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 FCS11061, please find S&P’s credit rating report for Hamilton. S&P’s report highlights three strengths and two weaknesses as follows:

Strengths:

   Improving Economic Prospects

   Hamilton census metropolitan area’s (including Burlington and Grimsby) unemployment rate has been on a positive trend declining to 6.4% in March 2011 following a rate of 7.6% in 2010 and 8.5% in 2009. The total value of building permits reached a record level of more than C$1 billion in 2010. The Pan American Games held in Toronto in 2015 are expected to provide some economic spin-off to Hamilton given Hamilton will host certain events.

   Adequate Operating Performance
S&P view Hamilton’s operating performance as adequate although they point out operating balance and after-capital deficit weakened in 2009 relative to three-year averages because of the recession with higher social services expenses and lower government grants and developer contributions. S&P point out that personnel-related expenses together with a modest 0.8% tax increase for 2011 may continue to squeeze operating performance but expect that revenues may recover in the near to medium term because Hamilton has enacted cost-containment initiatives.

**Strong Liquidity**

Hamilton has maintained a strong net creditor position due to its high reserves and liquidity levels. S&P adjusted cash and liquid assets at year end 2009 accounted for 49% of operating expenditures, which is a reduction from 64% in 2008 due to lower cash and liquid asset levels and an increase of 13% in operating expenses. S&P expects Hamilton will maintain strong liquidity in the next two years; however, it acknowledges that Hamilton’s capital plan demands are likely to strain liquidity in the medium term and Hamilton’s increased debt load will threaten its net creditor position in the next two-to-three years.

**Weaknesses:**

**Significant Capital Expenditures**

Capital spending has increased significantly during the past several years, increasing from C$226 million in 2008 to an estimated C$422 million in 2011 to be spent mainly on wastewater, roads, and water facilities. Hamilton has an infrastructure deficit backlog of about C$2 billion, which may limit financial flexibility. In addition, Hamilton has postponed a new wastewater treatment plant until 2017 to 2019. S&P point out the higher levels of spending projected during the next five years lack the previous levels of support from the federal and provincial stimulus funding.

**Increasing Debt**

S&P expects that Hamilton’s debt levels will rise significantly over the next three years to help fund the capital program. Given that Hamilton may be forced to rely more on its own source capital funding, this will likely limit its financial flexibility over the next several years. S&P believe Hamilton’s debt burden may top C$1 billion by 2020 to fund the capital program. Hamilton’s estimated C$394 million of direct debt outstanding (which includes $89 million for Social Housing mortgages) as at the end of 2010 is about 30% of S&P’s forecasted operating revenue, but they point out that direct debt could reach 55%-65% of adjusted operating revenues by 2014, which would push the debt burden close to the upper limit of what S&P views as appropriate for the ratings.
The “stable” outlook reflects S&P’s expectation that Hamilton will continue to diversify its economic base and maintain stable financial performance and robust liquidity levels during the forecast period. Maintaining net creditor status by mitigating the rise in its debt burden would positively affect Hamilton’s financial risk profile and possibly the ratings. “Conversely, debt that is significantly higher than forecast or a notable deterioration in financial performance or liquidity could put downward pressure on the ratings.”

Hamilton’s Credit Rating History

<table>
<thead>
<tr>
<th>Rating Agency</th>
<th>Rating (formerly Regional Municipality of Hamilton-Wentworth)</th>
</tr>
</thead>
</table>
| Standard & Poor’s (formerly CBRS) | AA: 2008 - 2010  
AA/Positive: 2005 - 2007  
AA: 1999 to 2005  
AA +: 1994 to 1999  
AAA: 1989 to 1994 |
| Moody’s | Aa3: since 1995  
Aa2: 1988 to 1995 |
| Dominion Bond Rating Service | AA: 2004 to 2009  
AA+: 1994 to 2004 |

Peer Comparison Using Standard & Poor’s Rating

<table>
<thead>
<tr>
<th>Municipality (or Regional Municipality)</th>
<th>Rating (Stable if not stated otherwise)</th>
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<tbody>
<tr>
<td>Hamilton</td>
<td>AA</td>
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<tr>
<td>Toronto</td>
<td>AA</td>
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<tr>
<td>Halton</td>
<td>AAA</td>
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<td>Niagara</td>
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<td>Peel</td>
<td>AAA</td>
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<tr>
<td>York</td>
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<td>Waterloo</td>
<td>AAA</td>
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<td>Durham</td>
<td>AAA</td>
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<tr>
<td>London</td>
<td>AAA</td>
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<tr>
<td>Windsor</td>
<td>AA</td>
</tr>
<tr>
<td>Ottawa</td>
<td>AA</td>
</tr>
</tbody>
</table>
Hamilton (City of)

Primary Credit Analyst:
Adam Gillespie, Toronto (1) 416-507-2565; adam_gillespie@standardandpoors.com

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Bhavini Patel, CFA, Toronto (1) 416-507-2558; bhavini_patel@standardandpoors.com

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Hamilton (City of)

Major Rating Factors

Strengths:
• Improving economic prospects
• Adequate operating performance
• Strong liquidity

Weaknesses:
• Significant capital spending requirements
• Increasing debt

Rationale

The ratings on the City of Hamilton reflect Standard & Poor's Ratings Services' view of the city's improving economic prospects, adequate operating performance, and strong liquidity position. In our opinion, its significant capital spending requirements and subsequent rising debt levels partially offset these strengths.

Hamilton is in southern Ontario (AA-/Stable/A-1+), on the western edge of the Golden Horseshoe, and has a population of more than 500,000. The city is on major transportation corridors linking the nearby Greater Toronto Area (GTA) and the U.S. (AAA/Negative/A-1+), which are both within 50 miles. Hamilton's economy continues to be somewhat concentrated in the manufacturing sector, particularly the steel industry, which the recession hit hard.

The city has focused its economic development strategy on diversifying further into knowledge-based sectors such as biotechnology, higher education, and health care. It has had some recent successes with McMaster University (AA-/Stable/--) and Mohawk College (not rated) looking to expand their downtown presences, and a new regional mental health center that Hamilton expects to open by early 2013 and provide more than 1,300 stable, public-sector jobs. We also expect that as the recovery continues, the local steel industry could make a partial comeback; in fact, we view Max Aicher North America Ltd.'s recent acquisition of two of U.S. Steel Corp.'s idled mills, which have been shut down due to a labor dispute, as a positive harbinger for the stalled industry.

The unemployment rate within the Hamilton census metropolitan area (which includes the nearby cities of Burlington and Grimsby) has been on a positive trend since peaking at 8.5% in 2009, decreasing to 7.6% in 2010 and 6.4% through March 2011. As well, the total value of building permits reached a record level of more than C$1 billion in 2010, with strong gains in the residential and institutional sectors; the latter being partially spurred by about C$136 million in stimulus funding from upper levels of government.

Hamilton will host certain events at the 17th Pan American Games to be held in Toronto (AA/Stable/A-1+) in July 2015 at a cost to Hamilton of C$60 million. This represents the city's 30% commitment towards funding new athletic facilities that will include a new multipurpose stadium and a velodrome. While this represents a significant investment, we expect the games themselves to bring substantial attention and economic spin-off to Hamilton.

The city has consistently produced what we view as adequate operating performance despite some weakening in 2009 when the operating balance and after-capital deficit were 7.1% and 10.8% of operating revenues, respectively (Standard & Poor's-adjusted). These results are down from the three-year averages of 11.0% and a surplus of 0.3%,
respectively. The recession affected operating results since some expense items, particularly social services expenses, were higher than usual and government grants and developer contributions were lower than budgeted for. We expect that these revenues will recover in the near-to-medium term, and the city has enacted cost-containment initiatives; however, we believe that personnel-related expenses coupled with a modest 0.8% tax increase for 2011 could continue to squeeze operating performance.

Hamilton has maintained what we view as a strong net creditor position due to its high reserves and liquidity levels. Free cash and liquid assets at Dec. 31, 2009 accounted for 49% of operating expenditures for the year (both Standard & Poor's-adjusted). Although this figure is much lower than the 64% coverage in 2008 because of lower free cash and liquid asset levels and a 13% increase in operating expenses, we believe that the continued recovery in investment values and more moderate operating expense growth will help boost liquidity levels back to previous levels in the near term. The capital plan's demands are likely to strain liquidity in the medium term but Standard & Poor's expects that the city will maintain strong liquidity in the next two years.

In our view, constraining the ratings are significant capital expenditures that are required to address the infrastructure deficit backlog of about C$2 billion. The 2011 capital budget forecasts C$422 million to be spent mainly on wastewater, roads, and water facilities. This is the highest level of spending projected during the next five years and caps a three-year rising trend, although it is lacking the previous levels of support from federal and provincial stimulus funding. Changes in capital revenues have exacerbated the volatility experienced in after-capital balances during the past several years and we expect that Hamilton will experience modest after-capital deficits for the medium-term which somewhat tempers our view of operating performance.

We expect that the large deficits budgeted for senior levels of government will force the city to rely more on own source capital funding and that this will likely limit its financial flexibility during the next several years. As such, we expect that Hamilton's debt levels will rise significantly in the next three years as the city undertakes its capital plan. At fiscal year-end 2009 (Dec. 31), direct debt was about 32% of adjusted operating revenues, a level that we view as moderate and in line with those of Hamilton's peers. However, we expect that debt could peak at about 55%-65% of operating revenues by 2014, which would push the debt burden close to the upper limit of what we would view as appropriate for the ratings.

Capital expenditure program, debt, liquidity, and contingent liabilities

Hamilton has been ramping up its capital spending during the past several years, from C$226 million in 2008 to an estimated C$422 million in 2011. The 10-year tax- and rate-supported capital budgets project about C$3.6 billion of spending focusing mainly on wastewater, roads, and water facilities. Lagging development and changes in forecast capacity and demand have caused some capital deferrals, such as a new wastewater treatment plant that has been pushed out to 2017-2019, and made the long-term plan somewhat back-ended. Hamilton maintains some ability to defer capital expenditures, but in our opinion, the high infrastructure renewal requirements will limit financial flexibility. The long-term capital plan does not include some significant projects that the city may choose to pursue such as a light rail transit plan, a police building, changes to the parks and harbor master plans, and the potential for additional costs related to the Pan-Am Games.

Hamilton has experienced declining capital affordability due to increasing debt commitments, aging infrastructure, a lower proportionate share of property tax directed towards capital, and inflationary pressures. The city is attempting to address these factors by raising water and sewer rates, increasing the capital levy, and directing targeted budget cuts towards capital. Hamilton also uses a number of strategies to fund its capital projects.
prudently, including cash from reserves and developer contributions, pay-as-you-go, debt issuance, funding from the federal and provincial gas taxes and, where available, infrastructure funding grants from higher levels of government.

Although Hamilton plans to fund much of the capital program through internal sources to mitigate debt issuance, the city faces material infrastructure renewal requirements which will require significant debt financing. Currently, we view Hamilton’s debt burden as moderate and note that it has remained relatively stable for the past nine years. The city’s estimated C$394 million of direct debt outstanding at the end of 2010 amounted to about 30% of Standard & Poor’s forecasted operating revenue, which is in line with the five-year average of about 32%. Average interest costs of about 1.5% of adjusted operating revenue during the past five years are modestly lower than the median for similarly rated international and domestic peers. We expect that Hamilton’s debt burden will increase rapidly during the next several years to help fund the capital program, possibly topping C$1 billion by 2020. Although this is beyond our rating horizon, Standard & Poor’s conservative forecasts indicate that direct debt could reach 55%-65% of adjusted operating revenues by 2014. This level would be high relative to those of similarly rated global peers but could be consistent with the current ratings, all other factors being equal.

In our opinion, Hamilton’s strong liquidity position bolsters its financial risk profile and remains a key credit strength. Free cash and liquid assets amounted to about 49% of operating expenditure in 2009 (Standard & Poor’s-adjusted). In addition, the city maintained a positive net debt position (defined as free cash and liquid assets minus direct debt). We estimate that after dipping slightly in 2009, liquidity in fiscal 2010 will have rebounded and will remain strong over the next several years. Nevertheless, we also expect that the increased debt load will threaten Hamilton’s net creditor position in the next two-to-three years.

The city has standard future employee benefits and obligations, and landfill postclosure costs that totaled almost 22% of fiscal 2009 operating revenue. We do not consider this to a significant amount since Hamilton has reserves in place to cover about 30% of these liabilities. However, it is also contingently liable for the principal and interest on about C$26 million of loans to local school boards. The city also has three defined benefit plans with a total liability estimated at close to C$90 million. All three are legacy plans but one still has active workers and continues to accrue obligations.

For 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.

Outlook

The stable outlook reflects our expectations that Hamilton’s economic base will continue increasing beyond its manufacturing roots and that the city will continue to demonstrate adequate operating performance and will maintain robust liquidity levels during our forecast period. We could revise the outlook to positive if operating balances were to improve meaningfully and Hamilton did not fully implement all of its planned debt issuance; however, the downside effect that significant capital deferrals would have on the city’s infrastructure make this scenario unlikely in the near-to-medium term. Conversely, debt that is significantly higher than forecast or a notable deterioration in financial performance or liquidity could put downward pressure on the ratings.
Table 1

City of Hamilton – Economic Statistics

<table>
<thead>
<tr>
<th></th>
<th>Total population</th>
<th>% aged 14 years or younger</th>
<th>% aged 65 years or older</th>
<th>Median age</th>
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<tbody>
<tr>
<td>Population</td>
<td>504,449</td>
<td>18</td>
<td>14.9</td>
<td>40.0</td>
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<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>7.8</td>
<td>8.5</td>
<td>6.2</td>
<td>6.0</td>
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<tr>
<td>Assessment base¶</td>
<td>6.9</td>
<td>7.4</td>
<td>8.9</td>
<td>1.3</td>
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</tbody>
</table>

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

Table 2

City of Hamilton – Financial Statistics

<table>
<thead>
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<th></th>
<th></th>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Operating balance/operating revenue</td>
<td>7.1</td>
<td>13.2</td>
<td>12.7</td>
<td>12.6</td>
<td>15.4</td>
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<tr>
<td>After-capital expenditure balance/total revenue</td>
<td>(10.8)</td>
<td>9.3</td>
<td>2.5</td>
<td>0.1</td>
<td>(1.7)</td>
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<tr>
<td>Capital expenditure/total expenditure</td>
<td>20.7</td>
<td>17.8</td>
<td>19.4</td>
<td>22.6</td>
<td>25.7</td>
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<tr>
<td>Direct debt/operating revenue</td>
<td>31.5</td>
<td>33.5</td>
<td>33.2</td>
<td>34.0</td>
<td>32.9</td>
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<tr>
<td>Debt service/operating revenue</td>
<td>3.8</td>
<td>3.7</td>
<td>3.5</td>
<td>3.9</td>
<td>3.6</td>
</tr>
<tr>
<td>Net debt*/operating revenue</td>
<td>(14.0)</td>
<td>(22.3)</td>
<td>(22.0)</td>
<td>(21.3)</td>
<td>(19.5)</td>
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<tr>
<td>(Free cash and liquid assets)/operating expenditure</td>
<td>62.5</td>
<td>79.0</td>
<td>63.3</td>
<td>63.3</td>
<td>61.9</td>
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</table>

*Direct debt minus cash and equivalents.

Related Criteria And Research

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

Ratings Detail (As Of June 3, 2011)*

<table>
<thead>
<tr>
<th>Hamilton (City of)</th>
<th>AA/Stable/--</th>
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<tr>
<td>Issuer Credit Rating</td>
<td>AAA</td>
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<tr>
<td>Senior Unsecured (5 Issues)</td>
<td>AA</td>
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</table>

Issuer Credit Ratings History

- 12-Nov-2008: AA/Stable/--
- 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.