S&P Global Ratings

RatingsDirect®

Summary:

Berlin, Connecticut; General Obligation; Note

Primary Credit Analyst:
Victor M Medeiros, Boston (1) 617-530-8305; victor.medeiros@spglobal.com

Secondary Contact:
Steven E Waldeck, Boston (1) 617-530-8128; steven.waldeck@spglobal.com

Table Of Contents

Summary:

Berlin, Connecticut; General Obligation; Note

Credit Profile		
US$4.84 mil GO bnds ser 2017 due 12/01/2029		
Long Term Rating	AA+/Stable	New
US$1.455 mil GO BANs dtd 05/18/2017 due 09/19/2017		
Short Term Rating	SP-1+	New
Berlin GO		
Long Term Rating	AA+/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA+' rating to Berlin, Conn.'s series 2017 general obligation (GO) bonds and affirmed its 'AA+' rating on the town's existing GO debt. The outlook is stable.

In addition, S&P Global Ratings assigned its 'SP-1+' short-term rating to the town's bond anticipation notes (BANs), payable Sept. 19, 2017.

The town's unlimited-tax-GO pledge to levy ad valorem taxes without limit as to rate or amount on all taxable property within its borders secures the bonds and notes. We understand officials intend to use bond proceeds to finance general-purpose and infrastructure projects including roads, sidewalk and bridge construction.

The short-term rating reflects our view of the town's very strong capacity to pay principal and interest when the BANs come due. Berlin maintains a low market risk profile with strong legal authority to issue long-term debt to take out the BANs, and it is a frequent issuer that regularly provides ongoing disclosure to market participants.

The long-term rating reflects our opinion of Berlin's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Adequate management, with "standard" financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with slight operating surpluses in the general fund and at the total governmental fund level in fiscal 2016;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2016 of 16% of operating expenditures;
- Very strong liquidity, with total government available cash at 26.6% of total governmental fund expenditures and 4.1x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges at 6.5% of expenditures and net direct debt that is 89.8% of total governmental fund revenue; and
- Very strong institutional framework score.

Very strong economy

We consider Berlin's economy very strong. The town, with an estimated population of 20,352, is in Hartford County in the Hartford-West Hartford-East Hartford MSA, which we consider to be broad and diverse. It has a projected per capita effective buying income of 130% of the national level and per capita market value of $155,355. Overall, market value grew by 0.9% over the past year to $3.2 billion in 2018. The county unemployment rate was 5.3% in 2016.

Berlin is a suburban and predominantly residential community. Residential property makes up approximately 90% of developed land and commercial and industrial properties account for about 10%. The town has been seeing increased growth in the grand list due to an increase to private property assessments and ongoing redevelopment.

Although much of the developed land in Berlin is residential, the town hosts Connecticut's largest electric utility service provider, Eversource (1,231 employees), and operations for Comcast Cable Systems (497), both of which have had modest employment gains. Berlin is also home to approximately 125 small-to-midsize businesses, including the following manufacturers:

- Assa Abloy (422 employees),
- Parker Hannafin (232),
- B&F Machine (216),
- Budney Industries (175), and
- TOMZ Corp. (141).

Unemployment remains low in the community and below state averages.

The property tax base is very diverse with the 10 leading taxpayers accounting for 13.4% of the net taxable grand list.

We note management reports various public infrastructure projects are ongoing. They include streetscape and energy-efficiency improvements, and upgrades to the town's train station and tracks as part of the New Haven-Hartford-Springfield regional rail service expansion project. Berlin has received state grants to study economic development and parcel planning in the area around the train station. Therefore, management expects economic and residential development to rise over the near term, particularly in the form of transit-oriented and mixed-use developments.

Adequate management

We view the town's management as adequate, with "standard" financial policies and practices under our FMA methodology, indicating the finance department maintains adequate policies in some, but not all, key areas.

Demonstrating Berlin's financial policies and practices is management's use of conservative budgeting assumptions to determine revenue and expenditures. Management uses five years of historical data to identify tax collection and growth trends, as well as the governor's proposed budget as a general guide to determine state aid revenue. On the expenditure side, management plans for year-over-year fixed costs and adjusts for growth in contractual obligations in its assumptions; it then prioritizes appropriations based on community needs. The town also conducts frequent internal monitoring of its budget-to-actual performance, and management delivers a report to the town council monthly to address variances and propose budget amendments when necessary.

Management's maintenance of a rolling five-year, long-term capital improvement plan (CIP) that identifies capital project priorities and internal and external financing sources strengthens policies and practices. Management presents the CIP before the town council to inform annual budget discussions. Although state statutes strictly limit investment instruments the town can use, management maintains a basic investment policy for short-term investment holdings and interest income and incorporates holdings into budget-to-actual reports on results it presents to the town council monthly.

However, management does not currently maintain a long-term financial plan. Berlin has a debt management policy, adopted in 1999; but town officials indicate the policy needs updating. Furthermore, it does not currently have a formal reserve policy; however, despite this absence, the town has set an informal target to maintain general fund balance between 11% and 15% of general fund expenditures. Berlin has historically met and sustained this informal target.

Management reports that in response to recommendations made by a proactive fraud risk assessment conducted in 2015, it is updating policies and procedures to reflect best management practices. Should the town establish and consistently maintain long-term planning and formal policies, all else being equal, we could revise our management assessment to "good" from "standard."

Strong budgetary performance

Berlin's budgetary performance is strong, in our opinion. The town had slight operating surpluses of 0.7% of expenditures in the general fund and 1.5% across all governmental funds in fiscal 2016. General fund operating results of the town have been stable over the last three years, with results of negative 0.7% in 2015 and negative 0.1% in 2014.

After a period of positive operating surpluses from fiscal years 2011 to 2013, Berlin recognized two consecutive negative net operating results in fiscal years 2014 and 2015, but returned to positive in fiscal 2016. The negative results mainly reflected planned draws to fund balance to pay for one-time capital. The positive operating result in 2016 reflected conservatively estimating expenditures and revenues that outperformed budget. Town officials are expecting stable budgetary results in 2017 as expenditures have been within budget and revenues have remained on target.

In calculating 2016 performance, we netted out one-time, nonrecurring expenditures associated with various capital leases, including $10.4 million issued for energy conservation. We also netted out other capital expenditures that were paid by routine bond and notes issuances in the capital projects fund.

Budgeted appropriations for 2017 are $82.9 million. The budget is balanced and includes full funding of its annual required contribution for its pension plan. We believe performance is stable, and aside from minor program funding decreases at the state level, management reports that those cuts to municipal aid have not had a significant effect on the town's intergovernmental revenues or performance objectives. This result, coupled with other revenues and expenditures remaining on-target with or reporting below budget, means that management does not expect any significant deterioration in operating performance relative to years past.

For fiscal 2018, the town's proposed budget totals $85.3 million. Taxes are the leading source of revenues at 83%, followed by intergovernmental aid at 9.4%. Total taxes are budgeted to increase 3.7% over the adopted 2017 budget. Notably, the town level funded state aid and other state revenues. As we noted in our commentary (see "Connecticut's Proposed State Budget Could Lead To Significant Local Government Budget Uncertainty," published Feb. 16, 2017, on RatingsDirect), the governor's proposal, among other things, shifts education cost-sharing grants to poorer communities at the expense of more affluent ones. According to the governor's budget, Berlin stands to lose roughly $2.3 million in education equalization and special-education grants. Management indicates the budget could be amended in response to potential shifts in funding. One potential avenue would be to levy an emergency appropriation midyear to mitigate any shortfalls. Other service-level adjustments and cuts could also be made throughout the year if needed.

Very strong budgetary flexibility

Berlin's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2016 of 16% of operating expenditures, or $13.5 million.

We anticipate budgetary flexibility will remain very strong in 2017. In keeping with what we consider its conservative budgeting practices, management has historically appropriated fund balance to account for one-time or contingency expenditures; but actual revenue and expenditures have typically performed better than budgeted. Management indicates it has an informal target to maintain reserves between 11% and 15% of budgeted expenditures annually. The town has historically met and has sustained this informal target.

In our opinion, due to management's ability to raise revenue or reduce appropriations, we expect available reserves to remain strong over our two-year outlook period. In our view, the town has demonstrated its ability to make budgetary adjustments so as to not deplete reserves. In addition, capital spending is done through bond issuances, and not typically through reserve appropriations.

Very strong liquidity

In our opinion, Berlin's liquidity is very strong, with total government available cash at 26.6% of total governmental fund expenditures and 4.1x governmental debt service in 2016. In our view, the town has strong access to external liquidity if necessary.

Berlin is a regular market participant that has issued debt frequently over the past several years, including GO bonds and short-term BANs. It does not currently have any variable-rate or direct-purchase debt, and management has confirmed it does not currently have any contingent liquidity risks from financial instruments with payment provisions that change on the occurrence of certain events.

Town investments are subject to strict state guidelines; and the town invests its cash in low-risk assets, including the state's short-term investment fund or short-term certificates of deposit. For these reasons, we expect the liquidity profile to remain very strong over the next two fiscal years.

Adequate debt and contingent liability profile

In our view, Berlin's debt and contingent liability profile is adequate. Total governmental fund debt service is 6.5% of total governmental fund expenditures, and net direct debt is 89.8% of total governmental fund revenue.

Following this bond issue, Berlin has $89.0 million of total direct debt and $1.4 million in BANs. These figures also include a roughly $10.4 million, 20-year capital lease for a multi-faceted energy saving program. Notably, the town is expected to realize energy savings that will be used to finance the annual lease payments. Longer term, this program will help mitigate future cost increases associated with energy usage and consumption.

Because it is a member of the Mattabassett District, the town's share of overlapping debt is $11.7 million for debt issued to maintain and operate sewage treatment and water pollution control systems. According to management, the town will likely issue about $8 million in additional debt within the next few years, which includes a rolling debt authorization plan for road-and-bridge repairs, as well as new equipment purchases and building repairs. Management expects to meet with the town council to prioritize community needs, and the council could increase the debt authorization. We note that Berlin's debt profile could improve over time once the town's existing debt amortization exceeds 65% over 10 years. Nevertheless, in our view, due to Berlin's above-average amortization, we do not expect our assessment of the debt profile to weaken from current levels.

Berlin's combined required pension and actual other postemployment benefit (OPEB) contributions totaled 1.2% of total governmental fund expenditures in 2016. The town made 76% of its annual required pension contribution in 2016 but has recently appropriated for the full funding of the pension contribution through its assigned fund balance.

Berlin administers pension benefits through a single-employer, defined-benefit, public-employee retirement system. It has been steadily increasing its contribution during the past few fiscal years and it doubled contributions to $700,000 in fiscal years 2013 and 2014. Management reported it closed the defined-benefit plan to all employees, except police, in March 1987; ultimately, it closed the plan to police in 2000.

According to Governmental Accounting Standards Board Statement No. 68 standards, the town's net pension liability was approximately $5.6 million as of June 30, 2016. Berlin's plan fiduciary net position as a percent of the total pension liability is 6.05%. The assumed discount rate on the plan is 5%. While we consider the funded status of the plan very low, we note that the overall cost is manageable, and note plans closed status. Also, we acknowledge the town's efforts in fully funding the actuarially determined contribution. This should mitigate significant increases in future liabilities.

Teachers and other certified personnel are eligible to participate in the Connecticut State Teachers' Retirement, a cost-sharing multiemployer system. Contributions into the plan are made by the state. Notably, as part of the governor's initial budget, the proposal seeks a one-third shift of costs down to local governments. This would increase contributions to the town by $2.4 million, roughly 3.0% of general fund revenues. We note this measure of the governor's proposal is meeting heavy political resistance. The town has not budgeted for this cost increase.

Berlin provides single-employer, self-insured OPEBs to certain eligible retirees and their spouses. Therefore, eligible retirees are required to contribute 100% to the cost of receiving OPEB medical benefits. The net OPEB obligation, as of June 30, 2016, was $5.4 million.

Very strong institutional framework

The institutional framework score for Connecticut municipalities is very strong.

Outlook

The stable outlook reflects S&P Global Ratings' opinion of Berlin's very strong economy, which benefits from its participation in the broad and diverse Hartford MSA. It also reflects the town's very strong liquidity and strong budgetary flexibility, which will likely ensure credit stability over our two-year outlook period. At the same time, we expect Berlin will likely maintain an adequate debt and contingent liability profile because we expect debt service to remain manageable. Conversely, due to state fiscal conditions and the potential effect of reduced intergovernmental revenue on the town in fiscal years 2017 and 2018, combined with management's expectation for break-even operating results during the current and next fiscal years, it is unlikely we will raise the rating. For these reasons, we do not expect to change the rating within the next two years.

Upside scenario

All else being equal, we could raise the rating if the town were to demonstrate strong and consistent positive budgetary performance, coupled with management instituting and sustaining more-comprehensive long-term financial practices and policies.

Downside scenario

If Berlin were to experience a material deterioration in intergovernmental revenue or an extended period of negative operating results that were to weaken budgetary performance, resulting in substantial drawdowns of reserves, we could lower the rating.

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