STANDARD & POOR'S RATINGS SERVICES
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Supplementary Analysis:
Norfolk County

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Supplementary Analysis:

Norfolk County

This report supplements our research update "Norfolk County Ratings Raised To 'A+' From 'A' On Improved Management Practices; Outlook Stable," published June 24, 2014. 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
A+/Stable/--

The rating on Norfolk County, in the Province of Ontario, reflects Standard & Poor's Ratings Services' view of the county's healthy budgetary performance, positive liquidity, and moderate debt burden. The rating also reflects our view of the "predictable and well-balanced" institutional framework for Canadian municipalities, limited contingent liabilities, and financial management that has a neutral impact on the credit profile. We believe that volatile after-capital deficits, constrained budgetary flexibility, and limited economic growth prospects partially mitigate these strengths.

In our view, Norfolk's economy is somewhat narrower than that of some peers, relying largely on manufacturing, agriculture, and tourism. Although municipal GDP data are not available, we believe that the county generated GDP per capita below that of the province (approximately US$49,000, based on the average of 2011-2013 data, as per our criteria). In addition, we estimate Norfolk's average household income to be below that of Ontario. We believe that economic problems related to very modest population growth, higher median age, and greater share of dependent population than those of the province could limit the county's economic performance in the next two years.

In our view, Norfolk has sound financial management practices that have a neutral impact on the credit profile. The county has improved the timing of the release of its audited financial statements in the past several years, and this is now in line with that of its peers. Financial statements are independently audited with no qualifications. Norfolk also produces a one-year detailed operating budget and a 10-year capital plan, with the corresponding funding sources. We believe that debt and liquidity management remain prudent.

We believe Canadian municipalities benefit from a 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.

In our view, Norfolk has moderate budgetary flexibility. It had modifiable revenues of about 73% of adjusted operating revenues in 2012, in line with the historical average, and we expect this to remain stable in the next two years. The county's budgetary flexibility is constrained on the revenue side as a result of its high tax burden and our opinion of

Norfolk's lower average household income compared with that of Ontario. Furthermore, the county has limited ability to defer or cut operating expenditures, in our view, because much of its salary and benefit expenses are subject to collective agreements. Personnel costs were more than 47% of adjusted operating expenses in 2012. Capital spending was close to 18% of total expenditures in 2012 and we expect it to average about 20% from 2011-2015, under our base-case forecast.

Norfolk continues to produce what we view as healthy operating surpluses and moderate after-capital deficits. In 2012, it posted an operating balance of 14.1% and after-capital deficit of 3.4% of adjusted operating and total revenues, respectively. We expect Norfolk's budgetary performance to wane over the next two years as a result of lower expected grants and water and wastewater fees as well as rising operating cost pressures, largely due to personnel costs. The county's after-capital deficit remains volatile and we expect it to widen in the next two years, in line with the county's capital program. Under our base-case forecast, we expect operating balances to remain at greater than 13% of adjusted operating revenues, based on a five-year average from 2011-2015; and after-capital balances to remain in a deficit, at more than 3% of adjusted total revenues.

We believe Norfolk has a moderate debt burden. As of year-end 2013, its tax-supported debt totaled about C$44 million, or an estimated 30% of consolidated operating revenues. We expect the debt burden to rise in the medium term as a result of issuance for the county's increasing capital program. Norfolk issued C$6.1 million in 2013 and plans to issue more than C$60 million from 2014-2016 to fund capital expenditures. We expect the county's debt burden to remain below 60% of consolidated operating revenues in the next two years and interest costs to be less than 5% of adjusted operating revenues, under our base-case scenario.

Norfolk's contingent liabilities are limited, in our view, representing about 15% of 2012 adjusted operating revenues. The county is selling Norfolk Power Inc. and remains contingently liable for the company's debt until the sale is final. Officials expect the sale to close by the fall of 2014.

Liquidity

Norfolk benefits from a strong liquidity position that is positive to the rating, in our view. At year-end 2013, its free cash and liquid assets were an estimated C$32 million (Standard & Poor's-adjusted) or more than 500% of the next 12 months' debt service. We expect liquidity to fall as Norfolk draws on its reserves for higher planned capital expenditures in the coming years. Nevertheless, we expect liquidity to remain at healthy levels and its debt service coverage to remain well above 100% during our outlook horizon. Similar to that of its peers, the county's access to external liquidity is satisfactory, in our opinion.

Outlook

The stable outlook reflects Standard & Poor's expectations that, within the two-year outlook horizon, Norfolk will continue to generate robust operating performances and maintain positive liquidity, with free cash and liquid assets exceeding 100% of next 12 months' debt service. We also expect that the county will maintain reasonable debt issuance prospects. We could raise the rating once the sale of Norfolk Power Inc. is realized, to the extent that this results in reduced contingent liabilities to the county and possible improvement in liquidity levels. Although unlikely within the next two years, downward pressure on the rating could result from material deterioration in budgetary performance, worsening management practices, and erosion of liquidity levels to a debt service coverage ratio of less than 100%.

Ontario Municipalities Benefit From A Well-Balanced And Predictable Institutional Framework

We view the Canadian provincial-municipal intergovernmental system as being "well-balanced and predictable" 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.

Economic Profile

Norfolk's economic performance has been showing signs of improvement in recent years, but we believe there are constraints that somewhat limit its growth prospects.

Although municipal data is not available, we believe that Norfolk would generate GDP per capita below that of Ontario which is more than US$49,000 (based on the average of 2011-2013 data, as per our criteria). Furthermore, we believe that its median household income is below that of Ontario.

The county's economy is traditionally based on manufacturing and agriculture, and thus, is somewhat narrower than that of peers. Toyotetsu Canada Inc. (an auto-parts manufacturer), one of the county's largest employers, is currently undergoing an expansion plan, which it expects will double production capacity and add about 150 jobs to the economy. Norfolk has also experienced new investment in the retail sector in recent years, as well as growing development in the wine and beer industries.

Norfolk has a population of 63,175, according to the 2011 Census data. This represents less 1% growth since 2006, well below the Ontario average growth of 4.8% for the five-year period. We expect population growth to remain modest in the outlook horizon. Given this modest growth and Norfolk's aging population (which is in line with that of many other Ontario municipalities), the county could face a shrinking labor force participation ratio in the next few years.

In our view, construction activity was strong in 2013. Building permits totaled more than C$103 million, an increase of more than 22% from 2012. Increased development in the residential sector is the main reason for the rise. As the economy slowly rebounds and consumer confidence grows, investment in real estate follows suit. Moreover, the aging population will increase demand for senior housing communities in the county.

Financial Management Continues To Develop

We believe Norfolk's financial management is credit neutral. The county has improved the timing of the release of its audited financial statements in the past several years, and this is now in line with that of its peers. Financial statements are independently audited with no qualifications. We view them as reasonably comprehensive and transparent. On the operating side, the county budgets only for the current budget year and does not provide a medium-term outlook. Operating budget information, however, is detailed and comprehensive. In addition, the county produces a detailed 10-year capital plan, with the corresponding funding sources. Norfolk has a formal investment policy and an internal conservative debt limit. We believe that debt and liquidity management remains prudent. The management is also working on an informal succession plan to mitigate the impact of expected staff turnover at the senior level in the next two years.

Operating Pressures Constrain Budgetary Flexibility

Norfolk has moderate budgetary flexibility, in our view. Under our base-case forecast, we expect its modifiable revenues to remain above 70% of adjusted operating revenues and capital expenditures to represent about 20% of total spending, on average, for the next two years. The county's modifiable revenues represented 73% of adjusted operating revenues in 2012 and have been more than 70%, on average, in the past few years. Norfolk's main revenue sources are property taxes (46%) and user charges (21%). Capital spending accounted for close to 18% of total spending in 2012, slightly below the five-year average of 20%.

In our view, the county's budgetary flexibility is constrained on the revenue side. Municipal sources suggest that

Norfolk has a comparatively high total municipal tax burden of 5.2% relative to income. The high tax burden, coupled with the county's comparatively low average household income, restricts the county's ability to raise modifiable revenues.

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. The county's largest operating expenses are social welfare, protection, and transportation services, accounting for 48% of adjusted operating expenses in 2012. Personnel costs alone were more than 47% of adjusted operating expenses for the year. Notably, Norfolk will face increasing operating pressure from upcoming union settlements at the end of 2014, including the police services contract.

Growing capital plan

Norfolk's 2014-2023 capital plan amounts to about C$400 million, C$74 million higher than last year's plan. The increase is largely a result of C$47 million in new initiatives starting in 2018. The county is considering a potential new water treatment plant or an expansion to the Nanticoke Water Treatment Plant in Haldimand County. Norfolk would then construct feeder mains and connections to the existing plant to service its urban centers. The remainder of the increase is for capital replacement projects, which are mainly road related. Conversely, some of the solid waste management projects for the Canborough Landfill site that are no longer required have been removed from the plan. The 2014 capital budget includes about C$33 million in spending.

The plan is currently largely funded through reserves. We expect the county to rely more on debt financing if it begins the water treatment plant project.

Volatile After-Capital Balances Offset Healthy Budgetary Performance

To improve comparability across local and regional governments globally, Standard & Poor's 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's budgetary performance remains healthy, in our view. Its operating balance increased to 14% of adjusted operating revenues in 2012, reflecting stable property tax revenues and above-average growth in water and wastewater (WW) user fees and charges. We expect operating performance to moderate in the forecast years as a result of expected declines in government grants and lower budgeted WW rates. The council approved a 1% WW rate increase for 2014, compared with about 7%, on average, since 2007.

In recent years, the county's balance after-capital accounts have fluctuated. The after-capital deficit narrowed to 3.4% of adjusted total revenues in 2012, compared with more than 17% in 2010, largely due to lower-than-planned capital spending during the year. We expect a near-balance after-capital budget for 2013 and 2014. However, we believe Norfolk's after-capital performance will reverse in 2015, when the county ramps up its capital spending program.

Under our base-case scenario, we expect Norfolk's operating balance to average more than 13% of adjusted operating revenues and after-capital balance to post an average deficit of more than 3% of adjusted total revenues, for the 2011-2015 period.

Positive Liquidity Position

In our view, Norfolk benefits from a liquidity position that is positive to the ratings. At year-end 2013, free cash and liquid assets were about C$32 million (Standard & Poor's-adjusted) and covered more than 500% of the next 12 months' debt service. Liquidity could fall in the next few years as the county draws on its reserves to fund the growing capital plan. Nevertheless, we expect liquidity to stay at healthy levels and the county's debt service coverage ratio to remain well above 100%. In line with that of peers, Norfolk's access to external liquidity is satisfactory, in our view.

Debt To Rise In The Medium Term

As of year-end 2013, Norfolk's tax-supported debt totaled about C$44 million, or 30% of consolidated operating revenues. The county expects debt issuance to increase significantly in the next few years. It issued C$6.1 million of debt in 2013 and intends to issue more than C$60 million from 2014-2016 to fund capital expenditures. As the county intends to use investment returns on the proceeds from the sale of Norfolk Power Inc. to finance capital needs, its estimated debt issuance could be lower than planned during the next decade.

We believe the county's debt burden is moderate and expect that it will remain below 60% of consolidated operating revenues in the next two years, under our base-case scenario. Interest costs to the county are modest, representing 1.5% of adjusted operating revenues in 2012, and we expect them to remain below 5% of adjusted operating revenues in the outlook horizon.

Contingent liabilities

The county has standard future employee benefits and obligations and landfill postclosure costs that totaled about 15% of 2012 adjusted operating revenue. The 2012 financial statements do not disclose any material unfunded obligations.

In 2013, Norfolk announced the sale of Norfolk Power Inc. to Hydro One Inc. for C$66 million (after debt repayment), which it expects to finalize by fall of this year. County council intends to place the proceeds in an endowment fund and use the investment income to partially finance projected capital needs. We believe this should bolster the county's liquidity position and could limit debt issuance. Until the sale is finalized, the county remains contingently liable for the company's debt at this time.

Published Rating Factor Scores

Table 1

Norfolk County -- Summary Of Published Rating Factor Scores*	
Rating factor	**Score**
Institutional Framework	Predictable and well-balanced
Financial management	Neutral
Liquidity	Positive

Table 1

Norfolk County -- Summary Of Published Rating Factor Scores* (cont.)
*Standard & Poor's ratings on local and regional governments are based on, among other things, a scoring system that covers eight main rating factors, as further explained in our criteria (see below). We publish our scores for the three rating factors above.

Key Statistics

Table 2

Norfolk County -- Economic Statistics

	--Fiscal year ended Dec. 31--				
	2008	**2009**	**2010**	**2011**	**2012**
Population	62,807	62,929	63,052	63,175	N.A.
Population growth (%)	0.19	0.19	0.20	0.20	N.M.

Note: The data and ratios above result in part from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. Sources typically include Statistics Canada. N.M.--Not meaningful. N.A.--Not available.

Table 3

Norfolk County -- Financial Statistics

	--Fiscal year ended Dec. 31--					
(Mil. C$)	**2010**	**2011**	**2012**	**2013bc**	**2014bc**	**2015bc**
Operating revenues	133	140	144	149	152	152
Operating expenditures	118	122	124	127	130	135
Operating balance	15	17	20	22	21	18
Operating balance (% of operating revenues)	11.15	12.38	14.11	14.99	14.04	11.69
Capital revenues	8	10	2	6	6	10
Capital expenditures (capex)	48	33	27	29	27	45
Balance after capital accounts	(25)	(6)	(5)	(0)	0	(18)
Balance after capital accounts (% of total revenues)	(17.45)	(3.67)	(3.42)	(0.13)	0.13	(10.99)
Debt repaid	2.3	3.7	7.5	4.0	3.9	4.6
Balance after debt repayment and onlending	(27)	(9)	(13)	(4)	(4)	(22)
Balance after debt repayment and onlending (% of total revenues)	(19.10)	(6.11)	(8.57)	(2.71)	(2.35)	(13.84)
Gross borrowings	23.0	0.0	3.4	6.1	11.5	33.6
Balance after borrowings	(4.0)	(9.2)	(9.1)	1.9	7.8	11.2
Operating revenue growth (%)	0.43	4.71	3.44	3.05	1.95	0.40
Operating expenditure growth (%)	(2.33)	3.26	1.40	2.00	3.08	3.14
Modifiable revenues (% of operating revenues)	74.86	74.07	73.42	74.26	74.42	75.71
Capital expenditures (% of total expenditures)	28.71	21.33	17.92	18.44	17.05	25.15
Direct debt (outstanding at year-end)	49.4	45.8	41.6	44.4	52.1	81.1
Direct debt (% of operating revenues)	37.06	32.78	28.82	29.84	34.34	53.25
Tax-supported debt (% of consolidated operating revenues)	37.06	32.78	28.82	29.84	34.34	53.25
Interest (% of operating revenues)	1.22	1.63	1.53	1.21	1.25	1.25
Debt service (% of operating revenues)	2.96	4.24	6.75	3.90	3.82	4.27

Table 3

Norfolk County -- Financial Statistics (cont.)
Note: The data and ratios above result in part from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's 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 Standard & Poor's expectations of the most likely scenario. Downside case represents some but not all aspects of Standard & Poor's scenarios that could be consistent with a downgrade. Upside case represents some but not all aspects of Standard & Poor's scenarios that could be consistent with an upgrade. bc--Base case.

Key Sovereign Statistics

Sovereign Risk Indicators, June 9, 2014

Related Criteria And Research

Related Criteria

Methodology For Rating International Local And Regional Governments, Sept. 20, 2010

Ratings Detail (As Of July 9, 2014)	
Norfolk County	
Issuer Credit Rating	A+/Stable/--
Issuer Credit Ratings History	
24-Jun-2014	A+/Stable/--
04-Jun-2013	A/Positive/--
16-Jan-2002	A/Stable/--

*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.