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Ratings

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Summary:

Norwich, Connecticut; General Obligation

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Credit Profile		
US$145.0 mil GO bnds ser 2022 due 08/01/2046		
Long Term Rating	AA/Stable	New
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 2022 general obligation (GO) bonds, totaling $145 million. 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 2022 GO bond proceeds to fully fund the unfunded pension liability relating to its pension plan for employees.

Credit overview

Norwich received approval by voters to bond up to $145 million to fund 100% of the unfunded liability associated with the City of Norwich's Employees' Retirement Pension Plan (NERPP). The city chose to fund this obligation in full in order to take advantage of current market conditions and in particular the historically low long-term interest rates. Officials indicate the expected net present-value savings over the life of the bonds is an estimated $35.5 million.

The city's general creditworthiness is characterized by a strong management environment, which historically has helped yield stable financial operations, including strong financial flexibility and very strong liquidity. For fiscal 2021, we understand Norwich's revenues came in significantly better than budget for the year while expenses came in below conservative estimates. As a result, the city ended the year with an operating surplus of nearly $2.7 million, increasing available reserves to nearly 13% of expenditures, a level we consider strong and in line with Norwich's reserve policy. Furthermore, for fiscal 2022, we understand revenues and expenses continue to outperform budget and management anticipates at least breakeven results for the year. Therefore, we believe the city will maintain strong financial performance and strong reserves over the outlook horizon.

The long-term rating reflects our view of Norwich's:

- Residential economy that benefits from a currently strong real estate market albeit with below-average wealth and income indicators;
- Financial operations that are supported by a strong management environment and a strong institutional framework score;
- Strong financial performance that has not been materially affected by the COVID-19 pandemic in addition to a

strong reserve position; and

- Manageable total fixed costs despite a large increase to the city's debt profile following the current issuance, offset by a corresponding decrease to the city's unfunded retirement liability.

Environmental, social, and governance

We have analyzed Norwich's 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 both are either below or in line with our view of the sector standard. Environmental risks for the city are also in line with peers, consisting mostly of inland flooding given that a portion of the city is located along the Thames River.

Stable Outlook

Downside scenario

We could lower the rating should Norwich experience sustained deterioration in budgetary performance--from a drop in state aid, rising fixed costs, 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 or if growth in the residential real estate market significantly stalls, the rating could come under pressure.

Upside scenario

We currently view the city as having limited-upside potential due in particular to wealth and income levels that are well below those of higher-rated peers. 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 due to consistently strong budgetary performance.

Credit Opinion

Residential economy that benefits from a currently strong real estate market albeit with below-average wealth and income indicators

Norwich, with an estimated population of 40,125, is a primarily residential community, along with some commercial and industrial uses, located in New London County. 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 (1,895 employees); the city government, public utility, and board of education (1,154); the state (944); Bob's Discount Furniture (553); and Norwich Free Academy (345). 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 7.7% 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. The city also indicates that a strong 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 Dynamics Corp.'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.

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 of years, is likely to support stable wealth and income metrics over the next two years.

Financial operations are supported by a strong management environment

We view the city's management as strong, with good financial policies and practices under our Financial Management Assessment 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. Norwich 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 13% at the end of fiscal 2021 according to results and expects close-to-balanced operations for fiscal 2022. 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.

Strong financial performance that has not been materially affected by the pandemic

We adjusted total governmental funds and general fund results to account 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.

Following a balanced fiscal 2020 in which the city increased available reserves by $671,000, we understand Norwich maintained very conservative revenue estimates heading into fiscal 2021 given the onset of the pandemic. Based on audited results for fiscal 2021, the city generated strong surplus operations increasing available reserves by $2.6 million, to $17.0 million, or nearly 13% of operating expenses, a level we consider strong. 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.

The fiscal 2021 budget was adopted without the use of reserves and kept the real estate tax rate unchanged. Management cites positive variances across most of its revenues sources, including property and conveyance taxes as well as building permits as the primary reasons for the strong operating result during the year. In addition, a mild winter and unfilled vacant positions kept expenses below budget.

The fiscal 2022 budget is balanced without the appropriation of reserves. Management reports conveyance taxes, which stem from home property sales, and building permit collections already being well above budget for the first half of the fiscal year. According to management, expenditures are also on track relative to budget. We note Norwich's largest collective bargaining contracts are current, reducing a potential area of cost uncertainty over the next year. Given the strength of revenues and conservative expense estimates, we anticipate the city maintaining balanced operations for the year.

In addition, we note the city has been allocated about $28 million in American Rescue Plan Act funding, half of which has already been received. We understand these funds will be used to promote continued growth through economic development projects and other one-time uses, providing ample financial flexibility over the next couple of years.

Norwich benefits from an overall stable property tax base that generate nearly two-thirds of general fund revenue. Tax collections have remained strong, with collections averaging 97% over the past five years. Management indicates that collections 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.

Moderate yet manageable debt and contingent liability profile following increase in debt to fund employees' pension liability

With the series 2022 new issuance of $145 million, the city's overall net debt position will increase considerably. Specifically, following the issuance, Norwich's overall net direct debt will increase from what we viewed as a low $42.6

million to a moderately high $187.6 million, net of $23.8 million in self-supporting utility revenue debt. Similar to most Connecticut municipalities, the city has no overlapping or underlying debt obligations. Nevertheless, the issuance will increase net direct debt to 101% of governmental revenues from 31% of revenues one year ago.

The purpose of the fiscal 2022 GO issuance is to fully eliminate the unfunded liability associated with NERPP, so that the pension plan becomes 100% funded. Officials are projecting estimated near-term debt service to increase to 5.7% from 3.1%, which we view as moderately low despite the large increase relative to previous levels.

Given low interest rates, management projects net present-value savings associated with the issuance of $35.5 million over the life of bonds. Amortization of existing and proposed debt will be 42% over the next 10 years, which we view as slightly below average, and which is down from about 60% before the current issuance. Management expects to repay the series 2022 GO bonds over a 25-year period.

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. However, management indicates that the timing and magnitude of future debt issuances are somewhat 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.

Demonstrated commitment to funding pension and other postemployment benefits

The city administers NERPP, a single-employer contributory defined-benefit plan. The plan provides benefits to eligible employees of the city's Department of Public Utilities, police officers, firefighters, and board of education, as well as to the city's general employees. Norwich anticipates that at the time of issuance later this month, the expected unfunded accrued liability will be approximately $144 million, or roughly equal to the proposed bond issuance.

The unfunded accrued liability has increased in recent years due in large part to changed assumptions by the city, which although prudent in our view, led to a substantial increase in Norwich's actuarially determined contribution (ADC) as well as an increased liability. Specifically, the city has lowered its assumed rate of return to 6.25%, which is considerably lower than its high of 8.25%, and in 2019 mortality rates were updated. Furthermore, in December 2014, the city council adopted formal funding policies for pensions and other postemployment benefits (OPEB) in which the city mandated increases to its pension contribution by 15% each year until it achieved 100% funding of the ADC, which occurred in fiscal 2020.

On Sept. 7, 2021, Norwich's City Council also created a pension reserve fund in anticipation of the current issuance. We understand the city will make an initial contribution of $13.7 million to the pension reserve fund from funds already included in the fiscal 2022 budget, equal to the ADC for fiscal 2022. Management indicates that in future years, if the cost of the pension ADC plus the debt service on the series 2022 bonds increases by more than 3% year-over-year, the city may use the pension reserve fund to contribute the excess into the pension plan rather than pursuing these amounts from the general fund budget. On the other hand, if the cost of the pension ADC plus the debt service on the bonds decreases, the amount of the decrease will be appropriated and contributed in the following cascading order:

- First, into the pension reserve fund, until this fund accumulates a balance of 6% of the pension plan accrued liability;
- Second, into the pension plan, until the plan is 115% funded; and

- Third, into the city's the OPEB Trust Fund, until the fund is 115% funded.

If all three criteria are met, the city indicates it can use excess funds for general fund expenditures.

Norwich participates in the following plans as of July 1, 2020:

- NERPP: 69% funded, with a net pension liability of $100.3 million, assuming a 7.25% discount rate;
- Volunteer Firefighters Relief Plan: 56% funded, with a net pension liability of $3.1 million, assuming a 7.0% discount rate;
- The state-administered Teachers' Retirement System, to which the state contributes on behalf of the city; and
- A retiree health care OPEB plan, 50% funded, with an unfunded actuarial accrued OPEB liability of $32.7 million. The city met 100% of its OPEB annual required contribution in fiscal 2021.

Following the current issuance, although debt service is expected to nearly triple to about $13 million annually, we believe the city's combined pension and OPEB contributions should decline significantly and remain low such that total fixed costs of about $17.4 million will be about $4.3 million lower than they otherwise would be without the current issuance. However, if total fixed costs pressure Norwich'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.

Norwich, Conn. Key Credit Metrics

	Most recent	**Historical information**		
		2021	**2020**	**2019**
Weak economy				
Projected per capita EBI % of U.S.	89.6			
Market value per capita ($)		72,845		
Population (no.)		40,125	40,125	40,143
County unemployment rate(%)			9.6	
Market value ($000)		2,922,923.00	2,889,841.00	2,719,377.00
Ten largest taxpayers % of taxable value	7.7			
Strong budgetary performance				
Operating fund result % of expenditures		1.8	0.5	(1.4)
Total governmental fund result % of expenditures		5.0	(0.6)	0.6
Strong budgetary flexibility				
Available reserves % of operating expenditures		12.1	10.5	10.4
Total available reserves ($000)		17,016	14,393	13,722
Very strong liquidity				
Total government cash % of governmental fund expenditures		49.5	39.2	29.7
Total government cash % of governmental fund debt service		1,522.9	1,144.1	832.2
Strong management				
Financial Management Assessment	Good			

Norwich, Conn. Key Credit Metrics (cont.)				
	Most recent	Historical information		
		2021	2020	2019
Adequate debt & long-term liabilities				
Debt service % of governmental fund expenditures		3.2	3.4	3.6
Net direct debt % of governmental fund revenue	101			
Overall net debt % of market value	6.4			
Direct debt 10-year amortization (%)	40.0			
Required pension contribution % of governmental fund expenditures		7.4		
OPEB actual contribution % of governmental fund expenditures		2.5		
Strong institutional framework				

EBI--Effective buying income. OPEB--Other postemployment benefits. Data points and ratios may reflect analytical adjustments.

Related Research

- Credit Conditions: U.S. Regions' Economies Perk Up As The Pandemic's Impact Ebbs, April 16, 2021
- 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
- 2021 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of February 3, 2022)		
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
Norwich GO		
Long Term Rating	AA/Stable	Affirmed
Norwich GO		
Long Term Rating	AA/Stable	Affirmed