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## Summary:

# Colchester Town, Connecticut; General Obligation; Note

### Primary Credit Analyst:

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

### Secondary Contact:

Christian Richards, Boston (1) 617-530-8325; christian.richards@spglobal.com

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### Credit Profile

US\$12.0 mil GO bnds ser 2018 due 10/15/2045

*Long Term Rating*

AA+/Stable

New

US\$8.85 mil GO BANs ser 2018 dtd 10/17/2018 due 10/16/2019

*Short Term Rating*

SP-1+

New

## Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to Colchester Town, Conn.'s series 2018 general obligation (GO) bonds. The outlook is stable.

We also assigned our 'SP-1+' short-term rating to the town's series 2018 GO bond anticipation notes.

Colchester's full faith and credit pledge, payable from the levy of an unlimited-ad valorem tax on all taxable property in the town secures the series 2018 bonds and notes.

The short-term rating on the notes reflects our criteria for evaluating and rating BANs. In our view, Colchester maintains a very strong capacity to pay principal and interest when the notes come due. We view the town's market risk profile as low because it has strong legal authority to issue long-term debt to take out the notes and is a frequent debt issuer that regularly provides ongoing disclosure to market participants.

We understand that officials intend to use proceeds (approximately \$12 million) from the series 2018 bonds to provide permanent financing for renovations and improvements to the town's William J. Johnston Middle School project. Concurrently, officials intend to use series 2018 note proceeds (approximately \$8.85 million) to provide temporary financing for a portion of the abovementioned middle school improvements.

The rating reflects our opinion of the following factors for Colchester, specifically its:

- Strong economy, with market value per capita of \$107,766 and projected per capita effective buying income at 129% of the national level;
- Strong management, with good financial policies and practices under our Financial Management Assessment methodology;
- Strong budgetary performance, with a slight operating surplus in the general fund and an operating surplus at the total governmental fund level in fiscal 2017;
- Very strong budgetary flexibility, with an available fund balance that we expect will improve in the near term from its fiscal 2017 level of 11.4% of operating expenditures;

- Very strong liquidity, with total government available cash at 37.1% of total governmental fund expenditures and 11.6x governmental debt service, and access to external liquidity we consider strong;
- Very strong debt and contingent liability position, with debt service carrying charges at 3.2% of expenditures and net direct debt that is 41.8% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value; and
- Strong institutional framework score.

### **Strong economy**

We consider Colchester's economy strong. The town, with an estimated population of 16,084, encompasses 49.1 square miles in New London County. Colchester has a projected per capita effective buying income of 129% of the national level and per capita market value of \$107,766. Overall, the town's estimated full value has risen by a modest 1% over the past year to \$1.7 billion in 2019, and its net taxable grand list increased to approximately \$1.21 billion in the current tax year.

Colchester is a semi-rural and primarily residential community in eastern Connecticut, about 20 miles northwest of New London and 25 miles southeast of Hartford. Connecticut Route 2 traverses the town, connecting residents with regional employment opportunities. Although the state has struggled to regain its economic footing and the Norwich-New London MSA's gross domestic product (GDP) contracted by approximately 1.8% between 2010 and 2018, Colchester's overall economic and employment conditions have remained stable relative that of the regional labor market and the state. Historically, we believe that Colchester has maintained a local unemployment rate (estimated at 3.4% in 2017) that trends lower relative to county (4.5%), state (4.7%), and national (4.4%) averages.

Government and health care anchor Colchester's employment base, which also features manufacturing, commercial retail, and professional services. In addition to the town and board of education (523 employees), S&S Worldwide (225), Incord (220), Stop & Shop (162), and Genesis Health Care (150) make up the town's leading employers. The town reports overall stability among its leading employers and taxpayers in recent years, with a few employers expanding their facilities and workforces. Due to its largely residential composition, its 10 leading taxpayers account for 5.4% of total AV, representing a very diverse tax base in our opinion.

Management indicates that the town made recent efforts to develop a master infrastructure plan to anticipate future development needs, and implement land development regulations that support sustainable development and affordable housing in the community. The town indicates that several new residential and commercial developments could provide steady growth to the town's population and net taxable grand list over the near term. Notably, EverSource—in partnership with the state of Connecticut—is planning a new fuel cell and energy storage facility, which will expand its natural gas infrastructure further into eastern Connecticut. According to management, the expansion project will likely generate additional tax revenue for the town, but could also reduce energy costs for residents and businesses that could attract future development.

Based on our expectation that a modest uptick tax base growth will continue to support Colchester's stable underlying wealth and income conditions, we believe its economic profile will remain strong over the next two years.

## **Strong management**

We view the town's management as strong, with good financial policies and practices under our Financial Management Assessment methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Key budget development and monitoring practices include management's use of three years of historical data to forecast annual revenue and expenditure assumptions, and to identify any outlying line items. In preparation of its annual budget, management reviews each department's annual operation requests and prioritizes operating expenditures. Due to uncertainty of state aid over the past several years, finance officials consult state legislators to conservatively estimate revenue from this source. It also monitors grand list growth to estimate changes in local tax revenue and mill rate. During each fiscal year, the town monitors the budget regularly, reporting budget-to-actual results monthly. Furthermore, Colchester adheres to state statutes governing investments and reports earnings and holdings in its annual audit.

Colchester maintains a strong focus on capital planning, evidenced by a comprehensive 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 of all capital projects. Furthermore, management has historically met and sustained reserves in accordance with its fund balance policy. The formal policy calls for unassigned fund balance to be maintained at a minimum of 5% of annual operating expenditures (including debt service), but the town strives to maintain its fund balance between 7% and 10% of operating expenditures. The policy notes that this minimum reserve target assists with managing cash flows in the event of a revenue shortfall and unexpected changes in expenditures.

Although the town does not currently maintain a formal debt management policy or a long-term financial forecast, it does incorporate a debt service affordability analysis and project for specific budget items in its annual budget.

## **Strong budgetary performance**

Colchester's budgetary performance is strong in our opinion. The town had slight surplus operating results in the general fund of 0.8% of expenditures, and surplus results across all governmental funds of 1.7% in fiscal 2017. General fund operating results of the town have been stable over the last three years, with a result of 1.6% in 2016 and a result of 0.8% in 2015. For analytical consistency, we adjust operating results for recurring net transfers from the general fund to other governmental funds, as well as capital outlay expenditures paid with bond and note proceeds.

We expect Colchester to maintain strong budgetary performance over the next several years, largely due to its embedded budgeting development and monitoring framework, coupled with its manageable expenditure and fixed-cost profile. Like many municipalities in Connecticut, the school budget accounts for a significant portion of Colchester's total operating budget; we understand that Colchester has exhibited a collaborative relationship between its board of education and municipal government to develop, monitor, and make timely adjustments to the budget in a less predictable state aid environment. As we note in our commentary, titled "Not Just An Academic Exercise: New England School Districts, Municipalities Benefit From Integrated Financial Reporting," published Sept. 20, 2018, we generally view active collaboration between school district and local municipalities positively.

Furthermore, the town benefits from an overall stable and strong property tax base, which generated approximately

62% of general fund revenue in fiscal 2017. In addition, tax collections have remained strong with collections exceeding 98.5% over the past five years. Intergovernmental (state) sources represent the second-highest share of general fund revenue at 35.4%, while fees and permits constitute about 1.3%. With statutory aid making up more than one-third of the town's general fund revenue, however, we believe the town would still be somewhat more susceptible to performance volatility during an extended period of state fiscal uncertainty and moderate-to-severe state aid reductions, particularly education cost sharing (ECS) grants.

Colchester reported positive year-end general fund performance for fiscal 2017, which management attributed to better-than-budgeted local tax receipts and departmental revenue (including fees, licenses, and permits). Increases in these locally derived revenue sources offset a nearly \$106,134 decline in intergovernmental revenue. At the same time, the town recognized expenditure savings, totaling \$417,000, from unexpended department appropriations from its education, public safety, and general government line items.

The state's budget impasse last year, which extended four months into the 2018-2019 biennium had a direct and harmful effect on municipal finances entering fiscal 2018. While the likelihood of statutory aid cuts affects all local governments in the state, we believe Colchester demonstrated ample capacity within its budget in fiscal 2018 to raise local revenue and reduce expenditures to produce positive operations. For fiscal 2018, Colchester's general fund budget totaled \$55.34 million, representing a 2.3% increase over the previous year. The town increased its mill rate by 4.7% to 32.37 mills from 30.91 mills. Based on projected state aid reductions totaling \$1.77 million (largely ECS grants), the town also reduced spending through a combination of expenditure savings and hiring freezes in the town and school budget. Due to tight control of spending throughout the year, officials reported additional departmental cost savings; it also projects positive revenue variances from property taxes and departmental fees. The town conservatively estimates an approximately \$900,000 surplus at fiscal year-end.

The adopted fiscal 2019 budget is balanced, featuring a \$113,227 (or 0.77%) annual increase expenditures for municipal government and an \$87,061 (0.21%) decrease in education expenditures. Due to identified expenditure reductions and slight growth in the net taxable grand list, Colchester was able to reduce its mill rate to 32.28 mills from 32.37. Although early in the current budget year, officials generally expect local revenues to outperform the budget, and the town expects to identify and adjust expenditures as necessary to produce at least balanced results at fiscal year-end.

Despite potential state fiscal challenges entering the next biennium, which could contribute to future cuts to statutory aid to municipalities, we believe Colchester is likely to maintain stable and strong performance over our two-year outlook period.

### **Very strong budgetary flexibility**

Colchester's budgetary flexibility is very strong, in our view, with an assigned and unassigned fund balance that we expect could improve in the near term from its fiscal 2017 level of 11.4% of operating expenditures, or \$7.0 million.

Due to strong and positive budgetary performance over the past three fiscal years, Colchester improved its reserve position to approximately \$7.04 million from \$5.63 million in fiscal 2015. Unaudited year-end results estimate that the town will maintain positive operating performance in fiscal 2018, and we understand that assigned and unassigned reserves could be approximately \$8.3 million, or 16% of general fund expenditures. Based on management's general

expectation that Colchester will maintain at least balanced operations for fiscal 2019, with no planned draws on reserves over the next two years, we do not expect its available fund balance to fall below current levels.

Furthermore, the town's formal reserve policy stipulates that it maintain an unassigned fund balance of at least 5% of annual operating expenditures. Colchester strives to maintain an optimal fund balance between 7% and 10% of general fund expenditures, a target it has historically met and sustained. Therefore, we expect the town's flexibility to remain very strong over the next two years.

### **Very strong liquidity**

In our opinion, Colchester's liquidity is very strong, with total government available cash at 37.1% of total governmental fund expenditures and 11.6x governmental debt service in 2017. In our view, the town has strong access to external liquidity if necessary.

With the majority of Colchester's cash invested in money market funds, certificates of deposit, and the state investment pool, which maintain maturities of less than one year, we believe the town's investments are not aggressive. Furthermore, Colchester is a regular market participant that has issued debt periodically over the past 20 years, including GO bonds and notes.

Finance officials also confirmed that the town does not currently have any contingent liquidity risks from financial instruments with payment provisions that change on the occurrence of certain events. In addition, it does not currently have any variable-rate or direct-purchase debt. For these reasons, and given the strong and stable budgetary environment, we believe the town's liquidity profile should remain very strong.

### **Very strong debt and contingent liability profile**

In our view, Colchester's debt and contingent liability profile is very strong. Total governmental fund debt service is 3.2% of total governmental fund expenditures, and net direct debt is 41.8% of total governmental fund revenue. Overall net debt is low at 1.7% of market value, which is in our view a positive credit factor.

Following the current bond issue, Colchester will have approximately \$31.1 million of total direct debt outstanding, of which \$8.85 million are BANs. Furthermore, the town has neither overlapping nor underlying debt. Over the next two years, officials plan could issue approximately \$3.5 million for a new senior center ; however, we note that the town will form a building committee in spring 2019 to evaluate the project design.

Due to what we believe to be its low and affordable overall debt metrics, we do not expect Colchester's direct debt profile to change materially.

Colchester's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 0.4% of total governmental fund expenditures in fiscal 2017. The town made its full annual required pension contribution over the previous three years, including \$121,754 in fiscal 2017.

The town administers a defined-benefit pension plan—the police department retirement plan—which substantially covers all of its police employees. The plan is well funded with a net pension funded ratio of 80.1%, assuming a 7.5% investment rate of return. As of June 30, 2017, the town's net pension liability was \$506,384.

Colchester also provides OPEBs in the form of postretirement health care and life insurance benefits, in accordance with collective bargaining agreements. It is responsible for 40% to 50% of certain benefits for retired employees. The unfunded OPEB liability totaled \$5.57 million across all employee groups as of the latest valuation date (July 1, 2015). The town contributed \$531,897, or 35.5% of its annual required contribution. Furthermore, the town has taken some steps to control pension and OPEB liabilities, including increased employee contributions. We believe that the town's pension and OPEB benefits remain affordable; therefore, we expect Colchester will be able to manage long-term liabilities over the near- and medium-term.

### **Strong institutional framework**

The institutional framework score for Connecticut municipalities is strong.

We lowered our predictability subfactor twice over the past two years, based on our view that local governments are operating in a less predictable environment when budgeting and forecasting state revenue. This action resulted from delayed passage of the state's biennial budget in 2017, which slowed payments to local governments, led to a period of significant budgetary stress, forced municipalities to adopt 2018 budgets amid significant uncertainty. While we view the state's creation of the Municipal Accountability Review Board (MARB) in 2017 as a formal system support mechanism for identifying fiscal distress and providing assistance to municipalities, we continue to monitor MARB's efficacy and its potential effect on the legal and practical environment in which local governments operate in Connecticut. (For more information, see the article, titled "Connecticut Rating Actions Do Not Affect Strong Institutional Framework Score on Local Governments," published April 19, 2018, on RatingsDirect.)

## **Outlook**

The stable outlook reflects our expectation that Colchester will sustain good financial practices and policies that contribute to generally strong and predictable budgetary performance. It also represents our view that the town maintains sufficient capacity to adjust revenue and expenditures to mitigate downward pressure from an uncertain state fiscal environment, which will likely support Colchester's very strong liquidity and flexibility. The outlook also reflects our view of the town's overall strong underlying wealth and income levels, which will likely ensure credit stability. For these reasons, we do not expect to change the rating within our two-year outlook horizon.

### **Upside scenario**

If Colchester maintains consistently positive financial performance that supports sustained improvement in its reserves, while growing and diversifying locally generated revenue to reduce its moderate reliance on state aid, and exhibiting improved wealth and income levels that are commensurate with those of higher-rated peers, we could raise the rating.

### **Downside scenario**

We could lower the rating if the town were to experience a substantial weakening of budgetary performance, due to significant state aid reductions or otherwise, leading to a material decline of available reserves or constrained liquidity.

## **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

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