S&P Global Ratings

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Summary:

Norfolk County

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Table Of Contents

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Issuer Credit Rating	AA-/Stable/--

Key Rating Factors

Credit context and assumptions	Base-case expectations
We expect institutions will remain supportive in Norfolk County, while economic growth will be somewhat limited. • We expect the county's levy increases to partially offset the expected budgetary stresses in 2020 stemming from the COVID-19 pandemic. • We do not expect major deviations in policy direction following changes in council and administration. • The county's relationship with upper levels of government should remain well balanced.	A steady stream of capital projects will require moderate levels of new debt. • We expect the county will continue to maintain modest operating balances from 2020 onward. • We expect the county will continue to face capital requirements that will result in larger after-capital deficits and borrowing during the forecast horizon. Consequently, we believe the debt burden will rise, although it will remain at moderate levels. • A healthy level of liquidity will continue to support creditworthiness.

Outlook

The stable outlook reflects our expectation that in the next two years, Norfolk will post after-capital deficits averaging 9% of total revenues, largely due to its expanding capital plan. We also expect the county's tax–supported debt will reach 57% of operating revenues by 2022, but that Norfolk will preserve sufficient total free cash to more than cover upcoming debt service.

Downside scenario

We could lower the rating over the next two years if aggressive capital spending pushed Norfolk's tax-supported debt to more than 60% of operating revenues, or if debt service coverage were to erode to less than 100%, and we expected such a scenario to persist over the forecast horizon.

Upside scenario

We could raise the rating in the next two years if after-capital budgetary performance strengthens such that after-capital deficits are consistently below 5% of adjusted total revenues, and if strong operating revenue performance or less reliance on debt financing led to tax-supported debt falling to less than 30% of operating revenues in the forecast horizon. However, we view this scenario as unlikely.

Rationale

Norfolk, in southern Ontario, is a largely rural municipality relying mainly on the stable manufacturing, agricultural, and tourism sectors. As the global spread of COVID-19 continues, we expect the municipality will not be immune to the expected deterioration in economic activity and increased budgetary stresses in 2020. While the impact of the outbreak will depend on its rate of spread and duration, S&P Global Ratings' baseline assumption is that the pandemic will peak about midyear globally ("The Escalating Coronavirus Shock Is Pushing 2020 Global Growth Toward Zero," published March 30, 2020). Therefore, we expect the county's economic activity and financial performance will rebound starting in 2021 and continue to produce solid operating surpluses over the next few years, although this will only partially fund its sizable capital developments and aging infrastructure requirements. We forecast the county will issue about C$74 million of debt from 2020-2022, resulting in its debt burden rising to about 57% of operating revenues by 2022. We also expect that Norfolk will continue to benefit from a supportive institutional framework. On the other hand, we believe that the county's economic profile, which reflects limited growth prospects and a less favorable socioeconomic profile, partially mitigates these strengths.

We expect institutions to remain broadly supportive, while the local economy will continue to show limited growth prospects and a weaker socioeconomic profile relative to the national economy.

We believe that Norfolk's lower income levels, aging demographics, and weaker growth prospects constrain its economy. We estimate that because of a continuing influx of retirees, those 55 and over will continue to represent more than 35% of the total estimated population of about 67,000 in 2020. The aging demographics could negatively affect the labor pool and hinder investment in Norfolk, in our view. In addition, we consider the county's location as less favorable compared with that of peers, based on Norfolk's relative remoteness from major cities and transportation routes. Although municipal GDP data are unavailable, we estimate that Norfolk's GDP per capita is below that of Canada, which we estimate to be about US$42,000, based on the county's lower income levels.

Despite these economic limitations, we believe that Norfolk, as do other Canadian municipalities, benefits 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.

We believe the management team has adequate expertise in implementing policy changes.

Although there has been some recent turnover in financial management, we do not expect significant policy deviations as a result. 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 corresponding funding sources. We believe that debt and liquidity management remains prudent, with a formal investment policy and a conservative internal debt limit.

We expect sizable capital spending will lead to larger after-capital deficits and more debt issuance in the forecast horizon.

In our base-case scenario for 2018-2022, we expect operating balances to average 14.1% of adjusted operating revenues. Considering capital expenditures of about C$54 million, or 26.4% of total expenditures, on average, we estimate the county will post a deficit after capital spending of 6.4% of total revenues, on average, in 2018-2022.

We estimate debt will continue rising as Norfolk proceeds with its capital plan. We expect additional borrowings of about C$74 million in 2020-2022, bringing tax-supported debt to about 57% of operating revenues by 2022. Interest costs accounted for 1.1% of operating revenues in 2019 and we expect them to remain below 2% through 2022. At the same time, in our opinion, the county has minimal contingent liabilities. Liabilities stemming from retirement-related benefits and landfill post-closure costs equaled about 13% of consolidated operating revenues in 2019.

In our view, the county's liquidity is solid. By our estimates, total free cash is about C$46.6 million and covers about 3.4x estimated debt service over the next 12 months. We expect this ratio will remain above 100% during the forecast outlook horizon. Similar to that of its domestic peers, Norfolk's access to external liquidity is satisfactory, in our view.

Key Statistics

Table 1

Norfolk County -- Selected Indicators

	--Fiscal year--				
(Mil. C$)	**2018**	**2019bc**	**2020bc**	**2021bc**	**2022bc**
Operating revenues	173	179	188	199	208
Operating expenditures	149	158	164	168	173
Operating balance	23	21	23	32	35
Operating balance (% of operating revenues)	13.5	11.9	12.4	15.9	16.6
Capital revenues	10	10	20	20	11
Capital expenditures	37	40	54	77	65
Balance after capital accounts	(3)	(8)	(11)	(25)	(20)
Balance after capital accounts (% of total revenues)	(1.5)	(4.3)	(5.5)	(11.6)	(9.0)
Debt repaid	6	5	15	7	8
Gross borrowings	0	27	17	31	25
Balance after borrowings	(8)	14	(9)	(1)	(3)
Direct debt (outstanding at year-end)	54	76	78	103	119
Direct debt (% of operating revenues)	31.4	42.4	41.6	51.5	57.4
Tax-supported debt (outstanding at year-end)	54	76	78	103	119
Tax-supported debt (% of consolidated operating revenues)	31.4	42.4	41.6	51.5	57.4
Interest (% of operating revenues)	1.3	1.1	1.3	1.1	1.3
National GDP per capita (single units)	60,011	61,290	58,634	62,727	64,658

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. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. N/A--Not applicable. N.A.--Not available. N.M.--Not meaningful.

Ratings Score Snapshot

Table 2

Norfolk County -- Ratings Score Snapshot	
Key rating factors	**Scores**
Institutional framework	2
Economy	3
Financial management	3
Budgetary performance	3
Liquidity	1
Debt burden	2
Stand-alone credit profile	aa-
Issuer credit rating	AA-

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "Methodology For Rating Local And Regional Governments Outside Of The U.S.," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

Key Sovereign Statistics

- Sovereign Risk Indicators, April 24, 2020

Related Criteria

- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009