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S&P Global Ratings

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Research Update:

Norfolk County Rating Affirmed At 'AA-'; Outlook Remains Stable

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Research Update:

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Overview

- Norfolk County faces significant capital requirements; we expect this will result in sustained after-capital deficits and debt borrowing in the next several years.
- Nevertheless, the debt burden will remain low.
- As a result, we are affirming our 'AA-' long-term issuer credit rating on the county.
- The stable outlook reflects our expectation that, throughout the next two years, Norfolk will maintain healthy liquidity, hold its tax-supported debt below 50% of operating revenues, and post sound budget results.

Rating Action

On June 14, 2018, 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, in the next two years, Norfolk will post after-capital deficits of about 9.7% of total revenues on average in 2018-2020 because of its expanding capital plan. We also expect the county to maintain tax-supported debt at about 47% of operating revenues through 2020 while preserving a healthy liquidity position.

Downside scenario

We could take a negative action if aggressive capital spending pushed Norfolk's tax-supported debt to more than 60% of operating revenues coupled with eroded 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 in the next two years if revenue flexibility improves from the limited ability to adjust modifiable revenues, and after-capital budgetary performance strengthens such that after-capital deficits are consistently below 5% of adjusted total revenues.

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Rationale

Norfolk, in southern Ontario, is a largely rural municipality relying mainly on the stable manufacturing, agriculture, and tourism sectors. The county, which will produce solid operating surpluses, has substantial budgeted capital expenditures and consequent debt issuance in the next few years, owing to impending developments and aging infrastructure requirements. In our updated base-case scenario for 2018-2020, we estimate Norfolk will maintain stable operating balances but increasing after-capital deficits. We expect the county to issue about C$43 million of debt in the next three years, resulting in a rising debt burden to about 47% of operating revenues by 2020. We also expect that Norfolk will continue to benefit from a supportive institutional framework, sound financial management, and healthy liquidity. We believe that the county's economic profile, which reflects limited growth prospects, partially mitigates these strengths.

Institutions remain broadly supportive and financial management is satisfactory, while the economy shows somewhat limited growth prospects compared with those of peers.

We believe Norfolk, like 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 that Norfolk's demographic profile constrains its economic growth prospects. 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 65,000 in 2018. While new developments and expansions, especially in Port Dover and Simcoe, might somewhat offset this trend in the medium term, we believe the aging demographics could negatively affect the labor pool and hinder investment in Norfolk. In addition, we consider the county's location as less favorable compared with that of peers, based on its relative remoteness from major cities and transport routes. Although municipal GDP data are unavailable, we estimate that for 2016, Norfolk generated GDP per capita below the threshold of US$38,000, as per our criteria, based on its lower income levels.

We believe the management team has adequate expertise in implementing policy changes. In addition, adequate financial management accountability has continued throughout changes in administration. We expect no significant turnover in the near term, which we believe lends stability to management practices. The county presents a one-year detailed tax-supported operating

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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 that debt and liquidity management remains prudent, with a formal investment policy and an internal conservative debt limit.

Expanding capital plan will result in higher after-capital deficits; debt issuance to fund some projects is likely in the next three years.

In our base-case scenario for 2016-2020, we expect operating balances to average 10.4% of adjusted operating revenues. Considering capital expenditures of about C$36 million, or 19.4% of total expenditures on average, we estimate the county will post a deficit of 7.6% of total revenues on average in 2016-2020.

In our opinion, Norfolk's limited ability to materially cut operating expenditures somewhat constrains its budgetary flexibility. While the significant capital spending suggests some ability to defer unessential capital projects, we believe that the county's operating expenditure flexibility is somewhat limited, similar to that of many Canadian municipalities, primarily due to provincially mandated service levels and collective agreements with employees.

We expect modifiable revenues to average 75.5% of adjusted operating revenues in 2016-2020. Although property taxes increased by above 5% in the current budget, we believe that Norfolk's budgetary flexibility is constrained by its limited ability to adjust modifiable revenues because of its above-average tax burden and the population's lower income levels compared with those of peers. In our view, decisions the new council makes about tax increases could play a vital role in determining the constraint's magnitude.

We estimate debt will continue rising as Norfolk proceeds with its capital plan. We expect additional borrowings of about C$43 million in 2018-2020, bringing tax-supported debt to about 47% of operating revenues by 2020. Interest costs accounted for 1% of operating revenues in 2016 and we expect them to remain below 2% during the two-year outlook horizon.

In our view, the county's liquidity is healthy. We estimate free cash and liquid assets will total near C$66 million in 2018 and cover more than 7x estimated debt service for the period. We expect this ratio to remain well 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.

In our opinion, the county has minimal contingent liabilities. Liabilities stemming from retirement-related benefits and landfill postclosure liabilities equaled about 14% of consolidated operating revenues in 2016.

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Key Statistics

Table 1

Norfolk County — Selected Indicators

	--Year ended Dec. 31--					
(Mil. C$)	**2015**	**2016**	**2017bc**	**2018bc**	**2019bc**	**2020bc**
Operating revenues	153.1	158.4	161.8	167.6	172.4	177.5
Operating expenditures	130.2	141.2	145.1	151.0	154.6	158.4
Operating balance	22.9	17.1	16.7	16.6	17.8	19.1
Operating balance (% of operating revenues)	15.0	10.8	10.3	9.9	10.3	10.7
Capital revenues	5.9	4.6	4.4	5.6	6.1	6.7
Capital expenditures	52.5	28.0	29.7	38.0	41.0	45.0
Balance after capital accounts	(23.7)	(6.2)	(8.6)	(15.7)	(17.1)	(19.3)
Balance after capital accounts (% of total revenues)	(14.9)	(3.8)	(5.2)	(9.1)	(9.6)	(10.5)
Debt repaid	4.0	4.4	5.0	5.6	6.7	7.6
Gross borrowings	14.2	0.0	19.1	0.0	18.9	24.2
Balance after borrowings	(13.5)	(10.6)	5.5	(21.3)	(4.9)	(2.7)
Modifiable revenues (% of operating revenues)	74.3	74.1	74.7	75.5	76.2	76.9
Capital expenditures (% of total expenditures)	28.8	16.5	17.0	20.1	21.0	22.1
Direct debt (outstanding at year-end)	50.3	45.8	59.9	54.3	66.5	83.1
Direct debt (% of operating revenues)	32.8	28.9	37.0	32.4	38.6	46.8
Tax-supported debt (outstanding at year-end)	50.3	45.8	59.9	54.3	66.5	83.1
Tax-supported debt (% of consolidated operating revenues)	32.8	28.9	37.0	32.4	38.6	46.8
Interest (% of operating revenues)	0.9	1.0	1.3	1.3	1.4	1.5
National GDP per capita (single units)	55,673	56,129	58,418	59,938	61,829	63,688

Note: 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. 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 factor	Assessment
Institutional Framework	Very predictable and well-balanced
Economy	Average
Financial Management	Satisfactory
Budgetary Flexibility	Average
Budgetary Performance	Average
Liquidity	Exceptional

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Table 2

Norfolk County Ratings Score Snapshot (cont.)

Key rating factor	Assessment
Debt Burden	Low
Contingent Liabilities	Very low

Note: S&P Global Ratings bases its ratings on local and regional governments on eight main rating factors listed in the table. Section A of S&P Global Ratings' "Methodology For Rating Non-U.S. Local And Regional Governments" summarizes how the eight factors are combined to derive the foreign currency rating on the government.

Key Sovereign Statistics

Sovereign Risk Indicators, April 10, 2018. 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

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

Rating 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.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.