

CREDIT OPINION

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Norwich (City of) CT

Update following downgrade of GO rating to Aa3

Summary

The City of Norwich (Aa3) has a moderately-sized and rebounding tax base local to a number of large employers in New London County. The city has an adequate financial position supported by a recent history of surplus operations and affordable fixed costs, but faces revenue constraints in the near term due to above-average exposure to fiscal stress on the state level, a high tax rate, and reliance on annual transfers from a utility enterprise.

On January 29, Moody's downgraded the city's general obligation rating to Aa3 from Aa2.

Credit strengths

- » Adequate reserves and strong liquidity
- » Affordable fixed costs
- » Rebounding tax base, driven by private investment in New London County

Credit challenges

- » State funding represents 36% of annual revenues
- » Declining property tax revenues
- » Reliance on transfers from a self-supporting utility enterprise
- » Underfunding of pension obligations

Rating outlook

Outlooks are not typically assigned to local government credits with this amount of debt outstanding.

Factors that could lead to an upgrade

- » A trend of surplus operations, leading to an increase reserves
- » Reduced reliance on state aid as a revenue source
- » Realization of expected growth in the tax base

This report originally was published with an error in the Key Indicators exhibit. The report was corrected and republished.

Factors that could lead to a downgrade

- » Operating deficits, leading to a decline in reserves
- » Significant reduction in state aid
- » Continued underfunding of the pension liability

Key indicators

Exhibit 1

Norwich (City of) CT	2013	2014	2015	2016	2017
Economy/Tax Base					
Total Full Value (\$000)	\$2,432,705	\$2,936,728	\$2,574,692	\$2,670,158	\$2,707,001
Population	40,424	40,378	40,254	39,899	39,556
Full Value Per Capita	\$60,180	\$72,731	\$63,961	\$66,923	\$68,435
Median Family Income (% of USMedian)	91.0%	90.1%	88.2%	88.2%	88.2%
Finances					
Operating Revenue (\$000)	\$117,184	\$120,944	\$120,838	\$130,666	\$133,625
Fund Balance (\$000)	\$11,195	\$10,981	\$10,399	\$14,879	\$17,681
Cash Balance (\$000)	\$17,790	\$27,630	\$28,093	\$35,236	\$39,999
Fund Balance as a % of Revenues	9.6%	9.1%	8.6%	11.4%	13.2%
Cash Balance as a % of Revenues	15.2%	22.8%	23.2%	27.0%	29.9%
Debt/Pensions					
Net Direct Debt (\$000)	\$33,995	\$42,123	\$44,794	\$49,380	\$32,197
3-Year Average of Moody's ANPL (\$000)	\$115,009	\$144,950	\$142,901	\$158,088	\$153,268
Net Direct Debt / Operating Revenues (x)	0.3x	0.3x	0.4x	0.4x	0.4x
Net Direct Debt / Full Value (%)	1.4%	1.4%	1.7%	1.8%	1.9%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.0x	1.2x	1.2x	1.2x	1.1x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	4.7%	4.9%	5.6%	5.9%	5.7%

As of June 30 fiscal year-end

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

Profile

Norwich is a city of approximately 40,000 in southeastern Connecticut's New London County.

Detailed credit considerations

Economy and tax base: rebounding tax base with weak wealth levels

Located 15 miles north of the Long Island Sound at the intersection of Route 2 and I-395 in eastern Connecticut, Norwich's \$2.7 billion tax base has stabilized after a period of significant contraction. Management expects tax base growth in the near term due to significant ongoing residential development, made viable by recent private sector investment in surrounding towns.

Resident incomes are below average, reflected in median family income equal to 65.4% and 88.2% of the state and national medians, respectively. Norwich residents have access to employment opportunities at large casino complexes in nearby Ledyard (Foxwoods) and Montville (Mohegan Sun), as well as at nearby Coast Guard and U.S. Navy facilities and with related government contractors.

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Financial operations and reserves: revenue constraints mitigated by solid reserves

Norwich's financial position is supported by adequate reserves and strong liquidity, as well as a recent history of balanced or surplus operations. A projected fiscal 2018 operating deficit, driven by overbudgeted state aid, will require a modest draw on reserves. Norwich may face short-term challenges in returning to balanced operations because of its high tax rate and reliance on state aid revenues that are outside its control.

Norwich has a high equalized mill rate relative to other Connecticut municipalities, and city officials have sought to lower the mill rate in recent years. This has led to a small decline in property tax revenues that will exacerbate state aid reductions in the near term.

Norwich is exposed to fiscal instability on the state level through its annual intergovernmental funding, which made up an above average 36% of 2017 general fund revenues. While the state did not substantially reduce Norwich's aid allocation in the state budget or through the November municipal aid holdbacks, Norwich's reliance on intergovernmental aid reduces its control over its revenues and exposes it to future holdbacks if fiscal conditions on the state level do not improve. Positively, Norwich Public Schools is an Alliance District, a designation that has generally protected state Education Cost Sharing (ECS) aid from cuts.

Norwich also faces revenue constraints from its reliance on transfers from Norwich Public Utilities. NPU annually transfers 10% of gross revenues derived from gas, electric and water sales to the Norwich general fund and fire districts fund, a transfer that has amounted to 4-6% of general fund revenues in recent years. While NPU has a history of profitable operations, the recurring transfers reduce the city's control over its revenues.

LIQUIDITY

Cash and investments at the end of fiscal 2017 totaled \$40 million, or 29.9% of operating revenues. Cash is partly offset by a large interfund liability, and available fund balance totals \$17.7 million, or an adequate 13.2% of operating revenues.

Debt and pensions: affordable fixed costs and high pension liability

Norwich's average debt burden of 1.2% of full value will remain stable in the near future given minimal near-term debt plans and continued tax base growth. Norwich has issued public improvement bonds at regular intervals in recent years, but plans to postpone this year's issuance as it assesses the impact of fiscal stress on the state level. Norwich had \$32.2 million in outstanding GOULT debt at the end of fiscal 2017, and the city's fixed costs (inclusive of debt service, pension, and OPEB contributions) were 13% of operating revenues.

DEBT STRUCTURE

The entire debt portfolio is fixed rate with 75.8% of principal paid within ten years. Fiscal 2017 debt service represented \$5.7 million, or 4.4% of revenues.

DEBT-RELATED DERIVATIVES

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

PENSIONS AND OPEB

Norwich maintains two single-employer defined benefit pension plans, the City of Norwich Retirement System and the City of Norwich Volunteer Firefighter's Relief Plan, which together cover all employees with the exception of teachers and certain school administrators. The city's 2017 three-year average Moody's adjusted net pension liability, under Moody's methodology for adjusting reported pension data, is \$153.3 million, or an elevated 5.7% of equalized value.

In December 2014, the city adopted a pension contribution policy, intended to smooth out fluctuations in the actuarially required contribution (ARC) to its pension systems, requiring the city to contribute the ARC unless the amount varied by more than 15% from the prior year's ARC, in which case it would contribute up to (or down to) that level. As a result, the city has contributed \$1.6 million less than the ARC on average over the past three years.

For its teachers and school administrators, the city participates in the Connecticut Teachers Retirement System (TRS), employer contributions to which are covered by the state through on-behalf payments to the city. The city's share of the TRS' Moody's adjusted net pension liability is \$201.5 million, representing 7.4% of equalized value.

Positively, the city maintains an OPEB trust fund for retiree health benefits, and has contributed the 100% of the ARC (4.1% of fiscal 2017 revenues) in four consecutive years. The OPEB trust fund is funded with \$16.2 million in assets restricted for OPEB benefits.

Management and governance

Norwich's fiscal management has adopted conservative budgeting procedures and is in compliance with the city's fund balance policy, but is constrained to some extent by policies related to property taxes and pensions that could create budgetary stress for the city in the future.

Connecticut cities and towns have an institutional framework score of "Aa," or strong. Revenues are highly predictable and stable, due to a large reliance on property taxes. Cities additionally benefit from high revenue-raising ability due to the absence of a statewide property tax cap. Expenditures primarily consist of personnel costs as well as education costs for those cities that manage school operations, and are highly predictable due to state-mandated school spending guidelines and employee contracts that dictate costs. Expenditure reduction ability is moderate as it is somewhat constrained by union presence.

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