S&P Global
Ratings

RatingsDirect®

Research Update:

Norfolk County 'AA-' Long-Term Issuer Credit Rating Affirmed; Outlook Stable

Primary Credit Analyst:
Hector Cedano, Toronto (1) 416 507 2536; hector.cedano@spglobal.com

Secondary Contact:
Dina Shillis, CFA, Toronto (416) 507-3214; dina.shillis@spglobal.com

Table Of Contents

Research Update:

Norfolk County 'AA-' Long-Term Issuer Credit Rating Affirmed; Outlook Stable

Overview

- We expect Norfolk County's debt burden to increase as a result of higher capital expenditures in 2018 and 2019 with debt service coverage ratios remaining above 100%.
- We are affirming our 'AA-' long-term issuer credit on Norfolk County.
- The stable outlook reflects our expectation that Norfolk will maintain very large cash balances, deficits after capital accounts will remain below 10% of adjusted total revenues, and tax-supported debt will remain below 45% of adjusted operating revenues in 2017-2019.

Rating Action

On June 16, 2017, S&P Global Ratings affirmed its 'AA-' long-term issuer credit rating on Norfolk County, in the Province of Ontario. The outlook is stable.

Outlook

The stable outlook reflects S&P Global Ratings' expectations that, as a result of its expanding capital plan, Norfolk will post deficits after capital accounts of 7% of adjusted total revenues on average in 2018 and 2019. We expect its tax-supported debt will increase, but remain below 45% of adjusted operating revenues through 2019. We estimate debt service coverage ratios will remain above 100% in the next two years.

Downside scenario

We could take a negative rating action if a more aggressive capital plan led to increased tax-supported debt to more than 60% of consolidated operating revenues coupled with erosion in debt service coverage to less than 100%. However, we view this scenario as unlikely in the next two years.

Upside scenario

We could take a positive rating action if revenue flexibility improves from the limited ability and willingness to adjust modifiable revenues or after capital budgetary performance strengthens such that after capital deficits are consistently below 5% of adjusted total revenues.

Rationale

We have updated our base-case scenario for Norfolk County and extended our forecast horizon through fiscal 2019. For 2017-2019, we estimate operating balances will remain stable and that capital expenditures will grow after 2017, which will increase the county's deficits after capital accounts. We expect Norfolk to issue about C$45 million of debt in the next three years to fund part of its capital program. Nevertheless, we believe the debt burden is mitigated by the county's high operating balances and we estimate debt service coverage ratios will remain above 100% in our forecast horizon. While we expect that the county will continue to benefit from a supportive institutional framework and from sound financial management, we believe that Norfolk's economic profile, which reflects limited growth prospects, partially mitigates these strengths.

Financial management is satisfactory and institutions remain broadly supportive while the economy shows limited growth prospects compared with those of peers.

Norfolk, in southern Ontario, relies mainly on manufacturing, agriculture, and tourism. Although municipal GDP data are unavailable, we estimate that in 2014-2016, Norfolk generated average GDP per capita below that of the province and below the threshold of US$38,000, as per our criteria, based on its lower income levels and lower value-added industries compared with those of peers.

We believe that Norfolk's demographic profile constrains its economic growth prospects. Its population stood at 64,044 in 2016, up 1.4% since 2011. Population aged over 55 represented 40% of total population in 2016, up from 35% in 2011. In addition, the average age of the population was 44.5 in 2016, higher than the provincial average age of 41.0. The county is becoming increasingly popular as a retirement residence. We believe that these trends could negatively affect the labor pool and hinder investment in Norfolk. In addition, we consider its location as less favorable compared with that of peers, based on its relative remoteness from major cities and transport routes.

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. Senior staffing has been relatively stable and we expect no significant turnover in the near term, which we believe lends stability to the credit profile. The county presents a one-year detailed tax-supported operating budget. It continues to produce a one-year rate-supported operating budget, and 10-year tax- and rate-supported detailed capital plans, with the corresponding funding sources. We believe debt and liquidity management remains prudent, supported by a formal investment policy and an internal conservative debt limit.

We believe Canadian municipalities benefit from a very predictable and well-balanced institutional 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.

Growing capital plan will result in higher deficits after capital accounts in 2018 and 2019 with debt issuance expected in the next three years to fund part of the projects.

In our base-case scenario, we expect modifiable revenues to average 75.4% and operating balances to remain at 14.6% of adjusted operating revenues on average in 2015-2019. With capital expenditures of C$41 million or 22.8% of total expenditures on average, we estimate the county will post a deficit of 6.5% of total revenues on average in 2015-2019. These deficits will fluctuate with the capital plan and will be higher in 2018 and 2019. The county plans to issue debt in each of the next three years to fund part of its capital projects.

We expect Norfolk's tax-supported debt to increase to 43.1% of consolidated operating revenues at year-end 2019, up from 32.9% at year-end 2015. Norfolk plans to issue about C$45 million in 2017-2019. The county's tax-supported debt is less than three years of operating surpluses, which mitigates our assessment of the county's debt burden. Interest costs accounted for 0.9% of adjusted operating revenues in 2015 and we expect them to remain below 2% during the two-year outlook horizon.

We believe Norfolk's budgetary flexibility is constrained by its limited ability and willingness to adjust modifiable revenues as a result of its above-average tax burden and the population's lower income levels compared with those of peers. In our opinion, this could limit the magnitude of approved annual tax increases to meet the needs of the local population. Property taxes increased 2.2% in the current budget, slightly above the 2.0% increment approved for the previous year.

Similar to other Ontario municipalities', Norfolk's budgetary flexibility is also constrained by its limited ability to cut expenditures because the province mandates the provision of most services. In addition, personnel costs accounted for 50% of adjusted operating spending in 2015, and much of these are subject to collective agreements. In addition, 83% of Norfolk's 10-year capital plan relates to infrastructure replacement projects, which might be costlier to defer.

In our view, Norfolk's liquidity bolsters the rating. We estimate its free cash and liquid assets to total C$66.0 million in 2017 and to cover more than 8x the estimated debt service for the year. We expect this ratio to remain well above 100% during the outlook horizon. Similar to that of its domestic peers, the county's access to external liquidity is satisfactory, in our view.

Norfolk's contingent liabilities consist primarily of standard employee benefits liabilities and landfill post-closure costs and represented 15.1% of adjusted operating revenues in 2015. The county does not have government-related entities, which greatly reduces its exposure to contingent liabilities and, in our view, improves its overall credit profile.

Key Statistics

Table 1

Norfolk County -- Selected Indicators

	--Fiscal year ended Dec. 31--					
(Mil. C$)	**2014**	**2015**	**2016bc**	**2017bc**	**2018bc**	**2019bc**
Operating revenues	151	153	156	160	163	167
Operating expenditures	131	130	133	136	140	143
Operating balance	20	23	23	23	24	24
Operating balance (% of operating revenues)	13.5	14.9	14.6	14.5	14.4	14.5
Capital revenues	8	6	6	5	8	8
Capital expenditures	37	53	34	28	45	44
Balance after capital accounts	(9)	(24)	(5)	0	(13)	(12)
Balance after capital accounts (% of total revenues)	(5.4)	(14.9)	(3.3)	0.1	(7.7)	(6.7)
Debt repaid	4	4	4	5	6	7
Gross borrowings	0	14	0	19	9	17
Balance after borrowings	(12)	(13)	(10)	14	(10)	(2)
Modifiable revenues (% of operating revenues)	74.3	74.4	74.9	75.4	76.0	76.5
Capital expenditures (% of total expenditures)	22.1	28.8	20.5	17.0	24.4	23.6
Tax-supported debt (outstanding at year-end)	40	50	46	60	62	72
Tax-supported debt (% of consolidated operating revenues)	26.5	32.9	29.3	37.3	38.2	43.1
Interest (% of operating revenues)	1.2	0.9	1.2	1.3	1.5	1.5
National GDP per capita (single units)	55,792	55,405	55,857	57,465	59,005	60,636

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. bc--Base case.

Ratings Score Snapshot

Table 2

Norfolk County -- Ratings Score Snapshot

Key Rating Factors	**Assessment**
Institutional Framework	Very predictable and well-balanced
Economy	Average

Table 2

Norfolk County -- Ratings Score Snapshot (cont.)

Key Rating Factors	Assessment
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 Sovereign Statistics

Sovereign Risk Indicators, April 10, 2017. Interactive version available at http://www.spratings.com/sri

Related Criteria

- Criteria - Governments - International Public Finance: Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014
- Criteria - Governments - International Public Finance: 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
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Public Finance System Overview: Canadian Municipalities, Dec. 1, 2016
- Institutional Framework Assessments For Non-U.S. Local And Regional Governments, April 21, 2016

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion.

The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria and Research').

Ratings List

Ratings Affirmed

Norfolk County	
Issuer Credit Rating	AA-/Stable/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.