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Ratings

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Research Update:

Norfolk County 'AA-' Ratings Affirmed; Outlook Remains Stable

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Overview

- Norfolk County continues to face capital requirements that we expect will result in larger after-capital deficits and borrowing in the forecast horizon.
- Consequently, we believe the debt burden will rise, although it will remain at moderate levels.
- As a result, S&P Global Ratings is affirming its 'AA-' long-term issuer credit rating on the county and maintaining a stable outlook.

Rating Action

On Nov. 26, 2019, 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 our expectation that, from 2019-2021, Norfolk will post after-capital deficits averaging 7.1% of total revenues, largely due to its expanding capital plan. We also expect the county will have tax-supported debt that reaches 54% of operating revenues by 2021 while preserving sufficient total free cash to more than cover upcoming debt service.

Downside scenario

We could take a negative rating action 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 take a positive rating action 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 a smaller 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. We expect the county to continue to produce solid operating surpluses over the next few years, which will only partially fund its sizable capital developments and ageing infrastructure requirements. We, therefore, forecast the county will issue about C$76 million of debt from 2019-2021, resulting in a rising debt burden to about 54% of operating revenues by 2021. 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, ageing demographics, and weaker growth prospects constrain its economy. Because of a continuing influx of retirees, we estimate that those 55 and over will continue to represent more than 35% of the total estimated population of about 65,000 in 2019. The ageing 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$46,400, 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 an internal conservative 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 2017-2021, we expect operating balances to average 11.7% of adjusted operating revenues. Considering capital expenditures of about C$36 million, or 19.3% of total expenditures, on average, we estimate the county will post a deficit after capital spending of 5.0% of total revenues, on average, in 2017-2021.

We estimate debt will continue rising as Norfolk proceeds with its capital plan. We expect additional borrowings of about C$76 million in 2019-2021, bringing tax-supported debt to about 54% of operating revenues by 2021. Interest costs accounted for 1% of operating revenues in 2018 and we expect them to remain below 2% through 2021. At the same time, in our opinion, the county has minimal contingent liabilities. Liabilities stemming from retirement-related benefits and landfill postclosure liabilities equaled about 13% of consolidated operating revenues in 2018.

In our view, the county's liquidity is solid. By our estimates, total free cash is about C$41.3 million and covers about 2.4x 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 ended Dec. 31--					
(Mil. C$)	2016	2017	2018	2019bc	2020bc	2021bc
Operating revenues	158	164	173	176	181	188
Operating expenditures	141	146	149	155	161	168
Operating balance	17	18	23	21	20	20
Operating balance (% of operating revenues)	10.8	11.2	13.5	11.9	11.1	10.5
Capital revenues	5	6	10	8	7	7
Capital expenditures	28	28	37	36	43	45
Balance after capital accounts	(6)	(4)	(3)	(7)	(16)	(18)
Balance after capital accounts (% of total revenues)	(3.8)	(2.2)	(1.5)	(3.7)	(8.5)	(9.3)
Debt repaid	4	5	6	5	16	7
Gross borrowings	0	19	0	27	23	26
Balance after borrowings	(11)	10	(8)	15	(9)	1
Direct debt (outstanding at year-end)	46	60	54	76	83	102
Direct debt (% of operating revenues)	28.9	36.7	31.4	43.3	45.8	54.3
Tax-supported debt (outstanding at year-end)	46	60	54	76	83	102
Tax-supported debt (% of consolidated operating revenues)	28.9	36.7	31.4	43.3	45.8	54.3

Table 1

Norfolk County -- Selected Indicators (cont.)

	--Fiscal year ended Dec. 31--					
(Mil. C$)	2016	2017	2018	2019bc	2020bc	2021bc
Interest (% of operating revenues)	1.0	1.1	1.3	1.1	1.5	1.7
National GDP per capita (single units)	56,169	58,607	59,879	61,413	63,082	65,120

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. dc--Downside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with a downgrade. uc—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. 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, Oct. 10, 2019. Interactive version available at http://www.spratings.com/sri

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

Related Research

- For Canada, Below-Potential Growth Is Likely In The Near Term, Oct. 7, 2019
- Credit Conditions North America: Rising Recession Risk Adds To Trade, Rate Uncertainty, Sept 30, 2019
- Guidance: Methodology For Rating Local and Regional Governments Outside of the U.S., July 15, 2019
- Institutional Framework Assessments For International Local and Regional Governments, July 4, 2019
- Public Finance System Overview: Canadian Municipalities, July 18, 2018

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/--