STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:

Norwich, Connecticut; General Obligation

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Credit Profile		
US$6.3 mil GO bnds iss (Cap Proj Bnds) ser 2016 A due 08/01/2035		
Long Term Rating	AA/Stable	New
US$2.5 mil GO bnds iss (Taxable Bnds) ser 2016 B due 08/01/2020		
Long Term Rating	AA/Stable	New

Rationale

Standard & Poor's Ratings Services has assigned its 'AA' long-term rating to the city of Norwich, Conn.'s series 2016A and B general obligation (GO) bonds. At the same time, Standard & Poor's affirmed its 'AA' long-term rating and underlying rating (SPUR) on the city's existing GO debt. The outlook on all the ratings is stable.

The bonds are GOs of the city, for which it has pledged its full faith and credit to levy ad valorem taxes on taxable property without limit as to rate or amount. We understand series 2016A bond proceeds will be used to finance various school facilities, road and gas system improvements, and other municipal improvements. The city intends to use series 2016B proceeds to finance economic development and other taxable projects.

The city's long-term rating reflects our assessment of the following factors, including its:

- Weak economy, with market value per capita of $62,780 and projected per capita effective buying income (EBI) at 89.9% 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 2015, which closed with slight operating deficits in the general fund and at the total governmental fund level in fiscal 2015;
- Strong budgetary flexibility, with an available fund balance in fiscal 2015 at 8.4% of operating expenditures;
- Very strong liquidity, with total government available cash at 25.2% of total governmental fund expenditures and 7.0x governmental debt service, as well as access to external liquidity we consider strong;
- Strong debt and contingent liability position, with debt service carrying charges at 3.6% of expenditures, net direct debt at 32.4% of total governmental fund revenue, and low overall net debt at less than 3% of market value, but a large pension and other postemployment benefit (OPEB) obligation; and
- Very strong institutional framework score.

Weak economy

We consider Norwich's economy weak. The city, with an estimated population of 40,986, is in New London County about 40 miles southeast of Hartford. The city has a projected per capita EBI of 89.9% of the national level and per capita market value of $62,780. Overall, the city's market value was stable over the past year at $2.6 billion in 2016. The county unemployment rate was 6.7% in 2014.

Norwich is four miles north of the Mohegan Sun Resort, a casino offering many jobs for residents. However, officials indicate the casino plans to renew construction efforts this year on a hotel on casino grounds, which could hurt hotels in Norwich, which are already suffering under below-average occupancy rates. However, the city continues to rebound from the recession and has been experiencing an uptick in commercial construction activity, development, and reinvestment, which should contribute to the tax base in the next two years. Economic development includes a number of redevelopment projects focused on former mills, nature walks, and mixed-use commercial space, as well as attracting manufacturing jobs and data centers to the city's business park. The largest employers in the city include William Backus Hospital (1,439 employees), Norwich itself (1,073), the State of Connecticut (911), and Bob's Discount Furniture (530).

The city experienced a revaluation for fiscal 2015, which resulted in a 26% decline in its tax base. We understand management raised the tax rate to remain revenue neutral and there are no significant tax appeals outstanding that could affect budgetary performance. Norwich's ten leading taxpayers account for a very diverse 6.6% of 2016 assessed value (AV).

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.

When drafting the budget, officials analyze three-to-five years of historical data and use conservative estimates. In our opinion, budget monitoring is sound as budget-to-actual reports are sent to the city council monthly. In addition to including an updated five-year long-term revenue and expenditure forecast in the budget each year, Norwich conducts a rolling capital improvement plan (CIP) that identifies funding sources. The city maintains its own investment management policy that is compliant with state guidelines but does not report investments to the city council regularly. Norwich's debt management policy caps overall debt to 5% of the city's total AV as well as dictates net utility income paying self-supporting debt to be no less than 125% of debt service. The city council unanimously adopted a formal available general fund balance policy in December 2014 that outlines a target range of 12%-17% of expenditures, to which the city is currently not adhering.

Adequate budgetary performance

Norwich's budgetary performance is adequate, in our opinion. The city had slight operating deficits of 0.8% of expenditures in the general fund and 1.0% across all governmental funds in fiscal 2015. Our assessment accounts for the fact that we expect budgetary results could improve from 2015 results in the near term. General fund operating results have been stable over the last three years, with a result of negative 0.7% in 2014 and positive 0.5% in 2013. Weakening our view of Norwich's budgetary performance is the city's deferral of significant expenditures, which we think inflates the budgetary result ratios.

The city drew down on reserves in fiscal years 2014 and 2015 due to a shortfall in the Special Education Excess Cost Grant from the state. Management reports it has excluded this revenue from future projections due to its volatility and should mitigate future reserve use. The income statement includes adjustments for one-time grants, recurring capital expenditures related to the city's CIP, netting out a one-time capital outlay of $6.4 million funded by bond proceeds from total governmental fund expenditures, and accounting for transfers from the city's utility fund as recurring revenue to general fund and governmental funds revenues. The 2016 budget was balanced as the city's newly adopted reserve policy prohibits the appropriation of reserves to balance the budget. Management indicates it is projecting a $1.5 million surplus in 2016 due primarily to one-time revenue from a personal property audit on Computer Sciences Corp., a local taxpayer. Officials indicate the city would achieve a small surplus absent this one-time revenue. Additionally, management reduced expenditures to adjust for the exclusion of the Special Education Excess Cost Grant that officials intend to be a positive revenue variance from now on.

The majority of Norwich's revenue comes from property taxes (60% of budget) followed by state aid (37%) and a transfer in from the city's utility fund (6%), which is equivalent to 10% of the system's gross revenue. Officials expect all three revenue sources to be stable in the future.

In our opinion, although the city started deferring some of its pension costs on a cash basis to account for its more conservative pension assumptions and officials expect significant tax increases to be unlikely, we believe the city will maintain at least an adequate budgetary performance in the next two years as its primary revenue source--property taxes--is predictable and collections are strong, averaging above 98.8% on a current basis over the past five years. In our opinion, budgetary performance will improve in the near term as management plans to build on fund balance to levels in line with its newly adopted minimum reserve policy by budgeting conservatively across the board on the expenditure side the next few years. Although the projected 2016 surplus is due primarily to a one-time revenue source, contributing to future stable performance is management's decision to exclude from the budget the volatile revenue streams from the Special Education Excess Cost Grant from the state that contributed to the 2014 and 2015 draws on reserves. Additionally, management maintains a long-term financial plan through fiscal 2020, which allows city officials to foresee any future budgetary pressures. Also, we believe management's demonstrated willingness to adjust revenues and expenditures will allow the city to yield balanced operations.

Strong budgetary flexibility

Norwich's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2015 at 8.4% of operating expenditures, or $10.4 million.

The city raised taxes 4.67% in fiscal 2015 and 6.1% in fiscal 2016, but officials do not expect significant tax increases over the next few years. Due to draws on reserves in the last two fiscal years, available reserves fell to 8.5% of expenditures from 9.4%. The city revised its formal general fund balance policy in 2014 to maintain an unassigned fund balance between 12%-17% of operating expenditures, which is a higher threshold than its former target of 8%. Management indicates it is planning to budget conservatively, thus allowing the city to add to available reserves in the next five-to-seven years to be in compliance with its new target level. However, despite limits on revenue-raising flexibility from now on, we expect reserves to grow modestly, consistent with our view that performance will remain at least adequate.

Very strong liquidity

In our opinion, Norwich's liquidity is very strong, with total government available cash at 25.2% of total governmental fund expenditures and 7.0x governmental debt service in 2015. In our view, the city has strong access to external liquidity if necessary.

Further enhancing our view of the city's liquidity position is that Norwich maintains strong access to external liquidity as it has issued GO bonds frequently in the past several years. We understand the city has not entered into any bank loans, direct-purchase debt, or any contingent liquidity risks from financial instruments with payment provisions that change on the occurrence of certain events. Norwich follows state investment guidelines and we do not consider the city's investments aggressive as nearly all are in mutual funds. The city has consistently had very strong liquidity and we do not expect these ratios to change in the near term, given what we view as its adequate budgetary performance.

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 32.4% of total governmental fund revenue. Overall net debt is low at 2.0% of market value, which is, in our view, a positive credit factor.

We consider about $14.5 million of Norwich's debt outstanding to be self-supporting utility debt. Management indicates the city plans to issue about $5 million in additional debt in 2017 for a gas line extension, infrastructure improvements, the possible acquisition of land for a boat launch, and self-contained breathing apparatus packs for fire departments, which we believe will not have a material effect on the city's debt burden. The city could issue debt in 2018 and 2019, depending on the timing and activity related to the gas line extension and infrastructure improvements, in addition to whether other capital needs (such as new fire trucks, a police station, radio network, and school improvements) are authorized. The city expects to retire all current debt outstanding by 2035.

In our opinion, a credit weakness is Norwich's large pension and OPEB obligation. Its combined required pension and actual OPEB contributions totaled 9.9% of total governmental fund expenditures in 2015. Of that amount, 6.4% represented required contributions to pension obligations, and 3.5% represented OPEB payments. The city made 71% of its pension annual required contribution (ARC) in 2015. The funded ratio of the largest pension plan is 65.6%.

The city is the administrator of its Consolidated Pension Plan, a single-employer contributory defined-benefit public employee retirement system and a Volunteer Firefighters Relief Plan. As of the fiscal 2015 reporting, the plan fiduciary net positions as a percentage of the total pension liability were 61.5% and 41.2%, respectively. All city teachers participate in a state-run retirement system for which the city has no liability. Starting in fiscal 2015, the city reviewed its assumptions for its retirement plans, lowered the assumed rate of return, and shortened amortization periods. As a result, the liabilities and actuarially determined employer contributions for these plans rose higher than they would have been under the previous sets of assumptions, reflecting the city's proactive steps in addressing its long-term retirement obligations. These changes increased the city's actuarially determined contribution (ADC) substantially and led to underfunding of its annual payment for the year. However, we recognize the city council adopted a plan as part of the formal funding policies for pensions and OPEBs in December 2014. Under these policies, the city will increase its pension contribution by 15% each year until it returns to funding 100% of the ADC, which will likely be in fiscal 2019. Norwich also provides a retiree health care plan and has an unfunded actuarial accrued OPEB liability of $43.8 million (July 1, 2015) which is 23.7% funded, and it is meeting 100% of its OPEB ARC each year.

Although we consider the combined pension and OPEB contributions elevated and likely to increase, we feel that since they are the result of plan assumption changes and management has a plan in place to fully fund its ARCs, we feel the city has a credit plan to address the liability. However, such rising contributions may pressure its ability to further increase its reserves.

Very strong institutional framework

The institutional framework score for Connecticut municipalities is very strong.

Outlook

The stable outlook reflects our view of the city's strong management practices and policies, contributing to adequate budgetary performance, strong budgetary flexibility, and very strong liquidity. We do not expect to change the rating in our two-year outlook horizon as we expect that the city will maintain its manageable debt burden.

Upside scenario

Although unlikely, we could consider a positive rating action should economic metrics improve significantly to those in line with peers of a higher rating, in addition to the posting of consecutive operating surpluses supporting very strong reserves.

Downside scenario

We could lower the rating should structural imbalance arise, resulting in the reduction of reserves to those in line with peers of a lower rating. Additionally, material deterioration in the city's local economy resulting in weak income and wealth levels could also put downward pressure on the rating.

Related Criteria And Research

Related Criteria

- USPF Criteria: Financial Management Assessment, June 27, 2006
- USPF Criteria: Debt Statement Analysis, Aug. 22, 2006
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Jan. 11, 2016
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- Institutional Framework Overview: Connecticut Local Governments

Ratings Detail (As Of February 5, 2016)		
Norwich GO		
Long Term Rating	AA/Stable	Affirmed
Norwich GO		
Long Term Rating	AA/Stable	Affirmed
Norwich GO		
Long Term Rating	AA/Stable	Affirmed
Norwich GO		

Ratings Detail (As Of February 5, 2016) (cont.)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.