S&P Global Ratings

RatingsDirect®

Summary:

Norwich, Connecticut; General Obligation

Primary Credit Analyst:
Thomas J Zemetis, New York + 1 (212) 438 1172; thomas.zemetis@spglobal.com

Secondary Contact:
Timothy W Barrett, Washington D.C. (1) 202-942-8711; timothy.barrett@spglobal.com

Table Of Contents

Summary:

Norwich, Connecticut; General Obligation

*(**Editor's Note:** This article was updated to reflect the city's decision to not pursue the refunding portion of the bond anticipation notes following our publication of the rating on Nov. 13, 2018.)*

Credit Profile		
US$7.97 mil GO bns ser 2018 due 12/01/2038		
Long Term Rating	AA/Stable	New
Norwich GO		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA' long-term rating to Norwich, Conn.'s series 2018 general obligation (GO) bonds. At the same time, we affirmed our 'AA' long-term on the city's outstanding GO debt. The outlook is stable.

Norwich's strong management environment, which historically yielded stable operating results and has led to strong financial flexibility and very strong liquidity to guard against recent state-level fiscal pressures, supports over view of the city's long-term rating. However, we believe that recent negative operating performance in fiscal 2018 demonstrates that Norwich's reliance on state aid as a significant revenue source that could expose it to long-term risk exposure under a less predictable state fiscal environment.

While we expect Norwich to maintain measured economic growth that will likely generate new locally derived revenue and to implement planning measures to mitigate local fiscal pressures, we believe prolonged state funding uncertainty and reaching full annual contributions toward its pension liabilities will remain principal challenges for the city to maintain balanced budgetary performance and sustain its long-term creditworthiness beyond the outlook period.

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 city officials intend to use the series 2018 bond proceeds (approximately $7.97 million) to finance various public improvement projects.

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

- Weak economy, with projected per capita effective buying income at 87.3% of the national level and market value per capita of $66,679;
- 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 deteriorate in the near term relative to fiscal 2017, which closed with slight operating surpluses in the general fund and at the total governmental fund level;

- Strong budgetary flexibility, with an available fund balance in fiscal 2017 of 13.2% of operating expenditures;
- Very strong liquidity, with total government available cash at 24.6% of total governmental fund expenditures and 7x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability position, with debt service carrying charges at 3.5% of expenditures and net direct debt that is 32% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value, but a large pension and other postemployment benefit (OPEB) obligation; and
- Strong institutional framework score.

Weak economy

We consider Norwich's economy weak, based on our view of the city's underlying wealth and income metrics, although they could improve slightly as new developments contribute to tax base expansion. The city, with an estimated population of 40,608, is located southeastern Connecticut in New London County. It has a projected per capita effective buying income of 87.3% of the national level and per capita market value of $66,679. Overall, the city's full estimated value grew by 1.9% over the past year to $2.7 billion in 2019.

Norwich is a primarily residential community--complemented by a substantial commercial and industrial base--approximately 40 miles southeast of Hartford and 40 miles west of Providence, R.I. 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); 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. Due to its largely residential composition, its 10 leading taxpayers account for 7.2% of the grand list, representing a very diverse tax base in our opinion.

However, as the state has faced difficulty regaining its economic footing and the Norwich-New London metropolitan statistical area's gross domestic product (GDP) contracted by approximately 1.8% between 2010 and 2018, Norwich's economic indicators, including property tax and employment trends, were mixed in recent years. Following a sharp 24.8% decline in its grand list in 2013 (due to a property revaluation), Norwich has experienced modest–albeit steady–tax base growth over the last five years. The city also anticipates that the accelerating local real estate market coupled with new housing construction and commercial development over this period will yield favorable grand list growth subsequent to the Oct. 1, 2018 revaluation. Concurrently, the local unemployment rate (estimated at 5.3% in 2017) has remained above county (4.5%), state (4.7%), and national (4.4%) averages. However, the city estimates that the local unemployment decreased to 4.4% as of August 2018.

According to city officials, regional development continues to support offshoot commercial and residential activity in Norwich, particularly Mohegan Sun casino and Electric Boat. The Norwich Community Development Corp. (NCDC) maintains relationships with regional partners, which allows city officials to identify and attract potential developments that support the regional economy and Norwich's tax and employment base. One such ongoing development is Preston Riverwalk, approximately 693 acres south of the city available for development. The city is anticipating at least $200 million in development by the Mohegan for housing and entertainment purposes, which would provide additional employment opportunities for Norwich's residents, supporting the health of the local residential property market.

Therefore, we believe Norwich's improving grand list projections and steadying job market, which has shown signs of convergence with county, state, and national over the past year, are 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. Due to uncertainty of state aid over the past several years, finance officials closely monitor state budget information to conservatively estimate state aid revenue. It also monitors grand list growth to evaluate changes in local tax revenue and mill rate. During each fiscal year, Norwich monitors the budget regularly, reporting budget-to-actual results to the city council monthly. The city also adheres to state statutes governing investments and the management reports earnings and holdings to the city council quarterly.

Norwich maintains a strong focus on capital planning, evidenced by a five-year capital improvement plan (CIP) that identifies projects and costs across all departments. The town 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, which requires it to maintain a target fund balance between 12% to 17% of annual general fund expenditures. While Norwich's available fund balance reached 13.2% of general fund expenditures at fiscal year-end 2017, the city reduced the policy minimum level to 10% until 2022 to accommodate the use of fund balance, if necessary, to ease potential budget pressures over the next four fiscal years. The town 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 it stipulates 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 operating surpluses of 0.6% of expenditures in the general fund and of 0.6% across all governmental funds in fiscal 2017. For analytic consistency, we adjusted general fund performance to reflect recurring transfers out of the general fund to other governmental funds and capital outlay expenditures financed with bond proceeds. However, our assessment accounts for the fact that we expect near-term budgetary results to will reflect historically adequate performance levels relative to fiscal 2017 results.

We also adjusted total governmental funds and general fund results to account for the deferred pension payment of $2.02 million in fiscal 2017. 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, which intends to phase in its full actuarially determined contribution (ADC) over a five-year period, returning to 100% in fiscal 2020. With pension costs rising to nearly 6.7% of the operating budget, ongoing deferral of annual pension contributions could have medium- to long-term implications under a more constrained budgetary environment.

Despite its recent history of deferring annual pension contributions, we expect Norwich to maintain at least adequate budgetary performance over the next several years, due to management's frequent monitoring of budget performance and adjustment of expenditures to support historically balance operations. The city also benefits from an overall stable property tax base, which generated approximately 58.6% of general fund revenue in fiscal 2017. In addition, tax collections have remained strong with collections averaging 99% over the past five years. Intergovernmental (state) sources represent the second-highest share of general fund revenue at 38.2%, while charges for services and other local revenue constitute about 3.2%. However, as statutory aid makes up a significant component of Norwich's general fund revenue, we believe the city is more susceptible to performance volatility relative to other municipalities during an extended period of state fiscal uncertainty and moderate-to-severe state aid reductions, including education cost sharing (ECS) and other state grants.

Net of adjustments, Norwich recognized a $781,000 general fund surplus for fiscal 2017. Finance officials attribute the positive operating result to better-than-budgeted property and conveyance tax receipts and sewer assessment collections. Other areas of improvement include improved utility revenues, 10% of which Norwich Public Utilities (NPU) diverted to the city as stated in the city charter. These positive local revenue variances offset a nearly $361,000 reduction in statutory aid, particularly ECS and health services grants. At the same time, the city indicates that actual expenditures were lower-than-budget due to savings from unexpended general government, public safety, public works, and social services expenditures.

The state's budget impasse last year had a harmful effect on municipal finances entering fiscal 2018. While statutory aid cuts challenged most local government budgets in the state, Norwich recognized a $1.2 million reduction in this funding source. Within its budget in fiscal 2018, the city reduced expenditures to stabilize operations. This included a combination of expenditure savings and hiring freezes in the city and school budgets. Although officials tightened controls of spending throughout the year, officials estimate a $1.7 million deficit operating results at year-end.

The city adopted a balanced $119.3 million fiscal 2019 budget, which includes an appropriation of $200,000 in reserves. The budget conservatively estimates a $750,000 increase state funding based and includes a mill rate increase to 41.01 mills from 40.52 mills, which management expects will support year-over-year increases to employee salaries and benefits, pension costs, and education spending. Although early in the current budget year, officials generally expect local revenues to outperform the budget. While management indicates that it is working closely with the board of education to find additional cost savings to mitigate a $2.3 million mid-year budget gap due to higher special education, transportation, and benefit expenses, the city plans to continue identifying and adjusting expenditures as necessary to produce at least balanced results at fiscal year-end for non-education operations.

We also note that the city's largest collective bargaining contracts are current, reducing a potential area of cost uncertainty over the next two years. Despite potential state fiscal challenges entering the next biennium, which could contribute to future cuts to statutory aid to municipalities, we believe Norwich is likely to maintain at least adequate performance over our two-year outlook period.

Strong budgetary flexibility

Norwich's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2017 of 13.2% of operating expenditures, or $17.7 million.

While management has historically budgeted to appropriate available fund balance to balance operations, revenue and expenditures typically outperformed budget expectations, and the city reported positive operating results at fiscal year-end. Due to strong and positive budgetary performance in fiscal 2016 and 2017, Norwich improved its assigned and unassigned reserve position to approximately $17.7 million in fiscal 2017 from $10.4 million in fiscal 2015.

Unaudited year-end results estimate that the city will recognize a $1.7 million deficit in fiscal 2018, and we understand that assigned and unassigned reserves could decrease to nearly $16 million, or less than 12% of general fund expenditures. Although the city factored in the potential use of $200,000 fund balance in fiscal 2019. However, the city's reserve policy, which was revised in lieu of potential pressure from additional state funding shortfalls, stipulates that it maintain an unassigned fund balance of at least 10% of annual operating expenditures. Therefore, we expect the city's 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 24.6% of total governmental fund expenditures and 7x governmental debt service in 2017. In our view, the city has strong access to external liquidity if necessary.

In our view, Norwich has strong access to external liquidity, demonstrated by its regular issuance of GO bonds and notes over the past 20 years. In addition, the city does not engage in an 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. Therefore, in our opinion, Norwich is likely to maintain its very strong liquidity over 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 3.5% of total governmental fund expenditures, and net direct debt is 32.0% of total governmental fund revenue. Overall net debt is low at 1.9% of market value, which is in our view a positive credit factor.

Following the current bond and note issuance, Norwich will have approximately $64.6 million in total direct debt outstanding, of which $13.8 million is tax-secured enterprise debt that is self-supported by the net operating revenues of the city's utility system. Like most Connecticut municipalities, the city has no overlapping or underlying debt obligations.

As outlined in the city's CIP, Norwich could issue up to $5 million annually over the next two years for additional capital improvements for general government purposes. However, management indicates that the timing and magnitude of future debt issuances are dependent on the city's economic and fiscal conditions, and an assessment that the debt service payments are sustainable over the life of the bonds. Currently, about 53% of the direct debt is scheduled to be repaid within 10 years.

In our opinion, a credit weakness is Norwich's large pension and OPEB obligation. Norwich's combined required pension and actual OPEB contributions totaled 10.0% of total governmental fund expenditures in 2017. Of that amount, 6.7% represented required contributions to pension obligations, and 3.3% represented OPEB payments. The city made 82% of its actuarially determined contribution (ADC) in 2017, but management intends to increase contributions to the full ADC over the next two years.

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 July 1, 2018, the plan fiduciary net positions as a percentage of the total pension liability were 62.2% and 44.6%, respectively. The city's teachers participate in a state-administered Teachers' Retirement System, which the state contributes to on behalf of the city.

As of July 1, 2013, the city modified its assumptions to reduce the discount rate to 7.75% from 8.25% and changed the amortization from an open 30-year plan to a 20-year closed plan, reflecting more realistic market return assumptions and unfunded pension liability estimates.

While we believe the assumption changes were prudent, they increased Norwich's ADC substantially and led to the 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 2020. Norwich also provides a retiree health care plan and has an unfunded actuarial accrued OPEB liability of $41.63 million (July 1, 2017), and is 28% funded. It is also 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 believe the city has a credible plan to address the liability since contributions were the result of expected assumption changes, and management has a plan in place to fund its ADC fully. However, such contribution increases may pressure its ability to maintain balanced financial performance and sustain its reserves, which could become a credit pressure beyond the two-year outlook period.

Strong institutional framework

The institutional framework score for Connecticut municipalities is strong.

Outlook

The stable outlook reflects S&P Global Ratings' view of Norwich's good management practices and policies, and our expectation that the city will continue to monitor changes in local expenditures and state revenue trends and exercise necessary expenditure controls to maintain at least balanced budgetary performance and sustain flexibility at currently strong levels. The outlook also reflects our expectation that Norwich's wealth and income characteristics, although weak, will continue to benefit from anticipated economic development in the community that will likely support tax base expansion. For these reasons, we do not expect to change the rating over the two-year outlook period.

Upside scenario

We currently view the city as having limited-upside potential given its wealth and income levels that are below higher-rated peers, coupled with potential budgetary pressures that could stem from a less predictable state-funding environment and rising fixed costs associated with its pension and OPEB liabilities. Nevertheless, we could raise the rating if the city's wealth and income levels improve substantially and flexibility and liquidity were to significantly improve due to consistently strong budgetary performance

Downside scenario

We could lower the rating should the city experience sustained deterioration in budgetary performance–due to a decline in state aid, rising fixed costs, or otherwise–resulting in a decline of reserves to levels we no longer view as commensurate with 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.

Related Research

- 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 November 14, 2018)		
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.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.