Determining a Safe Debt Limit for the City of Middletown: A Proposal

The City of Middletown has been fortunate to maintain a discipline and focused fiscal policy for the better part of the past half century. This has been rewarded with the third highest municipal credit rating of Aa2. Moody's explains in 2011 this was award based on "sound management with a history of healthy financial reserves" and a "stable local economy with sizable tax base".

The basic rules of thumb that have been adhered to for decades have been:

- Maintain a reasonably competitive tax rates;
- Investing in public infrastructure and education that will enhance our economic base and attract households;
- Requiring all bonding above a certain threshold to be approved by voter referendum (previously $500,000, now $750,000); and,
- Limit bonding terms to 10 years in order maximize debt maturity and minimize interest costs.

These rules have served the City well. In order to continue the balance between fiscal restraint and targeted investment the City should better understand threshold at which debt and spending would likely no longer work as investments rewarding the City, but act as a drag the City's Grand List and erode the capacity to attract private investment.

Typically, financial reports look to determine the amount of debt per capita and compare that figure to other communities. This method can be helpful for comparing communities, but it does not actually determine if the level of debt is too high or if the community has the capacity to pay off the debt without affecting economic viability.

The State of Connecticut imposes legal limits on the amount of debt that the City of Middletown is authorized to issue. Under Connecticut General Statutes, municipalities are not permitted to incur indebtedness that would exceed 7 times the annual receipts from taxation. For 2011, this limit was determined to be more than $750 million. If you subtract the existing outstanding debt the City can still authorize $657 million in bonds. If the City of Middletown were to incur this magnitude of debt it would surely find its credit rating in the "junk bond" category. For this reason the notional "legal debt" limit in Connecticut is of no practical use to the City of Middletown.

Proposed New Safe Debt Level Model

This paper proposes a new method for determining a safe debt level, based on the capacity to pay and level of debt our community has traditionally been willing to accept. The method proposed to determine the "traditional willingness" of the community is to utilize ratios of debt to the grand list, median home values and median household values over a significant time period.

The following table contains the value of debt, Grand List, median home value and median income in Middletown from 1960 to 2010.

Data	1960	1970	1980	1990	2000	2010
Debt	$5,101,000	$6,979,000	$21,705,000	$31,433,621	$68,685,000	$73,845,000
Grand List	$91,272,790	$215,702,980	$543,257,877	$1,216,139,779	$2,204,418,144	$3,502,729,129
Med Home Value	$15,900	$24,000	$57,600	$156,100	$134,400	$239,700
Median Income	$5,544	$11,280	$17,308	$37,644	$47,067	$57,655

Using this data, the following ratios can be calculated below to show how debt related to the value of the grand list, home values and median income. These ratios stay within a range. This range can be used to create a high and low threshold for what is the locally preferred debt level.

Ratios	1960	1970	1980	1990	2000	2010	Average
Debt vs Grand List	0.056	0.032	0.040	0.026	0.031	0.021	0.034
Debt vs Home Value	321	291	377	201	511	308	335
Debt vs Median Income	920	619	1254	835	1459	1281	1061

To put these ratios into perspective the lowest debt level converted into 2010 dollars is $35 million and the highest debt converted into 2010 debt is $195 million.

Determining the average of the ratios above gives you the following:

- Average Debt vs Grand List Ratio- 0.034
- Average Debt vs Home Value Ratio- 335
- Average Debt vs Median Income Ratio- 1061

The average of the ratios allows a calculation of what the current level of acceptable debt is based on historic trends. Therefore if we take the grand list value for 2010 and multiply it by 0.034 we get a historically acceptable debt level of $119 million. Taking the median home value for 2010 and multiply it by 335 we get a historically acceptable debt level of $80 million. Taking the median household income for 2010 and multiply it by 1061 we get a historically acceptable debt level of $61 million.

Since these ratios result in different levels of bonding we can use these to obtain a range within which bonding would be considered safe. To determine the high level threshold and the low level threshold we can add or subtract one standard deviation from the ratio.

The tables below applies this over the past 50 years as a high and low target and then averages the results to determine the actual safe level of debt.

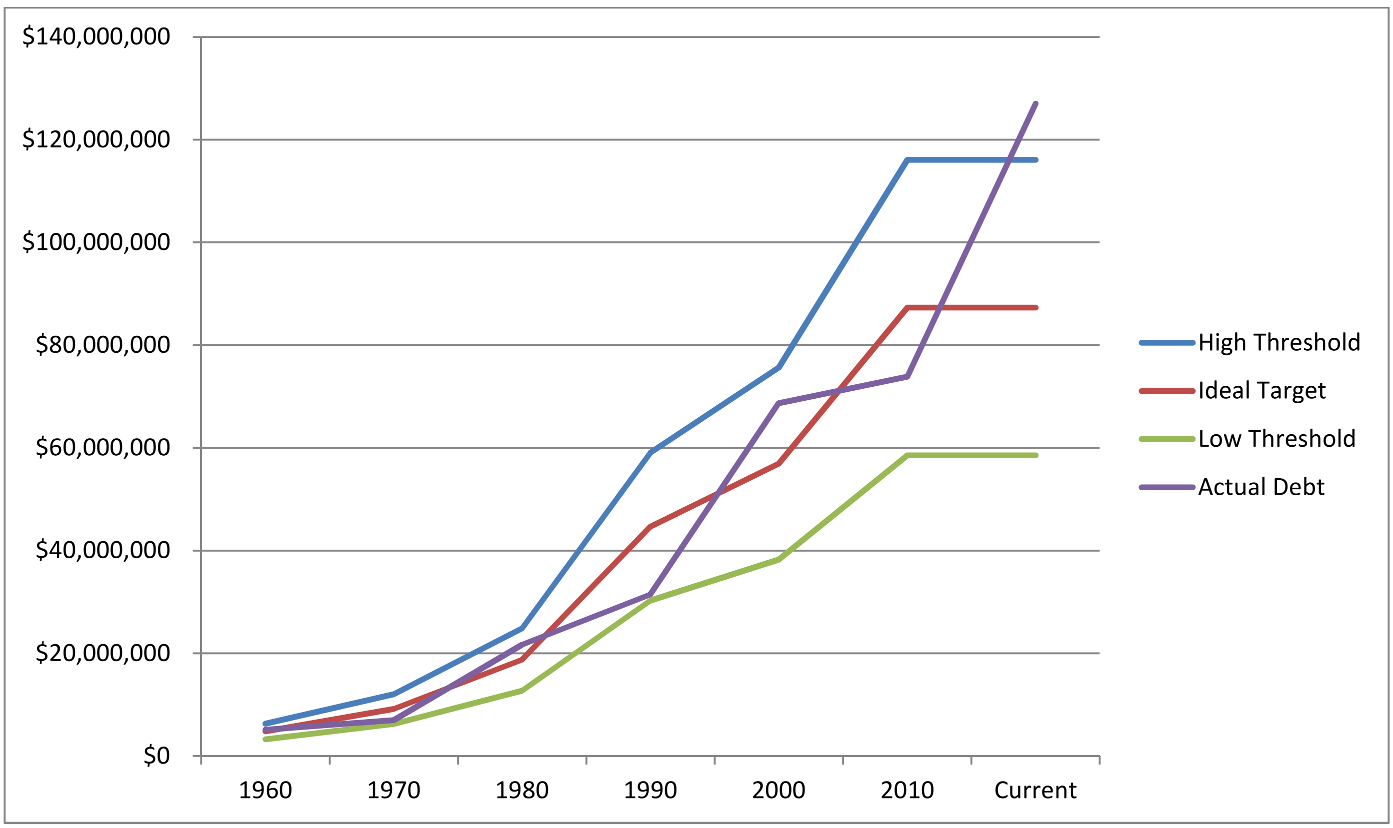
Thresholds	1960	1970	1980	1990	2000	2010
Grand List						
High Target	$4,261,624	$10,071,403	$25,365,293	$56,782,870	$102,926,646	$163,546,177
Low Target	$2,014,370	$4,760,517	$11,989,581	$26,839,935	$48,651,019	$77,304,455
Home Value						
High Target	$6,968,049	$10,517,810	$25,242,744	$68,409,590	$58,899,737	$105,046,629
Low Target	$3,679,239	$5,553,569	$13,328,565	$36,121,337	$31,099,986	$55,466,269
Median Income						
High Target	$7,655,960	$15,577,062	$23,901,400	$51,984,302	$64,996,949	$79,618,397
Low Target	$4,112,063	$8,366,536	$12,837,589	$27,921,088	$34,910,261	$42,763,530

Thresholds	1960	1970	1980	1990	2000	2010
Averages						
High Threshold	$6,295,211	$12,055,425	$24,836,479	$59,058,921	$75,607,777	$116,070,401
Ideal Target	**$4,781,884**	**$9,141,150**	**$18,777,529**	**$44,676,520**	**$56,914,100**	**$87,290,910**
Low Threshold	$3,268,558	$6,226,874	$12,718,578	$30,294,120	$38,220,422	$58,511,418
Actual Debt	**$5,101,000**	**$6,979,000**	**$21,705,000**	**$31,433,621**	**$68,685,000**	**$73,845,000**
Difference from Ideal Target	+$319,116	-$2,162,150	+$2,927,471	-$13,242,899	+$11,770,900	-$13,445,910

The results of the table above show that applying this method shows that Middletown has been very consistent in its level of bonding. It has fallen within one standard deviation of the composite averages generated by comparing debt to the grand list, home values and median household income.

In 2010 the level of debt fell within the high and low threshold of this proposed model for safe debt level.

Recently, the City of Middletown has added $4 million in bonding for a new Senior Center, $13 million in bonding to buy into the Mattabassett Regional Sewerage Treatment Facility and $37 million in bonding to decommission the River Road Sewer Treatment Facility and pipe the effluence to the Mattabasset facility. This totals $54 million in new bonding. Based on the model above this would bring the amount of debt to approximately $127 million, the upper threshold in this proposed safe debt level model. This would be $86 million above the ideal target of $87 million. The City would need to refrain from authorizing any new debt for at least four years to bring the $127million down to around $87 million.



Recommendations

The council should request that the Finance Department issue a safe debt level report as part of the budget process and as a part of any bond authorization request before the Common Council.

This would put the amount of existing debt and proposed debt into perspective, based on historical trends, what the City of Middletown's true capacity and traditional willingness to pay are. The Safe Debt Level model is not meant to be a rigid set of standards, but it should be considered a guideline. The City should bond to meet its responsibility to construct and maintain roads, acquire property for parks and open space, or construct or renovate schools and other public facilities. These investments benefit the public and improve quality of life and economic opportunity. The question is to what level does investment and debt become irresponsible.