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Ratings

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Summary:

Norwich, Connecticut; General Obligation

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Summary:

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Credit Profile		
US$2.8 mil Go rfdg bnds ser 2016C due 08/01/2024		
Long Term Rating	AA/Stable	New
Norwich GO		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Rationale

S&P Global Ratings has assigned its 'AA' long-term rating to Norwich, Conn.'s series 2016C general obligation (GO) refunding bonds. At the same time, we affirmed our '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 2016C bond proceeds will be used to refund a portion of the outstanding maturities of the series 2009A GO capital project bonds for interest savings. There is no extension of maturities.

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

- Weak economy, with market value per capita of $63,956 and projected per capita effective buying income (EBI) at 91.2% 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 2015, which closed with 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 8.2% of operating expenditures;
- Very strong liquidity, with total government available cash at 24.8% of total governmental fund expenditures and 7.0x governmental debt service, as well as access to external liquidity we consider strong;
- Very strong debt and contingent liability position, with debt service carrying charges at 3.5% of expenditures, net direct debt at 33.9% of total governmental fund revenue, and low overall net debt at less than 3% of market value and rapid amortization, with 67.7% of debt scheduled to be retired in 10 years, but with 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 41,036, is in New London County. It has a projected per capita EBI of 91.2% of the national level and per capita market value of $63,956. Overall, market value grew by 0.6% over the past year to $2.6 billion in 2017. The county unemployment rate was 5.8% in 2015.

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Norwich is four miles north of the Mohegan Sun Resort, a casino offering many jobs for residents. 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 city is actively addressing its blighted properties for future commercial or residential use. In the last 12 months, through economic development initiatives, it was able to renovate 23 residential housing units, increasing taxable value 13% on average.

The largest employers in the city include William Backus Hospital (1,439 employees), Norwich itself (1,097), the State of Connecticut (881), and Bob's Discount Furniture (553). Norwich's ten leading taxpayers account for a very diverse 6.6% of 2017 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, in our opinion, 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 five-year capital improvement plan that identifies funding sources and uses. The city maintains its own investment management policy that is compliant with state guidelines, with holdings reviewed at least annually. Norwich's debt management policy caps overall debt to 5% of the city's total AV, and 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 but will likely reach this target when the fiscal 2016 audit is complete.

Adequate budgetary performance

Norwich's budgetary performance is adequate, in our opinion. It had operating deficits at negative 3.1% of expenditures in the general fund and negative 2.8% 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.

For analytic consistency, we have adjusted total governmental expenditures for the use of bond proceeds on capital outlay and one time expenditures, and added back recurring transfers to revenues and expenditures. We also note that due to actuarial assumption changes, the city began underfunding its annual required pension contribution, which is expected to continue until fiscal 2019. For fiscal 2015, the amount of the deferral--$2.9 million--has been added to general fund and total governmental fund expenditures and reflected in the results reported above.

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 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 $4.4 million surplus in 2016 due primarily to one-time revenue from a personal property audit on Computer Sciences Corp., a local taxpayer. Revenues performed at 103% of budget. Absent the one-time revenue, the city would still have reported a surplus in operations.

The 2017 budget is balanced without use of reserves. The general fund totals $116 million in expenditures. There was a property tax increase of 0.78%. Management reports tax collections and other revenues are on target so far, although it is too early in the year to make accurate predictions. The State of Connecticut made $172,000 in midterm budget cuts to grants to municipalities in fiscal 2016 and there is a looming threat of $20 million in statewide municipal aid cuts for fiscal year 2017. These cuts were announced in June 2016 and it is unknown what, if any, effect they will have on the city. The majority of Norwich's revenue comes from property taxes (60% of budget), followed by state aid (37%).

Based on expected fiscal 2016 results, 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. However, continued adjustments for deferral of required pension payments may likely keep performance adequate until fiscal 2019.

Strong budgetary flexibility

Norwich's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2015 at 8.2% of operating expenditures, or $10.4 million.

The city is expected to post strong operating results for fiscal 2016, increasing fund balance by $4.4 million. At June 30, 2016, the unrestricted fund balance in the general fund was $14.8 million, or 11.7% of actual expenditures and operating transfers. Given this performance and the lack of appropriated reserves in the fiscal 2017 budget, budgetary flexibility should remain strong.

Very strong liquidity

In our opinion, Norwich's liquidity is very strong, with total government available cash at 24.8% 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 regularly 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 its investments aggressive as nearly all are in mutual funds. The city has consistently had very strong liquidity and we do not expect this to change in the near term.

Very strong debt and contingent liability profile

In our view, Norwich's debt and contingent liability profile is very strong. Total governmental fund debt service is 3.5% of total governmental fund expenditures, and net direct debt is 33.9% of total governmental fund revenue. Overall net debt is low at 1.9% of market value, and approximately 67.7% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

The city will likely issue in 2017 about $5 million in tax-exempt bonds for a gas line extension project and other infrastructure improvements. Similarly sized issuances are also expected in 2018 and 2019. New capital projects on the horizon include fire trucks, a radio network, school improvements, and a police station. Debt service represents 3.62% of total the fiscal 2017 general fund budget.

In our opinion, a credit weakness is Norwich's large pension and OPEB obligation. Its combined required pension and actual OPEB contributions totaled 9.7% of total governmental fund expenditures in 2015. Of that amount, 6.3% represented required contributions to pension obligations, and 3.4% represented OPEB payments. The city made 71% of its annual required pension contribution 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 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. While the assumption changes were prudent, they 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) and is 23.7% funded and it is meeting 100% of its OPEB annual required contribution (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 credible plan to address the liability. However, such increasing 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 Norwich'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

Upside scenario

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 maintaining strong operating performance.

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 Research

- U.S. State And Local Government Credit Conditions Forecast, July 27, 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

Ratings Detail (As Of September 13, 2016)		
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
Norwich GO		
Long Term Rating	AA/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 the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.