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Ratings

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Summary:

Norwich, Connecticut; General Obligation

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Credit Profile		
US$15.945 mil GO rfdg bnds iss of 2020 (federally taxable) ser B due 08/01/2033		
Long Term Rating	AA/Stable	New
US$1.205 mil GO bnds issue of 2020 (bank qualified) ser A due 10/15/2040		
Long Term Rating	AA/Stable	New
Norwich GO		
Long Term Rating	AA/Stable	Affirmed
Norwich GO		
Long Term Rating	AA/Stable	Affirmed
Norwich GO		
Long Term Rating	AA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA' long-term rating to the City of Norwich, Conn.'s series 2020A general obligation (GO) bonds and series 2020B GO refunding bonds, totaling $1.2 million and $15.9 million, respectively. At the same time, S&P Global Ratings affirmed its 'AA' long-term rating on the city's GO debt outstanding. The outlook is stable.

The bonds are secured by the city's full faith and credit pledge to levy ad valorem taxes on taxable property, without limit on the rate or amount. We understand Norwich intends to use the series 2020A bond proceeds as new money to finance a portion of the city's current capital needs and series 2020B bond proceeds to refund previously issued GO debt for interest-rate savings. There is no extension of maturities on the refunded debt.

Credit overview

The long-term rating includes our assessment of Norwich's strong management environment, which historically has helped yield stable financial operations, including strong financial flexibility and very strong liquidity to guard against state-level fiscal pressures, despite some draws on reserves in the past two fiscal years. We believe that recent negative operating performance in fiscal years 2018 and 2019 is due in part to the city's reliance on state aid as a significant revenue source, accounting for about 30% of general fund revenues.

However, for fiscal 2020, we understand the city's revenues came in a little better than budget for the year while expenses came in slightly below budget. As a result, we understand Norwich ended the year with an operating surplus of about $750,000, which maintains available reserves at what we view as a strong 12% of expenditures.

Furthermore, for fiscal 2021, we understand management reduced some of its revenue estimates to account for the impact of the COVID-19 pandemic. We understand that year-to-date revenues and expenses are tracking well relative to budget and that revenues in particular are ahead of where they were last year at this time. In addition, management indicates that non-education pandemic-related costs have been limited to just $140,000 in fiscal 2020 and an estimated

$200,000 in fiscal 2021 for which the city will seek reimbursements. Education pandemic-related costs are much higher but have a variety of federal and state funding sources to pay for them.

Although we believe Norwich is well-positioned to manage the effects of the pandemic on its finances and operations, given that the city's primary revenue source is from property taxes, which have remained stable, we believe state revenues could be pressured in fiscal 2021 because of the pandemic, which could affect the city's intergovernmental revenues. For more information on the pandemic's effect on U.S. public finance, please see our reports "The COVID-19 Outbreak Weakens U.S. State And Local Government Credit Conditions" (published April 2, 2020), and "The U.S. Economy Reboots, With Obstacles Ahead" (Sept. 24, 2020), both on RatingsDirect.

The stable outlook reflects our view of Norwich's good management practices and policies, and our expectation that the city will monitor changes in local expenditures and state revenue trends, exercising necessary expenditure controls to maintain at least balanced budgetary performance and sustain flexibility at currently strong levels, in compliance with its revised reserve policy. The outlook also reflects our expectation that Norwich's wealth and income characteristics will benefit from anticipated community economic development that will likely support tax base expansion and new locally derived revenue. For these reasons, we do not expect to change the rating over the outlook period. Our outlook is generally for two years, but we see some risks due to the pandemic and the related recession over the next six-to-12 months.

The long-term rating reflects our view of Norwich, specifically its:

- Weak economy, with market value per capita of $72,610 and projected per capita effective buying income at 88.2% of the national level;
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with operating results that we expect could improve in the near term relative to fiscal 2019, which closed with a slight operating deficit in the general fund but a slight operating surplus at the total governmental fund level in fiscal 2019, in addition to a general fund surplus in fiscal 2020 according to unaudited results;
- Strong budgetary flexibility, with an available fund balance in fiscal 2019 of 10.4% of operating expenditures, which we understand will increase close to 12% of expenditures at the end of fiscal 2020 according to unaudited results;
- Very strong liquidity, with total government available cash at 29.7% of total governmental fund expenditures and 8.3x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability profile, with debt service carrying charges at 3.6% of expenditures and net direct debt that is 31.2% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of market value, but a large pension and other postemployment benefit (OPEB) obligation; and
- Strong institutional framework score.

Environmental, social, and governance factors

We have analyzed Norwich's environmental factors, including health and safety risks posed by the COVID-19 pandemic, along with social and governance risks relative to the economy, financial management, budgetary performance, and budgetary flexibility, as well as the city's debt and liability profile, and have determined all are either below or in line with our view of the sector standard.

Stable Outlook

Downside scenario

We could lower the rating should Norwich experience sustained deterioration in budgetary performance--from a decline in state aid, rising fixed costs, pandemic-related reasons, or otherwise--resulting in a decline of reserves to levels we no longer view as commensurate with those of its peers at the current rating. In addition, material weakening of the city's local income and wealth levels could put downward pressure on the rating.

Upside scenario

We currently view the city as having limited-upside potential, given recent draws on reserves in addition to wealth and income levels that are well below those of higher-rated peers, coupled with potential budgetary challenges that could stem from the COVID-19 pandemic even though we recognize that year-to-date pandemic-related impacts have been minimal. Nevertheless, we could raise the rating if Norwich's wealth and income levels improve substantially, and if the city's flexibility and liquidity were to significantly improve because of consistently strong budgetary performance.

Weak economy

We consider Norwich's economy weak. The city, with an estimated population of 40,143, is located in New London County. The city has a projected per capita effective buying income of 88.2% of the national level and per capita market value of $72,610. Overall, the city's market value grew by 0.9% over the past year to $2.9 billion in 2021. The county unemployment rate was 3.6% in 2019 although we note the unemployment rate spiked to 13.9% in May 2020 following the onset of the pandemic and currently stands at 9.5%, which is above the national rate (7.9%).

Norwich is a primarily residential community, complemented by a substantial commercial and industrial base. Although we do not consider the Norwich-New London metropolitan statistical area to be broad and diverse, we note the city has direct access to Hartford, Conn., and Providence, R.I., each of which is approximately 40 miles from the city. Interstate 395 and State Route 2 traverse the city, connecting residents with regional employment centers.

The local economy and employment base are anchored by the health care, government (state and local), manufacturing and distribution, and commercial retail sectors. Norwich's leading employers include William W. Backus Hospital (1,439 employees); the city government, public utility, and board of education (1,116); state of Connecticut (788); Bob's Discount Furniture (553); and U.S. Food Service (325). The city reports overall stability among its leading employers and taxpayers in recent years. Because of Norwich's largely residential composition, the city's 10 leading taxpayers account for just 7.8% of the grand list, representing a very diverse tax base, in our opinion.

Following a sharp 24.8% decline in its grand list in 2013 (following a property revaluation), Norwich has experienced modest, albeit steady, tax base growth in the past six years. The city also indicates that a good local real estate market, coupled with new housing construction and commercial development over this period, helped yield a 6.7% increase to the grand list from the Oct. 1, 2018, revaluation.

According to management, regional developments such as Mohegan Sun Casino and General Dynamic's Electric Boat new submarine facility support the city's commercial and residential activity. The Norwich Community Development Corp. maintains relationships with regional partners, which allows management to identify and attract potential developments that stimulate the regional economy and the city's tax and employment base. One such development is Ponemah Mills, a $90 million adaptive reuse project. In addition, General Dynamics, a global aerospace and defense company, is generating significant economic activity in the region with its new Electric Boat facility, which broke ground in 2019.

We believe Norwich's increasing grand list, as well as a job market that has shown signs of convergence with county, state, and national markets over the past couple years, is likely to support stable wealth and income metrics over the next two years.

Strong management

We view the city's management as strong, with good financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

In development of its annual budget, management uses three-to-five years of historical data to build revenue and expenditure assumptions. The city reviews each department's annual operation requests and prioritizes operating expenditures. Because of uncertainty regarding state aid over the past several years, finance officials closely monitor state budget information to conservatively estimate state aid revenue. They also monitor grand list growth to evaluate changes in local tax revenue and mill rate. During each fiscal year, management monitors the budget regularly, reporting budget-to-actual results to the city council monthly. Norwich also adheres to state statutes governing investments and management reports earnings and holdings to the city council quarterly.

Norwich maintains a strong focus on capital planning, as evidenced by a five-year capital improvement plan (CIP) that identifies projects and costs across all departments. The city updates its CIP annually and details pay-as-you-go funding, intergovernmental grants, and bond financing for all capital projects. Although the city does not currently maintain a long-term financial forecast, it does incorporate some forward-looking projections for debt service and other budget items in its annual budget.

The city adopted a formal general fund unrestricted fund balance policy that requires it to maintain a target fund balance of 12%-17% of annual general fund expenditures. While Norwich's available fund balance stood at 10.4% of general fund expenditures at fiscal year-end 2019, the city reduced the policy minimum level to 10% until 2022 to accommodate the use of the fund balance, if necessary, to ease potential budget pressures over the next few fiscal years. However, we note the city increased reserves closer to 12% at the end of fiscal 2020 according to unaudited results and expects close-to-balanced operations for fiscal 2021. Norwich also adopted a formal debt management policy that sets forth guidelines for issuing debt and measurable debt affordability benchmarks; this includes capping direct debt to 5% of the city's taxable assessed value and stipulating net utility income-paying self-supporting debt to be no less than 125% of debt service.

Adequate budgetary performance

Norwich's budgetary performance is adequate in our opinion. The city had slight deficit operating results in the general fund of 1.4% of expenditures, but a slight surplus result across all governmental funds of 0.6% in fiscal 2019. Our assessment accounts for risks on budget performance related to the pandemic as well as our expectation that the city will maintain surplus operations in fiscal 2020 and close-to-balanced operations in fiscal 2021.

We adjusted total governmental funds and general fund results to account for the deferred pension payment of $578,000 in fiscal 2019. We also adjusted for annual transfers from the city's enterprise funds. Specifically, 10% of Norwich Public Utilities revenues is diverted to Norwich each year, as stated in the city charter. In addition, we adjusted general fund results for recurring transfers in and out of the general fund.

The city previously reduced its discount rate for its single-employer pension plan in 2013, which consequently increased outstanding liabilities and annual contributions. Norwich adopted an ordinance in fiscal 2015 that phases in its full actuarially determined contribution (ADC) over a five-year period, returning to 100% in fiscal 2020. With pension costs rising to about 6.6% of the operating budget, ongoing deferral of annual pension contributions could have medium- to long-term implications under a more constrained budgetary environment.

Despite Norwich's recent history of deferring annual pension contributions through fiscal 2019, we expect the city to maintain at least adequate budgetary performance in the next several years, as a result of management's frequent monitoring of budget performance and adjustment of expenditures to support historically balanced operations, in addition to the fund balance policy. Norwich also benefits from an overall stable property tax base, which generated about 63% of general fund revenue in fiscal 2019. Tax collections have remained strong, with collections averaging 99% over the past five years. Management indicates that collection have not been materially affected by the pandemic. Intergovernmental (state) sources represent the second-highest share of general fund revenue, at 34%, while charges for services, investments and other local revenue constitute the remaining 3.0%. We believe in general the city is somewhat susceptible to performance volatility relative to other municipalities during extended periods of state fiscal uncertainty and moderate-to-severe state aid reductions given that state revenues account for about one-third of general fund revenues.

According to audited fiscal 2019 results, net of transfers and including the deferred pension payment, Norwich recognized a $1.8 million general fund deficit for the year. In fiscal 2019, the city's budget included a mill rate increase to 41.01 mills from 40.52 mills, which helped support year-over-year increases to employee salaries and benefits, pension costs, and education spending. Nevertheless, revenues came in $1.0 million below budget because of timing of the state's audit relating to a school construction project, and expenditures were $800,000 above budget primarily due to continued increases in special education expenses for the year. As a result, the city drew down reserves by about $1.8 million to $13.7 million or about 10.4% of expenditures.

Despite the onset of the pandemic in fiscal 2020, we understand Norwich posted positive operating results for the year according to unaudited figures. Management attributes this to revenues coming in on target, expenses coming in slightly below budget and pandemic-related expenses being minimal for the year at just $140,000. As a result, management indicates it expects to end the year with a surplus of $750,000, increasing available reserves to $14.4 million or nearly 12% of expenses.

Norwich adopted a balanced budget for fiscal 2021 without the use of reserves and kept the real estate tax rate unchanged. Management indicates it expects growth in property taxes due to increases in the grand list as well as for state aid to remain stable. So far through the first few months of the fiscal year, management indicates that revenues are slightly ahead of pace and expenditures are on track relative to budget. Management also indicates it plans to identify and adjust expenditures as necessary to produce at least balanced results at fiscal year-end and maintain reserves in line with its fund balance policy.

The city's largest collective bargaining contracts are current, reducing a potential area of cost uncertainty over the next year. Despite state fiscal challenges in previous years, we believe Norwich is likely to maintain at least adequate performance over our outlook period.

Strong budgetary flexibility

Norwich's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2019 of 10.4% of operating expenditures, or $13.7 million.

While management has historically budgeted to appropriate available funds to balance operations, revenue and expenditures have typically outperformed budget expectations, and the city has maintained what we view as strong reserves. Norwich has improved its assigned and unassigned reserve position to approximately $14.4 million at the end of fiscal 2020, from $10.4 million in fiscal 2015, although we note reserves are lower than the city's high of $17.7 million at the end of fiscal 2017.

Unaudited year-end results estimate that Norwich will recognize a $750,000 surplus in fiscal 2020, net of transfers, and we understand that assigned and unassigned reserves increased to $14.4 million, or nearly 12% of general fund expenditures. This remains in compliance with the city's reserve policy, which was revised in 2018 given potential pressure from additional state funding shortfalls, and which stipulates Norwich will maintain an available fund balance of at least 10% of annual operating expenditures.

In addition, we understand the city anticipates at least breakeven operations for the current fiscal year. Therefore, we expect its flexibility to remain at least strong over the next two years.

Very strong liquidity

In our opinion, Norwich's liquidity is very strong, with total government available cash at 29.7% of total governmental fund expenditures and 8.3x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary as demonstrated by its regular issuance of GO bonds and notes over the past 20 years.

In addition, the city does not engage in any aggressive use of investments that could add significant volatility to its liquidity position. Furthermore, Norwich is not exposed to variable-rate or privately placed debt that could result in undue contingent liabilities through acceleration events or interest-rate risk. In our opinion, the city is likely to maintain its very strong liquidity in the near term.

Strong debt and contingent liability profile

In our view, Norwich's debt and contingent liability profile is strong. Total governmental fund debt service is 3.6% of total governmental fund expenditures, and net direct debt is 31.2% of total governmental fund revenue. Overall net debt is low at 1.7% of market value, which is in our view a positive credit factor.

Norwich has approximately $64 million in total direct debt outstanding, of which $14.6 million is tax-secured enterprise debt that is self-supported by the net operating revenues of the city's utility system. Similar to most Connecticut municipalities, the city has no overlapping or underlying debt obligations.

As outlined in its CIP, Norwich could issue up to $5 million annually over the next two years for additional capital improvements for various capital projects, consisting primarily of infrastructure improvements, public safety equipment, and radio improvements. We also understand the city brought a $5 million infrastructure bond to voters on the November 2019 ballot and could bring another referendum to voters in November 2020. However, management indicates that the timing and magnitude of future debt issuances are dependent on the city's economic and fiscal conditions, and in its assessment the debt service payments are sustainable over the life of the bonds. Currently, almost 60% of direct debt is scheduled to be repaid within 10 years.

Pension and other postemployment benefits

In our opinion, a credit weakness is Norwich's large pension and OPEB obligation. The city's combined required pension and actual OPEB contributions totaled 10.7% of total governmental fund expenditures in 2019. Of that amount, 7.5% represented required contributions to pension obligations, and 3.2% represented OPEB payments. Norwich made 95% of its annual required pension contribution in 2019. The funded ratio of the largest pension plan is 63.1%.

Norwich participates in the following plans as of July 1, 2019:

- City of Norwich Retirement System: 63.1% funded, with a net pension liability of $107.2 million, assuming a 7.5% discount rate;
- Volunteer Firefighters Relief Plan: 46.6% funded, with a net pension liability of $3.4 million, assuming a 7.0% discount rate;

In addition:

- The city's teachers participate in a state-administered Teachers' Retirement System, to which the state contributes on behalf of the city; and
- Norwich provides a retiree health care OPEB plan, 35.4% funded with an unfunded actuarial accrued OPEB liability of $40.0 million. The city is meeting 100% of its OPEB annual required contribution each year.

Since 2013, Norwich has modified its assumptions in its city-administered retirement plan to reduce the discount rate to 7.50% from 8.25%, and changed the amortization to a 20-year closed plan from an open 30-year plan, reflecting more realistic market return assumptions and unfunded pension liability estimates.

While we believe the assumption changes were prudent, they have increased Norwich's ADC substantially and led to the underfunding of the city's annual payment in the two fiscal years. However, we recognize the city council adopted a plan as part of its formal funding policies for pensions and OPEB in December 2014. Under these policies, the city increased its pension contribution by 15% each year until it returns to funding 100% of the ADC, which management indicates it did in fiscal 2020.

Although we consider the combined pension and OPEB contributions elevated and likely to increase, we believe

Norwich has a credible plan to address the liability, since contributions were the result of expected assumption changes, and management is now funding its ADC in full. However, if contribution increases pressure the city's ability to maintain balanced financial performance and sustain reserves, this could become a credit pressure beyond the outlook period.

Strong institutional framework

The institutional framework score for Connecticut municipalities is strong.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- 2019 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of October 9, 2020)		
Norwich GO bnds iss (Cap Proj Bnds)		
Long Term Rating	AA/Stable	Affirmed
Norwich GO bnds iss (Taxable Bnds)		
Long Term Rating	AA/Stable	Affirmed