S&P Global
Ratings

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Research Update:

Norfolk County Issuer Credit Rating Affirmed At 'AA'; Outlook Is Stable

June 13, 2024

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Overview

- We expect Norfolk County's solid operating surpluses will continue due to meaningful increases in property tax collections that will support the large capital plan, leading to modest after-capital deficits, on average, over the next three years.
- We believe the county's healthy reserves will help moderate reliance on debt to fund capital, limiting the rise in the debt burden to 43% of operating revenues by 2026.
- Accordingly, S&P Global Ratings has affirmed its 'AA' long-term issuer credit rating on the county.
- The stable outlook reflects S&P Global Ratings' expectation that, in the next two years, Norfolk will continue posting strong operating margins and modest after-capital deficits, while the debt burden will remain below 60% of operating revenues.

Rating Action

On June 13, 2024, S&P Global Ratings affirmed its 'AA' long-term issuer credit on the County of Norfolk in the Province of Ontario. The outlook is stable.

Outlook

The stable outlook reflects our expectation that, over the next two years, Norfolk will maintain overall strong financial results, with modest after-capital deficits. We also expect the county will progress on its capital plan while keeping debt below 60% of operating revenues and maintaining a robust liquidity position.

Downside scenario

In the next two years, we could take a negative rating action if the county's revenue is significantly lower than expected due to a meaningful reduction in provincial support, or if aggressive capital spending weakens financial performance. This could result in sustained after-capital deficits larger than 5% of operating revenues and a higher debt burden, with tax-supported debt exceeding 60% of operating revenues over the forecast period.

Upside scenario

We could raise the rating in the next two years if Norfolk's management continues its commitment to prudent financial performance, sustaining operating balances above 15% of operating revenues, and near-balanced after-capital results without constraints on financial flexibility due to greater reliance on provincial transfers. We would also expect decreasing reliance on debt such that tax-supported debt approaches 30% of operating revenues in our forecast horizon.

Rationale

Norfolk's willingness to raise taxes and higher-than-expected grants have strengthened the county's operating balances in the past two years, even when faced with operating pressures stemming from elevated inflation. We expect strong performance will continue in the next two years and that grants will normalize. The county is undertaking a large capital plan, which we expect will lead to after-capital deficits. Although we expect some new borrowings to fund the plan, the county will fund the majority of it through operations and existing reserves, such that the debt burden will remain at less than 60% of operating revenues. We believe that Norfolk's steady economy, albeit with a socioeconomic profile weaker than that of peers, helps it continue collecting property taxes. Its robust liquidity and extremely supportive and predictable institutional framework for Canadian municipalities remain key strengths that support the county's creditworthiness.

We expect manufacturing and agriculture will continue to bolster the local economy; however, the county has a weaker socioeconomic profile than the national economy.

Although Norfolk's management is making efforts to encourage population growth, we believe that lower income levels, less-than-favorable population dynamics, and weaker growth prospects constrain the economy. Without updated official figures, the most recent Canadian Census in 2021 shows that almost 26% of the population is over the age of 65, higher than the national average of 19%. We expect the aging population, exacerbated during the pandemic and driven by the growth of retirement communities, will limit the labor pool. While key industries such as manufacturing and agriculture have expanded, the potential for growth remains hampered by the insufficient work force. Furthermore, the county's location is less favorable than that of peers due to its 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 at about US$54,000.

We believe management has adequate expertise in implementing policy changes. Management presents to the county council a one-year, detailed, tax-supported operating budget; a one-year, rate-supported operating budget; and 10-year, tax- and rate-supported detailed capital plans, with corresponding funding sources. We believe debt and liquidity management is prudent, with a formal investment policy and a conservative internal debt limit.

As do other Canadian municipalities, Norfolk benefits from an extremely predictable and supportive local and regional government framework that has demonstrated high institutional stability and evidence of systemic extraordinary support in times of financial distress. Most recently through the pandemic, senior levels of government provided operating and transit-related grants to municipalities, in addition to direct support to individuals and businesses. 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) through reserve contributions. Municipalities have demonstrated a track record of strong budget results and, therefore, debt burdens, on average, are low relative to those of global peers and growth over time has been modest.

Operating results will remain very strong and limit reliance on debt, despite a sizable capital plan and projected after-capital deficits through 2026 and beyond our base case.

We expect Norfolk will post strong operating performance, with balances exceeding 15% as a percentage of operating revenues. This is due to the stable influx of grants from senior levels of government and the county government's willingness to raise taxes to support operating and capital needs. We expect this will result in modest after-capital deficits starting this year.

Specifically, we expect deficits after-capital of less than 5% of total adjusted revenues, on average, due to large capital projects, progress delays, and increasing costs. The main capital projects are for water and wastewater and environmental infrastructure services such as roads and rehabilitation or reconstruction programs. Norfolk's ambitious capital plan budgets C$1.0 billion from 2024-2033, of which 50% will be funded by reserves and 32% by debt.

As Norfolk proceeds with its plans, we estimate debt will keep rising but remain below 60% of operating revenues. We believe that high operating balances will support the county in managing its debt burden and contribute positively to its overall debt issuance. We expect additional borrowing of about C$44 million in 2023-2026, bringing tax-supported debt to 42% of operating revenues by 2026. We also believe interest payments will remain very modest, at less than 5% of operating revenues over the outlook period. In our opinion, the county has minimal contingent liabilities, stemming largely from retirement-related benefits and landfill post-closure costs.

In our view, the county's liquidity is exceptional. By our estimate, total free cash is about C$199 million and covers about 19x the estimated debt service over the next 12 months. We expect this ratio will remain above 100% during the outlook horizon. Similar to that of domestic peers, Norfolk's access to external liquidity is satisfactory, in our view.

Key Statistics

Table 1

Norfolk County--Selected indicators

	--Fiscal year-end Dec. 31--					
(Mil. C$)	2021	2022	2023bc	2024bc	2025bc	2026bc
Operating revenues	211	227	226	230	234	240
Operating expenditures	155	174	179	185	190	196
Operating balance	56	54	47	45	44	44

Table 1

Norfolk County--Selected indicators (cont.)

	--Fiscal year-end Dec. 31--					
(Mil. C$)	2021	2022	2023bc	2024bc	2025bc	2026bc
Operating balance (% of operating revenues)	26.5	23.5	20.8	19.6	18.8	18.2
Capital revenues	17	21	16	18	17	11
Capital expenditures	46	48	59	70	71	74
Balance after capital accounts	27	27	4	(7)	(10)	(19)
Balance after capital accounts (% of total revenues)	11.9	10.7	1.7	(2.8)	(4.0)	(7.6)
Debt repaid	7	7	7	7	7	6
Gross borrowings	0	16	7	0	29	7
Balance after borrowings	20	36	4	(14)	12	(18)
Direct debt (outstanding at year-end)	75	85	85	78	100	101
Direct debt (% of operating revenues)	35.7	37.4	37.6	33.8	42.6	42.0
Tax-supported debt (outstanding at year-end)	75	85	85	78	100	101
Tax-supported debt (% of consolidated operating revenues)	35.7	37.4	37.6	33.8	42.6	42.0
Interest (% of operating revenues)	1.1	0.9	1.1	1.2	1.0	1.5
National GDP per capita (single units)	65,825	72,249	72,047	73,083	74,672	77,095

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.

Ratings Score Snapshot

Table 2

Norfolk County--Ratings score snapshot

Key rating factors	Scores
Institutional framework	1
Economy	3
Financial management	3
Budgetary performance	2
Liquidity	1
Debt burden	1
Stand-alone credit profile	aa

Table 2

Norfolk County--Ratings score snapshot (cont.)

Key rating factors	Scores
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 our "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 8, 2024. Interactive version available at disclosure.spglobal.com/sri

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Institutional Framework Assessment: Fiscal Autonomy Has Effective Limits For Canadian Provinces, April 2, 2024
- Economic Outlook Canada Q2 2024: Staying Subdued, March 26, 2024
- S&P Global Ratings Definitions, June 9, 2023

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/--