Moody's
INVESTORS SERVICE

Rating Update: MOODY'S DOWNGRADES THE TOWN OF COLCHESTER'S (CT) GENERAL OBLIGATION BONDS TO Aa3 FROM Aa2 AND REMOVES THE NEGATIVE OUTLOOK

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DOWNGRADE AFFECTS $21.1 MILLION IN OUTSTANDING GENERAL OBLIGATION DEBT

Municipality
CT

Opinion

NEW YORK, Jun 2, 2011 -- Moody's Investors Service has downgraded to Aa3 from Aa2 the rating on the Town of Colchester's (CT) general obligation bonds, affecting $21.1 million in outstanding general obligation debt. Concurrently, Moody's has removed the negative outlook. The bonds are secured by the town's unlimited general obligation tax pledge.

RATINGS RATIONALE

The downgrade to Aa3 from Aa2 reflects the town's moderately sized tax base with socioeconomic factors on par with state medians, narrowed financial position, and a manageable debt profile with average principal payout.

DETERIORATING FINANCIAL POSITION EXPECTED TO STABILIZE

The town's reserve levels have seen consistent decline in each of the past four fiscal years, ending in 2010 with a total general fund balance of $3.38 million or 7.0% of revenues, down from $6.00 million, or a healthier 13.3% of revenues in fiscal 2006. This decline was driven by Town's practice of appropriating General Fund reserves to balance annual operating budgets, and a failure to fully replenish those reserves. In addition to fund balance appropriations in 2008, 2009 and 2010 of $680,000, $600,000 and $220,000, respectively, the town received less than anticipated revenues from property taxes in each of those years. Importantly, the town implemented a 0.6 mill property tax increase in fiscal 2010, representing the first increase since 2006; although operating results posted a deficit of $311,757. The town holds $529,647 in capital reserves outside of the general fund; however these reserves are designated for specific purposes and are unavailable to be used for operations.

To date, near term projections indicate that fiscal 2011 will see a slight decline in total general fund balance to $3.08 million or 6.5% of General Fund revenues, which represents a $257,167 decline from 2010. Similar to prior years, this projected decline is due to a failure to replenish the $300,000 in reserves that were appropriated to balance the 2011 budget, as well as an unfavorable budget to actual variance for snow removal. Positively, the Town implemented a 1.42 mill levy increase. Property tax revenues are expected to exceed budgetary estimates by approximately $37,000, largely due strong collection rates. The proposed 2012 budget is a minimal 0.81% increase over 2011 and includes another property tax levy increase of 0.78 mills. Favorably, the structurally balanced 2012 budget does not include a fund balance appropriation. Moody's believes that this will help the town prevent an additional decline in reserves and stabilize its financial position.

TAX BASE GROWTH EXPECTED TO CONTINUE AT SLOWER RATE

Moody's expects continued, but slower growth for the $1.85 billion tax base, due to continued residential and commercial development. Colchester is located in New London County , approximately 25 miles south of Hartford (G.O. rated A1/stable outlook), and 15 miles west of Norwich (G.O. rated Aa2/no outlook). The town is primarily zoned residential, however, there is an important commercial presence, which includes several large retail centers that have been permitted and approved for construction. Residential growth is less robust, with just 7 single family home permits being issued in 2011. Wealth levels in the town are roughly on par with Connecticut medians, with per capita and median family incomes at 94.0% and 110.4% of the state, respectively.

MANAGEABLE DEBT BURDEN; FUTURE BORROWING PLANS COULD INCREASE LEVERAGE

Moody's expects the Town's debt profile to remain manageable in the near term, due to its minimal debt burden of 1.1%, and a slightly above average amortization rate, with 83.1% of principal retired in 10 years. The town is currently in the planning phases of a mixed use development that would include a new middle school, community center, and senior center all on the same site. While a definitive timeline and sizing has not been established, preliminary estimates are around $50 million, with the town share being closer to $26 million after state school reimbursement. This project could be brought to voters as early as late fiscal 2012. An additional borrowing of $26 million would more than double the town's debt burden, and potentially increase strain on town financial operations. It should be noted that the front loaded structure of the town's outstanding general obligation debt will result in annually decreasing debt service payments through the remaining life of the bonds. The decreasing debt service payments on the existing bonds will help to mitigate some of the pressures associated with an additional borrowing. Debt service as a percent of expenditures was a moderate 7.6% in fiscal 2010. All of the town's debt is fixed rate and the town is not party to any derivative agreements.

WHAT COULD CHANGE THE RATING- UP:

-Strengthening of reserve levels and improved liquidity position

- Return to and maintenance of structurally balanced operations

WHAT COULD DRIVE THE RATING- DOWN:

-Further deterioration of fund balance

-Significant increase in debt burden

-Significant declines in the town's grand list

KEY STATISTICS

2008 Equalized Net Grand List: $1.85 billion

Equalized Net Grand List per capita: $118,878

Equalized Net Grand List Five Year Average Annual Growth: 6.5%

Fiscal 2009 General Fund balance: $3.9 million (7.9% of General Fund Revenues)

Fiscal 2010 General Fund balance: $3.4 million (7.0% of General Fund Revenues)

2009 Overall Debt Burden: 1.1%

Principal Payout (10 years): 83.1%

1999 Per Capita Income (as % of CT and US): $27,038 (94.0% and 125.3%)

1999 Median Family Income (as % of CT and US): $72,346 (110.4% and 134%)

Total rated debt outstanding: $21.1 million

The principal methodology used in this rating was General Obligation Bonds Issued by U.S. Local Governments published in October 2009.

REGULATORY DISCLOSURES

Information sources used to prepare the credit rating are the following: parties involved in the ratings, parties not involved in the ratings, public information, and confidential and proprietary Moody's Analytics information.

Moody's Investors Service considers the quality of information available on the credit satisfactory for the purposes of maintaining a credit rating.

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