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Norfolk County

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Norfolk County

This report supplements our research update "Norfolk County 'AA-' Rating Affirmed On Exceptional Liquidity And Very Low Debt Burden," published on June 2, 2016. To provide the most current information, we may cite more recent data than that stated in the previous publication. These differences have been determined not to be sufficiently significant to affect the rating and our main conclusions.

Rationale

Issuer Credit Rating
AA-/Stable/--

The rating on Norfolk reflects S&P Global Ratings' view of the county's exceptional liquidity profile, very low debt burden and contingent liabilities, and average budgetary performance. The rating also reflects our view of the very predictable and well-balanced institutional framework for Canadian municipalities and satisfactory financial management. We believe that constrained and average budgetary flexibility and an average economic profile with limited growth prospects partially mitigate these strengths.

Norfolk maintained its average budgetary performance in 2014, posting an operating balance of 13% of adjusted operating revenues, down from 15% in 2013, and a deficit after capital accounts of 5% of adjusted total expenditures, also down from the balanced after capital accounts result of 0% recorded in 2013. In our base-case forecast, we expect operating balances to remain at similar levels but after capital deficits to average negative 8% of adjusted total spending in 2013-2017. While the county revised its 10-year capital program down to C$305 million, from C$424 million in the previous year, we expect 2015-2017 to be capital intensive.

This revised capital program results in a less-aggressive debt plan for the next two years, resulting in our view of a very low debt burden. The county plans to issue C$13 million of debt in 2016-2017 to fund part of its capital program. In our base-case forecast, we expect tax-supported debt to be less than 30% of adjusted operating revenues by 2017. Interest costs are low and we expect them to remain below 5% of adjusted operating revenues in the outlook horizon. We estimate that the county's tax-supported debt totaled C$36 million and accounted for about 24% of adjusted operating revenues as of year-end 2015 (Dec. 31).

Norfolk's contingent liabilities are what we view as very low at 15% of adjusted operating revenues in 2014 and consist primarily of standard employee benefits liabilities and landfill postclosure costs. The county does not have government-related entities, which, in our view, greatly reduces its exposure to contingent liabilities.

We believe Canadian municipalities benefit from a very predictable and well-balanced local and regional government framework that has demonstrated a high degree of institutional stability. Although provincial governments mandate a significant proportion of municipal spending, they also provide operating fund transfers and impose fiscal restraint through legislative requirements to pass balanced operating budgets. Municipalities generally have the ability to match expenditures well with revenues, except for capital spending, which can be intensive. Any operating surpluses typically fund capital expenditures and future liabilities (such as postemployment obligations and landfill closure costs) through reserve contributions.

Norfolk, in southern Ontario, has an average economic profile and relies mainly on manufacturing, agriculture, and tourism. We believe the county's economic growth prospects are limited compared with those of peers and reflect its weakening demographic profile. In our view, its above-average median age, modest population growth, and increasing dependent population will affect long-term labor availability and might hinder business investment. While GDP data are not available at the local level, we believe that Norfolk would generate GDP per capita below that of the province and below US$38,000, based on its lower income levels and lower value-added industries compared with those of peers.

In our base-case forecast, we expect Norfolk to maintain average budgetary flexibility and demonstrate modifiable revenues of more than 70% of adjusted operating revenues and capital spending of about 24% of adjusted total spending, on average, in 2013-2017. We believe the county's flexibility is constrained on the revenue side as a result of its high tax burden and lower household incomes compared with those of Ontario. Furthermore, Norfolk has limited ability to defer or cut operating expenditures, in our view and in line with domestic peers. This is because the province mandates provision of many services and the county's salary and benefit expenses are subject to collective agreements. Personnel costs accounted for 47% of adjusted operating spending in 2014. Capital spending was 22% of adjusted total spending in 2014, up from 18% in 2013, and we expect it to remain elevated, in line with the capital program in the outlook horizon.

In our view, Norfolk has satisfactory financial management practices that a knowledgeable and experienced team oversees. We consider that the management team has adequate expertise in implementing policy changes. In addition, adequate financial management accountability has been maintained throughout changes in administration. The county releases financial statements regularly, and they are independently audited with no qualifications. Norfolk also produces one-year operating tax- and rate-supported budgets and a 10-year capital program with the corresponding funding sources. The county approves budgets annually and we believe these are detailed, are transparent, and incorporate reasonable assumptions. A formal investment policy and internal debt guidelines support prudent debt and liquidity management, in our view.

Liquidity

Norfolk benefits from an exceptional liquidity position, in our view. We estimate its free cash and liquid assets (S&P Global Ratings-adjusted) to total C$74 million in 2016 and to cover more than 11x the estimated debt service for the year. This figure includes the balance of the legacy fund from the Norfolk Power Distribution Inc. sale totaling about C$69 million. Even if we believe that the county's reserve funds could come under pressure due to its capital commitments, we expect its debt service coverage ratio to remain well above 100% during the two-year outlook horizon. Similar to that of its peers, the county's access to external liquidity is satisfactory, in our view.

Outlook

The stable outlook reflects S&P Global Ratings' expectations that, within the two-year outlook horizon, Norfolk's budgetary performance will remain average and the county will maintain an exceptional liquidity position, with free cash and liquid assets of more than 100% of the next 12 months' debt service. We also expect tax-supported debt to remain below 30% of consolidated operating revenues.

We could raise the rating if there were sustained growth and diversification in the economy that could lead to improvement in budgetary performance with after capital deficits consistently below 5% of adjusted total revenues in the next two years. Conversely, we could lower the rating if deterioration in financial management practices led to a notable increase in after capital deficits to more than 10% of adjusted total revenues, on average, and significant growth in the debt burden to more than 60% of consolidated operating revenues. However, we view this scenario as unlikely in the next two years.

Canadian Municipalities Benefit From A Very Predictable And Well-Balanced Institutional Framework

We view the Canadian provincial-municipal intergovernmental system as being very predictable and well-balanced because of its maturity and stability, low-to-moderate degree of mismatching of revenues and expenditures, moderate levels of transparency and accountability, and strong likelihood of extraordinary support from provincial governments.

Provincial-municipal relationships have proven to be more dynamic than the federal-provincial one, largely because the municipal governments are established through provincial statute and not the constitution. Historically, the provinces have taken a more active role in municipal affairs than the federal government in provincial matters. Although there have been long periods of relative stability, provincially imposed large-scale changes to municipal revenue powers and expenditure responsibilities have occurred.

Provinces mandate a significant proportion of municipal spending and, through legislation, require municipalities to pass balanced operating budgets (although they also provide operating fund transfers). Nevertheless, municipalities generally have the ability to match expenditures well with revenues, except for capital spending, which can be intensive for some. Many have been limited in their ability to renew their infrastructure, roads, water, and wastewater, due to constraints on fee and property tax increases. Property taxes are the primary source of own-source revenues for Canadian municipalities, followed by fees and transfers from both the provincial and federal governments. Chief expenditure categories of Canadian municipalities are transportation services, which include roads and transit; environmental services, which include water distribution and treatment and wastewater collection; protection services such as fire and police; and recreation and cultural services. Small and rural municipalities generally receive higher provincial transfers, for both operating and capital programs, compared with those of their more urban counterparts, but there are no formal equalization schemes.

We believe financial information is quite timely. National accounting standards are strong and improving, in our view, although adoption can vary somewhat. Statutes require audited statements. While there are no national standards that apply to budgeting practices, a five-year capital budgeting process is usually the minimum. In addition, only current-year budgeting is required generally for operations.

The provinces have an established history assisting their distressed municipalities through grants.

Average Economic Profile

Norfolk is a rural municipality in southern Ontario. Its economy has traditionally centered on manufacturing and agriculture, while the tourism sector, wine tourism in particular, continues to expand. In our view, muted growth prospects continue to constrain local economy. Although GDP data are not available at the local level, we believe that Norfolk would generate GDP per capita below that of Ontario and below US$38,000, based on its lower income levels and lower value-added industries compared with that of peers.

Norfolk's existing industries are stable. Toyotetsu Canada Inc., an auto-parts manufacturer, is one of the county's major employers and continues to expand in the county. There has been increased demand for medical care in Norfolk in recent years and we expect more medical centers to open. Fanshawe College plans to revise its programs to focus on health care, personal care, and training for local manufacturing, to meet the needs of the local population and employers.

In our view, the county's demographic profile points to constrained growth. The population was 63,175 in 2011, up 2.8% from 2006, of which 19.3% was 65 and over. This is compared with Ontario's average of 15%. The median age increased to 46.1 from 43.4 in the five-year period, compared with the provincial average of 40.4 in 2011. The county is becoming increasingly popular as a retirement residence. We believe that these trends would result in a reduced labor pool and might hinder business investment. In addition, we view Norfolk's location as less favorable compared with that of peers, based on its relative remoteness from major cities and transport routes.

The unemployment rate varies through the year, having decreased to 7.7% in March 2016 from 10.1% in March 2015. The underlying trends are less favorable for Norfolk's long-term prospects. The labor force continues to shrink, either due to retirement or people exiting because of an inability to find work. Monthly caseloads decreased in 2015, averaging 1,412 cases in 2015 compared with 1,425 the year before. In the past 10 years, average monthly caseloads have increased 51%.

Satisfactory Financial Management

We believe Norfolk has satisfactory financial management and a knowledgeable and experienced management team. In our view, the management team has adequate expertise in implementing policy changes. In addition, financial management accountability has been adequately maintained throughout changes in administration. The county releases detailed financial statements on a timely basis and these are independently audited with no qualifications. It also produces annual tax- and rate-supported budgets and a 10-year capital program with the corresponding funding sources. On the operating side, Norfolk only budgets for the current year and does not produce long-term projections. Information in the budgets is comprehensive, is transparent, and reflects realistic and well-documented assumptions, in our view. The county has a formal investment policy and an internal debt limit. We view its debt and liquidity management practices as prudent. Nonetheless, internally generated funds continue to decline and could become cause for concern if the county does not take the necessary measures to restore the balances.

Operating Pressures Constrain Average Budgetary Flexibility

Norfolk has average budgetary flexibility with a history of healthy modifiable revenues, averaging more than 70% of adjusted operating revenues. In 2014, property taxes and user fees and service charges were the main sources of own-source revenues, accounting for 48% and 20% of adjusted operating revenues, respectively. In our view, the county's limited ability to raise own-source revenues and leeway to cut spending constrain its budgetary flexibility. In our base-case scenario, we expect modifiable revenues to average 76% of adjusted operating revenues and capital expenditures to average 24% of adjusted total spending in 2013-2017.

We believe the county's flexibility is constrained on the revenue side as a result the population's lower incomes compared with peers' and its above-average tax burden. We believe this could limit the magnitude of approved annual tax increases to meet the needs of the local population. Taxes increased 2.0% in the current budget, slightly below the 2.3% increment approved for the previous year.

Similar to other Ontario municipalities, Norfolk is also constrained on the spending side, because many of its services are provincially mandated and multiyear collective agreements cover all employees. Salaries and wages alone represented 47% of spending for the year. Furthermore, 79% of the 10-year capital program is for infrastructure replacement projects, which might be costlier to defer.

Capital plan

Capital spending was 22% of adjusted total spending in 2014 and we expect this ratio to average 26% in 2015-2017. Norfolk's 2016 capital budget totals C$46.3 million and consists largely of replacement projects related to roads, bridges, and wastewater operations. The county's revised 10-year capital program totals C$305 million, down from C$424 million in the previous program given the exclusion of the wastewater treatment plant. The program has peak annual spending in 2017 of C$48 million and is funded largely by reserves (82%), debt (9%), and external financing (4%).

Average Budgetary Performance

To improve comparability across local and regional governments globally, S&P Global Ratings adjusts the published figures of all municipalities to reflect their budgetary balances on a cash basis. This includes adjusting for major accruals; restating capital spending to a cash basis by removing the influence of capital amortization and net income of certain government business enterprises; and adjusting for one-time revenues.

Norfolk demonstrates average budgetary performance, in our view. We believe operating balances are strong and largely in line with those of other Canadian counties we rate. After-capital balances have been in a deficit, on average, since the recession and we expect them to remain elevated in the next three years in line with the county's capital program. In our base-case scenario, we expect operating balance to average 14% of adjusted operating revenues and after-capital deficit to average 8% of adjusted total revenues in 2013-2017.

The county's operating balance slightly decreased in 2014 mainly due to an increase in goods and services of C$5 million. This led to a surplus of 13% of adjusted operating revenues, down from the 15% the year before. Our base-case scenario considers that even when the tax increments for the following years might be similar to the ones council approved in 2016 and 2015 of 2.0% and 2.3%, respectively, operating pressures, in particular those related to personnel costs, will maintain the average operating surplus at 13% of adjusted operating revenues in 2015-2017.

An increase in capital expenditures led to an after-capital deficit of 5% of adjusted total revenues in 2014, down from a balanced result in the previous year. We expect after-capital deficits to average 12% in 2015-2017 given the county's capital program.

Exceptional Liquidity Profile

Norfolk's exceptional liquidity position bolsters the rating, in our view. At year-end 2015, the county's free cash and liquid assets (S&P Global Ratings-adjusted) were about C$69 million, including the balance of the legacy fund from the Norfolk Power Distribution Inc. sale. We expect these to total C$74 million in 2016 and cover more than 11x the estimated debt service in 2016. Even if we believe that the county's reserve funds could come under pressure due to its capital commitments, we expect its debt service coverage ratio to remain well above 100% during the two-year outlook horizon. Similar to that of its peers, the county's access to external liquidity is satisfactory, in our view.

Very Low Debt Burden

Following Norfolk's capital program revision, its debt plan for the following years is less aggressive than the one it had the year before. The county does not issue debt regularly and tax-supported debt has represented about 30% of consolidated operating revenues, on average, in the past decade. It plans to issue C$23 million of debt in 2016-2018. In our base-case forecast, we expect the county's tax-supported debt to remain below 30% of consolidated operating revenues by 2017, a level that we consider very low. We estimate that tax-supported debt totaled C$36 million and accounted for about 24% of adjusted operating revenues as of year-end 2015. Interest costs are low and we expect them to remain below 5% of adjusted operating revenues in the outlook horizon. Unfunded pension obligations are not significant, accounting for less than 1% of adjusted operating revenues.

Very Low Contingent Liabilities

Norfolk has standard future employee benefits and obligations and landfill postclosure costs that totaled about 15% of 2014 adjusted operating revenues. We view these as not significant for the rating and low risk.

The county does not have government-related entities, which greatly reduces its exposure to contingent liabilities and improves its overall credit profile, in our view.

Ratings Score Snapshot

Table 1

Rating Score Snapshot	
Key Rating Factors	**Assessment**
Institutional Framework	Very predictable and well-balanced
Economy	Average
Financial Management	Satisfactory
Budgetary Flexibility	Average
Budgetary Performance	Average
Liquidity	Exceptional
Debt Burden	Very Low
Contingent Liabilities	Very Low

*S&P Global Ratings' ratings on local and regional governments are based on eight main rating factors listed in the table above. Section A of S&P Global Ratings' "Methodology For Rating Non-U.S. Local And Regional Governments," published on June 30, 2014, summarizes how the eight factors are combined to derive the government's foreign currency rating.

Key Statistics

Table 2

Norfolk County -- Economic Statistics					
	--Year ended Dec. 31--				
	2010	**2011**	**2012**	**2013**	**2014**
Population	63,052	63,175	63,175	63,175	63,175
Population growth (%)	0.2	0.2	0.0	0.0	0.0

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. Sources typically include national statistical offices.

Table 3

Norfolk County -- Financial Statistics						
	--Year ended Dec. 31--					
(Mil. C$)	**2012**	**2013**	**2014**	**2015bc**	**2016bc**	**2017bc**
Operating revenues	144	148	151	153	155	159
Operating expenditures	124	126	131	132	136	139
Operating balance	20	22	20	21	20	21
Operating balance (% of operating revenues)	14.1	15.0	13.5	13.9	12.7	12.9
Capital revenues	2	5	8	10	9	7
Capital expenditures	27	27	37	52	46	48
Balance after capital accounts	(5)	0	(9)	(21)	(18)	(20)
Balance after capital accounts (% of total revenues)	(3.4)	0.0	(5.4)	(12.7)	(10.9)	(12.0)
Debt repaid	8	4	4	4	4	5
Net budget loans	N/A	N/A	N/A	N/A	N/A	N/A
Balance after debt repayment and onlending	(13)	(4)	(12)	(25)	(22)	(25)
Balance after debt repayment and onlending (% of total revenues)	(8.6)	(2.5)	(7.8)	(15.2)	(13.6)	(15.0)
Gross borrowings	3	6	0	0	1	12

Table 3

Norfolk County -- Financial Statistics (cont.)						
	--Year ended Dec. 31--					
(Mil. C$)	**2012**	**2013**	**2014**	**2015bc**	**2016bc**	**2017bc**
Balance after borrowings	(9)	2	(12)	(25)	(21)	(13)
Operating revenue growth (%)	3.4	2.3	2.3	1.4	1.4	2.5
Operating expenditure growth (%)	1.4	1.2	4.2	0.9	2.9	2.2
Modifiable revenues (% of operating revenues)	73.4	73.5	74.3	75.6	76.8	77.3
Capital expenditures (% of total expenditures)	17.9	17.7	22.1	28.2	25.4	25.6
Direct debt (outstanding at year-end)	42	44	40	36	32	40
Direct debt (% of operating revenues)	28.8	29.7	26.5	23.5	20.9	24.9
Tax-supported debt (% of consolidated operating revenues)	28.8	29.7	26.5	23.5	20.9	24.9
Interest (% of operating revenues)	1.5	1.2	1.2	1.1	1.3	1.3
Debt service (% of operating revenues)	6.7	3.9	3.8	3.7	4.1	4.4

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. Base case reflects S&P Global Ratings' expectations of the most likely scenario. Downside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with a downgrade. Upside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with an upgrade. N/A--Not applicable.

Key Sovereign Statistics

Sovereign Risk Indicators, May 3, 2016. Interactive version available at www.spratings.com/SRI.

Related Criteria And Research

Related Criteria

- Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014
- Methodology And Assumptions For Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs, Oct. 15, 2009
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- 2014 Annual International Public Finance Default Study and Rating Transitions, June 8, 2015

Ratings Detail (As Of June 8, 2016)	
Norfolk County	
Issuer Credit Rating	AA-/Stable/--
Issuer Credit Ratings History	
18-Jun-2015	AA-/Stable/--
24-Jun-2014	A+/Stable/--
04-Jun-2013	A/Positive/--

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.