

CREDIT OPINION

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Contacts

Isaac Rauch +1.212.553.4346
Associate Lead Analyst
 isaac.rauch@moody's.com

Thomas Jacobs +1.212.553.0131
Senior Vice President
 thomas.jacobs@moody's.com

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Americas 1-212-553-1653
Asia Pacific 852-3551-3077
Japan 81-3-5408-4100
EMEA 44-20-7772-5454

Colchester (Town of) CT

Update to credit analysis

Summary

Colchester (Aa3) has a moderately-sized, primarily residential tax base in east-central Connecticut. The town had a \$59 million revenue budget in fiscal 2017 and has a recent history of surplus operations, reflecting conservative fiscal management. The town has low debt and pension burdens and very affordable fixed costs, but is exposed to fiscal stress at the state level because of its above-average reliance on state funding.

On December 15, Moody's confirmed the town's general obligation rating at Aa3. That action concluded the review for possible downgrade initiated on October, 16, 2017. The review was prompted by the [State of Connecticut's](#) (A1 stable) then ongoing budget impasse and the significant cuts in state funding to the town of Colchester in the executive order, which governed spending during the impasse. The rating confirmation reflected the town's stable financial operations, wealth, and financial flexibility, as well as its above average mill rate and elevated exposure to state funding.

Credit strengths

- » History of balanced financial operations
- » Recent growth in fund balance and liquidity
- » Minimal fixed costs
- » Demonstrated willingness to increase taxes

Credit challenges

- » State funding represents 33% of annual revenues
- » Already lean operating profile
- » Above average mill rate

Rating outlook

Moody's does not typically assign outlooks to local government credits with this amount of debt outstanding.

Factors that could lead to an upgrade

- » Continued growth in fund balance
- » Expansion of tax base

Factors that could lead to a downgrade

- » Depletion of fund balance
- » Contraction of the tax base
- » Further cuts to state funding not offset by local revenues

Key indicators

Exhibit 1

Colchester (Town of) CT	2012	2013	2014	2015	2016
Economy/Tax Base					
Total Full Value (\$000)	\$1,768,925	\$1,681,199	\$1,713,187	\$1,683,452	\$1,686,096
Population	16,044	16,119	16,143	16,130	16,130
Full Value Per Capita	\$110,255	\$104,299	\$106,126	\$104,368	\$104,532
Median Family Income (% of USMedian)	159.6%	162.5%	164.7%	164.7%	164.7%
Finances					
Operating Revenue (\$000)	\$54,642	\$55,054	\$57,443	\$58,053	\$58,880
Fund Balance (\$000)	\$4,595	\$5,555	\$5,351	\$5,785	\$6,796
Cash Balance (\$000)	\$4,754	\$6,045	\$5,640	\$6,386	\$8,618
Fund Balance as a % of Revenues	8.4%	10.1%	9.3%	10.0%	11.5%
Cash Balance as a % of Revenues	8.7%	11.0%	9.8%	11.0%	14.6%
Debt/Pensions					
Net Direct Debt (\$000)	\$15,905	\$17,646	\$16,279	\$14,448	\$12,628
3-Year Average of Moody's ANPL (\$000)	\$371	\$523	\$677	\$1,181	\$1,841
Net Direct Debt / Operating Revenues (x)	0.3x	0.3x	0.3x	0.2x	0.2x
Net Direct Debt / Full Value (%)	0.9%	1.0%	1.0%	0.9%	0.7%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	0.0x	0.0x	0.0x	0.0x	0.0x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	0.0%	0.0%	0.0%	0.1%	0.1%

As of June 30 fiscal year-end

Source: Moody's Investor's Service; Town's Annual Financial Statements

Profile

The Town of Colchester is in east-central Connecticut, at the intersection of Connecticut's Route 2 and Route 11. The population is approximately 16,143.

Detailed credit considerations

Economy and tax base: stable tax base with above average wealth

Colchester's moderate \$1.7 billion, primarily residential tax base should remain stable in the near term, as management reports expansion among two of the town's major employers and small pockets of residential development. Including the results of a revaluation in fiscal 2016, the town's overall grand list has contracted 3.6% since 2010, a relatively modest decline compared to many Connecticut towns.

The town has raised its mill rate and levy in anticipation of the revaluation and to accommodate state funding uncertainty. Though the equalized mill rate is slightly above the median of Connecticut towns, Colchester believes it has further room to raise mill rates if necessary, as evidenced by recent voter authorization for new debt issuance.

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Colchester's tax base is supplemented by a strong median family income, which is 164.7% of the national median, a stable population, and a low unemployment rate of 3.2%. A combined 450 residents are employed by three midsize manufacturers within the town, and two, Incord and Alpha Q, are expanding operations in Colchester.

Financial operations and reserves: healthy financial position supported by conservative budgeting

Colchester's healthy and improved financial position is likely to remain stable in the near term based on the town's credible plan for addressing reductions in state funding and conservative budgeting practices, which have yielded three years of surplus operations.

Colchester is exposed to fiscal instability on the state level through its annual intergovernmental funding, which made up an above average 33% of 2016 revenues. Including November cuts, the state reduced Colchester's state funding allocation by \$1.7 million (11.8%) in fiscal 2018, largely through a reduction in the Education Cost Sharing payment.

During the state budget impasse, the town achieved cost savings by instituting a budget freeze, leaving town and Board of Education positions unfilled, and holding its motor vehicle tax until a higher mill rate had been approved by the state legislature. The fiscal 2018 Board of Education budget has been modified to absorb approximately half the reduction in state funding. The town expects positive revenue variances and the application of approximately 3% of the available operating fund balance to fill the remaining gap. Reserves will not dip below 2016 levels because of the town's fiscal 2017 surplus.

Colchester's financial operations have generally been balanced, and the town has used surpluses to add to fund balance in recent years. Available operating fund balance at the end of fiscal 2016 was 11.5%, in line with rating category medians. The town has achieved favorable expenditure variances through cuts to its Board of Education budget. While the town may be challenged to increase savings in its already lean operating profile, the town expects recurring revenue enhancements through higher conveyance taxes and building permit fees, as well as improved collection of delinquent taxes.

LIQUIDITY

Cash and investments at the end of fiscal 2016 totaled \$8.6 million, or an average 14.6% of operating revenues.

Debt and pensions: minimal fixed costs due to low debt and pension burdens

The town's below average debt burden and affordable fixed cost profile will remain stable in the near future, as the town has no major debt plans and very few employees covered by its small pension and OPEB plans.

The town had \$12.6 million in debt outstanding at the end of fiscal 2016 and increased its debt load through a \$9.5 million school construction BAN issuance after the end of the 2016 fiscal year. The town expects to roll this BAN over the next few years to maintain flexibility, as the project is coming in under budget.

DEBT STRUCTURE

The entire debt portfolio is fixed rate and amortization is rapid, with 98.3% of principal to be retired within ten years. Debt service in fiscal 2016 represented a below average 3.9% of operating expenditures.

DEBT-RELATED DERIVATIVES

The town is not party to any interest rate swaps or other derivative agreements.

PENSIONS AND OPEB

The town's minimal pension and OPEB obligations provide budget flexibility. The town has only one defined benefit plan, the Town of Colchester Police Department Retirement Plan, which is a now-closed single-employer plan covering 9 participants. In fiscal 2016, the town made \$105,755 in pension contributions to the plan and the three year average Moody's adjusted net pension liability, under Moody's methodology for adjusting reported pension data, is a very modest \$2.8 million. Moody's uses the adjusted net pension liability to improve comparability of reported pension liabilities. The adjustments are not intended to replace the town's reported liability information, but to improve comparability with other rated entities.

For teachers, the town participates in the State of Connecticut Teachers Retirement System. Employer contributions to the TRS are covered by on-behalf payments made by the state, which totaled \$4.5 million in fiscal 2017. The town's share of the TRS ANPL as of fiscal 2016 was \$53.1 million, representing 3.1% of full value.

The town funds OPEB on a pay-as-you-go basis through the budget, which cost \$213,180 in fiscal 2016, representing 36% of the town's ARC. The total unfunded liability is \$2.3 million as of July 1, 2013, the date of the most recent actuarial valuation.

Total fixed costs in 2016 including debt service, retirement contributions and retiree healthcare payments were \$2.6 million or a very low 4.4% of operating expenditures.

Management and governance: Cost-controls implemented by forward-looking management

Town fiscal management is strong, as evidenced by recent surpluses, expenditure controls, and a credible plan for addressing reductions in state funding.

Connecticut towns and cities have an Institutional Framework score of Aa, which is high compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. Connecticut towns' major revenue source, property taxes, is not subject to any caps. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally greater than 25% of expenditures. Connecticut has public sector unions and additional constraints, which limit the ability to cut expenditures. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

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