

# RatingsDirect®

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## Summary:

# Colchester, Connecticut; General Obligation; Note

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### Credit Profile

US\$7.04 mil GO bnds ser 2019 due 10/15/2045		
<i>Long Term Rating</i>	AA+/Stable	New
US\$2.845 mil BANs ser 2019 dtd 10/16/2019 due 10/15/2020		
<i>Short Term Rating</i>	SP-1+	New
Colchester Twn BANs ser 2019 dtd 10/16/2019 due 10/15/2020		
<i>Short Term Rating</i>	SP-1+	Affirmed
Colchester Twn GO bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Colchester Twn GO BANs		
<i>Short Term Rating</i>	SP-1+	Affirmed

## Rationale

S&P Global Ratings has assigned its 'AA+' long-term rating to Colchester, Conn.'s series 2019 general obligation (GO) bonds. We also assigned our 'SP-1+' rating to the town's series 2019 GO bond anticipation notes (BANs) due Oct. 15, 2020, and affirmed our 'SP-1+' rating on the town's existing short-term debt. At the same time, we affirmed our 'AA+' rating on the town's existing long-term debt. The outlook, where applicable, is stable.

### Credit summary

In our view, Colchester's strong financial operations evident by its continued positive general fund results and increases in available reserves over the past few years support the long-term ratings. Furthermore, we believe the town's strong management conditions and economy with manageable fixed costs also support its stable financial position.

### Security and use of bond proceeds

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 2019 bonds and notes. The short-term rating 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. The town has what we view as a low market risk profile, because it has strong legal authority to issue long-term debt to take out the notes and is a frequent issuer that regularly provides ongoing disclosure to market participants.

The town plans to use the bond proceeds to permanently finance a portion of its existing BANs. Note proceeds will be used to renew its remaining short-term debt.

The 'AA+' rating reflects our view of Colchester's:

- Strong economy, with market value per capita of \$108,869 and projected per capita effective buying income (EBI) at 120% of the national level;
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2018;
- Strong budgetary flexibility, with an available fund balance that we expect will improve in the near term from its fiscal 2018 level of 13.2% of operating expenditures;
- Very strong liquidity, with total government available cash at 27.3% of total governmental fund expenditures and 9.5x governmental debt service, and access to external liquidity that we consider strong;
- Very strong debt and contingent liability profile, with debt service carrying charges at 2.9% of expenditures and net direct debt that is 36.5% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of market value; and
- Strong institutional framework score.

### **Strong economy**

We consider Colchester's economy strong. The town, with an estimated population of 16,049, is in New London County. It has a projected per capita EBI of 120% of the national level and per capita market value of \$108,869. Overall, the town's market value grew 0.8% over the past year to \$1.7 billion in 2020. The county unemployment rate was 4.0% in 2018.

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.

The government and health care sectors 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 (243), Genesis Health Care (129), and Alpha Q (104) comprise the town's leading employers. Colchester reports overall stability among its leading employers and taxpayers in recent years, with a few expanding their facilities and workforces. Due to its largely residential composition, the town's 10-leading taxpayers account for 5.4% of total assessed value (AV), representing a very diverse tax base, in our opinion.

Management indicates 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. White Oak Farm, the town's largest permitted residential development, has a new phase of development that is currently underway. Northwoods Development has entered its final phase of construction, with 125 of the proposed 140 homes completed. The town's commercial sector is also expanding. About 25,000 square feet of commercial construction is underway with an additional anticipated 179,000 square feet that is undergoing planning and zoning approvals. These commercial projects include a convenience store, coffee shop, gas station at Westchester Village, a retail/commercial

facility in the town center, and a four-acre solar farm in the town's arterial/commercial zones, among others. The town has also permitted and construction is being or has been completed on approximately 28,700 square feet of redevelopment of previously existing but vacant commercial space in the past two years.

Based on our expectation that a modest uptick in tax base growth will continue to support Colchester's stable underlying wealth and income metrics, 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 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.

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, as 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. In addition, management has historically met and sustained reserves in accordance with its fund balance policy. The formal policy calls for Colchester to maintain unassigned fund balance at a minimum of 5% of annual operating expenditures (including debt service), but the town strives to maintain its fund balance between 7%-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 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 operating surpluses of 2.0% of expenditures in the general fund and of 2.7% across all governmental funds in fiscal 2018. General fund operating results of the town have been stable over the past three years, with a result of 0.8% in 2017 and 1.6% in 2016.

Fiscal 2018 results include adjustments for recurring transfers and one-time capital expenditures paid for with bond proceeds.

According to management, the fiscal 2018 positive financial performance was primarily due to the town's conservative budgeting practices even amidst midyear state revenue shortfalls as a result of late state budget adoptions, which resulted in unexpected state aid cuts for almost all Connecticut municipalities. Officials indicate the town was facing a

\$1.8 million shortfall in state aid midway through fiscal 2018. However, the town made the necessary budgetary adjustments on the expense side that netted about \$1.2 million in savings. The town also realized higher-than-budgeted revenues including building permits, investment income, ambulance revenues, and tax collections. For fiscal 2019, the town estimates to have ended the year with a \$732,000 general fund surplus also due to positive budget-to-actual revenue and expenditure variances including school department, public works, contingencies, as well as various revenue items.

The fiscal 2020 budget totals \$55.4 million, which represents a 1.85% increase over the previous year and no use of fund balance toward the budget. The budget also includes a 1.73% increase in the mill rate to 32.84 cents from 32.28 cents. Officials indicate the fiscal 2020 budget does not contain any major increases over the previous year, although the town was able to budget for new personnel and increases in enrollment at the school department. Overall, given Colchester's historically positive financial operations and balanced estimated results, we expect its budgetary performance to remain strong.

Property taxes account for 62% of general fund revenues, followed by intergovernmental, which includes on-behalf state payments for teachers' pension contribution, totaled 34%. Property tax collections have averaged 99% over the past three years.

### **Strong budgetary flexibility**

Colchester's budgetary flexibility is strong, in our view, with an available fund balance that we expect could improve in the near term from its fiscal 2018 level of 13.2% of operating expenditures, or \$8.1 million.

The town has maintained strong budgetary flexibility over the past three years. For fiscal 2019, management expects available reserves to improve by approximately \$732,000 to \$8.4 million. The town also did not appropriate fund balance into the fiscal 2020 budget and does not plan to draw down on reserves by fiscal year-end. We expect its budgetary flexibility to remain, at least, strong in the next several years.

Furthermore, Colchester's formal reserve policy stipulates that it maintain an unassigned fund balance of at least 5% of annual operating expenditures. Management strives to maintain an optimal fund balance between 7%-10% of general fund expenditures, a target it has historically met and sustained.

### **Very strong liquidity**

In our opinion, Colchester's liquidity is very strong, with total government available cash at 27.3% of total governmental fund expenditures and 9.5x governmental debt service in 2018. 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 have any contingent liquidity risks from financial instruments with payment provisions that change on the occurrence of certain events. In addition, the town does not 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 2.9% of total governmental fund expenditures, and net direct debt is 36.5% 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 \$30 million in total direct debt outstanding. Officials indicate the town does not plan to issue any additional debt over the next two-to-three years. According to management, the town is considering building a new senior center, however, this is still in the planning stages and any potential bonding for this project would not occur for several years.

Colchester's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 0.4% of total governmental fund expenditures in 2018. The town made 99% of its annual required pension contribution in 2018.

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 81.45%, assuming a 7.0% investment rate of return. As of June 30, 2018, the town's net pension liability was \$540,514.

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%-50% of certain benefits for retired employees. The unfunded OPEB liability totaled \$6.3 million across all employee groups as of the latest valuation date (July 1, 2017). Furthermore, the town has taken steps to control pension and OPEB liabilities, including increased employee contributions. We believe the town's pension and OPEB benefits remain affordable, therefore, we expect Colchester will manage long-term liabilities over the near and medium term.

### **Strong institutional framework**

The institutional framework score for Connecticut municipalities is strong.

## **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 and support its 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 and it exhibits 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's budgetary performance weakens substantially 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
- 2018 Update Of Institutional Framework For U.S. Local Governments

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