuer credit rating on the City of Hamilton. The outlook is positive.

The rating on Hamilton, in the Province of Ontario (AA/ Stable/A-1+), primarily reflects:

- Solid liquidity support. The city improved its net creditor position modestly in 2006, continuing the trend of the past four years. As at Dec. 31, 2006, cash balances represented 63.3% of operating expenses. In addition, reserves have increased notably, by 6.2% on a year-over-year basis, ending the year with a balance of about C$423.8 million. Standard & Poor’s expects that the city will maintain strong liquidity in the next two years;

- Respectable budgetary performances. Hamilton’s operating balance as a percentage of operating revenue was a moderate 12.6% in 2006. As a result of operating expenses rising at a modestly higher pace than operating revenues, the year-end fiscal 2006 (Dec. 31) operating balance figure as a percentage of operating revenue narrowed from a peak of 15.4% at year-end 2005. This was largely a result of a one-time C$18.2 million recapitalization dividend paid out to the city from Hamilton Utilities Corp. (A/Positive—) that bolstered 2005 operating revenues. Nevertheless, Hamilton’s operating surplus as a percent of revenues is at the low end compared with the median for similarly rated domestic and international peers; and

- A moderately diversified economy. Hamilton’s economy continues to benefit from its proximity to the Greater Toronto Area and access to the U.S. market. However, much like other municipalities across Canada, the city’s economy remains affected by the rising Canadian dollar and the sharp increase in energy prices. Despite these challenges, the city’s steel sector is still doing well. Hamilton is focusing its economic development strategy on diversifying further into key high-growth sectors such as biotechnology and health care, in an effort to move away from more traditional, manufacturing-based...
industries such as steel. The success in attracting new businesses to Hamilton can be seen in the city’s robust nonresidential permit, employment, and assessment growth in recent years. Nevertheless, the recent slowdown in Ontario’s manufacturing sector is hurting employment, as illustrated by the modest increase of 0.4% (on a year-over-year basis) in the city’s unemployment rate.

The rating is constrained by rising debt levels in the medium term. Hamilton continues to face relatively high infrastructure renewal requirements—although this is typical of most Canadian municipalities. We expect debt levels to rise in the next three years as the city funds a large capital program, particularly for the revitalization and expansion of its water and sewer systems.

Outlook

The positive outlook reflects Standard & Poor’s expectation that the city will maintain its net creditor position in the next three years and that the city will continue to take steps to keep its debt burden from rising significantly in the medium term. Debt accumulation or liquidity reduction substantially more than forecast (as a result of an acceleration of the city’s capital plan from currently planned levels) could result in a revision in the outlook back to stable.

Ratings List

Hamilton (City of)
Rating Affirmed
Issuer credit rating AA/Positive/—
Hamilton (City of)

**Issuer Credit Rating**

AA/Positive/—

**Major Rating Factors**

**Strengths:**
- Strong liquidity support
- Solid financial performance
- Moderately diversified economy

**Weaknesses:**
- Rising debt levels in the medium term as a result of an aggressive capital plan

**Rationale**

The ratings on the City of Hamilton, in the Province of Ontario (AA/Stable/A-1+), primarily reflect:

- Strong liquidity support. The city improved its net creditor position modestly in 2006, continuing the trend of the past four years. As at Dec. 31, 2006, cash balances represented 63.3% of operating expenses. In addition, reserves have increased notably, by 6.2% on a year-over-year basis, ending the year with a balance of about C$423.8 million. Standard & Poor’s Ratings Services expects that the city will maintain strong liquidity in the next two years;
- Respectable budgetary performances. Hamilton’s operating balance as a percentage of operating revenue was a moderate 12.6% in 2006. As a result of operating expenses rising at a modestly higher pace than operating revenues, the year-end fiscal 2006 (Dec. 31) operating balance figure as a percentage of operating revenue narrowed from a peak of
15.4% at year-end 2005. This was largely a result of a one-time C$18.2 million recapitalization dividend paid out to the city from Hamilton Utilities Corp. (A/Positive/—) that bolstered 2005 operating revenues. Nevertheless, Hamilton’s operating surplus as a percent of revenues is low compared with the median for similarly rated domestic and international peers; and

- A moderately diversified economy. Hamilton’s economy continues to benefit from its proximity to the Greater Toronto Area and access to the U.S. market. However, much like other municipalities across Canada, the city’s economy continues to be affected by the rising value of the Canadian dollar and the sharp increase in energy prices. Despite these challenges, the city’s steel sector is still doing well. Hamilton is focusing its economic development strategy on diversifying further into key high-growth sectors such as biotechnology and health care, in an effort to move away from more traditional, manufacturing-based industries such as steel. The success in attracting new businesses to Hamilton can be seen in the city’s robust nonresidential permit, employment, and assessment growth in recent years. Nevertheless, the recent slowdown in Ontario’s manufacturing sector is hurting employment, as illustrated by the modest increase of 0.4% (on a year-over-year basis) in the city’s unemployment rate.

The ratings are constrained by rising debt levels in the medium term. Hamilton continues to face relatively high infrastructure renewal requirements—although this is typical of most Canadian municipalities. We expect debt levels to rise in the next three years as the city funds a large capital program, particularly for the revitalization and expansion of its water and sewer systems.

**Capital expenditure program, liquidity, and debt**

The city’s capital expenditure was about C$276 million in 2006, moderately higher than the five-year average of C$223 million. With a C$3.1 billion 10-year capital program, expenditures should increase notably in the next three to five years. The vast majority of this spending will go to Hamilton’s water and waste-water infrastructure; some will also go to roads and waste management, which are always major expenditures for the city. We view these expenditure levels as manageable, although this spending leaves less room for overruns or other difficulties which constrains Hamilton’s financial flexibility. Nevertheless, Hamilton uses a number of strategies to fund its capital projects, including cash from reserves and developer contributions, pay-as-you-go, debt issuance, and (more recently) funding from the federal and provincial gas taxes. In addition, the city has adequate flexibility to service the rate-supported debt by increasing water rates.

Hamilton’s liquidity is very strong, helping to provide a substantial cushion against unforeseen requirements. Cash, liquid investments, and committed facilities amounted to 76.6% of operating expenditure in 2006, while cash and liquid investments minus direct debt amounted to 21.3% of operating revenue. Liquidity will likely increase in the next three years and should remain strong, although the city’s net creditor position should narrow notably as debt issuance increases.

Hamilton’s overall direct debt reached 34% of operating revenues in 2006, but after allowing for its ample liquidity, the city maintained its net creditor status. The need for infrastructure renewal will keep upward pressure on the city’s debt service levels and debt burden in the medium term. As the city proceeds with its capital program, we expect that debt levels will increase to 45%-50% of operating revenues in the next five years, which is still in the range for domestic and international peers.
Outlook

The positive outlook reflects Standard & Poor’s expectation that the city will maintain its net creditor position in the next three years and that the city will continue to take steps to keep its debt burden from rising significantly in the medium term. Debt accumulation or liquidity reduction substantially more than forecast as a result of an acceleration of the city’s capital plan from currently planned levels could result in a revision in the outlook back to stable.

Table 1

City of Hamilton—Economic Statistics

<table>
<thead>
<tr>
<th>Population summary</th>
<th>Total population</th>
<th>% aged 14 years or younger</th>
<th>% aged 65 years or older</th>
<th>Median age</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>504,449</td>
<td>18</td>
<td>14.9</td>
<td>40.0</td>
</tr>
<tr>
<td>Population*</td>
<td>0.6</td>
<td>0.6</td>
<td>0.6</td>
<td>0.6</td>
</tr>
<tr>
<td>Unemployment rate (%)</td>
<td>5.9</td>
<td>5.5</td>
<td>5.6</td>
<td>6.0</td>
</tr>
<tr>
<td>Assessment base†</td>
<td>16.4</td>
<td>1.8</td>
<td>9.5</td>
<td>11.1</td>
</tr>
</tbody>
</table>

*Annualized census results. †Includes both unit growth and market value changes

Table 2

City of Hamilton—Financial Statistics

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating balance/total revenue</td>
<td>12.6</td>
<td>15.4</td>
<td>12.5</td>
<td>9.9</td>
<td>7.3</td>
</tr>
<tr>
<td>After capital expenditure balance/total revenue</td>
<td>0.1</td>
<td>(1.7)</td>
<td>(9.7)</td>
<td>(4.2)</td>
<td>(7.1)</td>
</tr>
<tr>
<td>Capital expenditure/total expenditure</td>
<td>22.6</td>
<td>25.7</td>
<td>18.8</td>
<td>17.8</td>
<td>16.6</td>
</tr>
<tr>
<td>Direct debt/operating revenue</td>
<td>34.0</td>
<td>32.9</td>
<td>28.7</td>
<td>28.3</td>
<td>31.8</td>
</tr>
<tr>
<td>Debt service/total revenue</td>
<td>3.4</td>
<td>3.2</td>
<td>4.5</td>
<td>4.9</td>
<td>4.6</td>
</tr>
<tr>
<td>Net debt*/operating revenue</td>
<td>(21.3)</td>
<td>(19.9)</td>
<td>(15.9)</td>
<td>(18.0)</td>
<td>(20.3)</td>
</tr>
<tr>
<td>Cash and committed facilities/operating expenditure</td>
<td>75.6</td>
<td>75.2</td>
<td>63.8</td>
<td>63.7</td>
<td>71.5</td>
</tr>
</tbody>
</table>

*Direct debt minus cash and equivalents.

Ratings Detail (As Of 22-Nov-2007)*

Hamilton (City of)

Issuer Credit Rating

AA/Positive/

Issuer Credit Ratings History

05-Oct-2006

AA/Positive/

28-Feb-2001

AA/Stable/

*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.