

RatingsDirect®

Summary:

Stonington Town, Connecticut; General Obligation; Note

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Table Of Contents

Rationale

Outlook

Related Research

Summary:

Stonington Town, Connecticut; General Obligation; Note

Credit Profile

US\$7.0 mil GO bnds ser 2018 due 10/15/2038

<i>Long Term Rating</i>	AA+/Stable	New
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US\$6.5 mil GO BANs ser 2018 dtd 10/31/2018 due 10/30/2019

<i>Short Term Rating</i>	SP-1+	New
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Stonington Twn GO bnds ser 2016 due 10/15/2036

<i>Long Term Rating</i>	AA+/Stable	Affirmed
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Stonington Twn GO BANs ser 2017 dtd 11/01/2017 due 10/31/2018

<i>Short Term Rating</i>	SP-1+	Affirmed
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Stonington Twn GO BANs ser 2018 dtd 10/31/2018 due 10/30/2019

<i>Short Term Rating</i>	SP-1+	Affirmed
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Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to Stonington Town, Conn.'s series 2018 general obligation (GO) bonds. At the same time, we affirmed our 'AA+' long-term rating on the town's outstanding GO debt. The outlook is stable.

We also assigned our 'SP-1+' short-term rating on the town's series 2018 GO bond anticipation notes (BANs) and affirmed our 'SP-1+' rating on its BANs outstanding that mature Oct. 31, 2018.

The rating reflects Stonington's overall strong budget monitoring framework, which has yielded consistent and positive budgetary performance over the last three audited fiscal years. As a result, the town's overall stable operating trends supported its maintenance of very strong flexibility and liquidity to guard against recent state-level fiscal pressures. While we expect Stonington to maintain measured economic growth and a manageable debt profile over the two-year outlook period, we believe it remains somewhat susceptible to medium-term pressures from a less predictable state fiscal environment. A potentially multi-billion dollar deficit in the next biennial budget cycle (2020-2021) could prompt the state to make discretionary statutory aid cuts or potentially pass responsibility for unfunded pension liabilities or mandates down to local governments, which we believe could negatively affect municipal credit quality.

The short-term rating on the notes reflects our criteria for evaluating and rating BANs. In our view, Stonington maintains a very strong capacity to pay principal and interest when the notes come due. We view the town's market risk profile as low because it has strong legal authority to issue long-term debt to take out the notes and is a frequent debt issuer that regularly provides ongoing disclosure to market participants.

Stonington's full faith and credit pledge, payable from the levy of an unlimited-ad valorem tax on all taxable property

in the town secures the series 2018 bonds and notes. We understand that officials intend to use proceeds (approximately \$7 million) from the series 2018 bonds and series 2018 notes (approximately \$6.5 million) to provide permanent financing for construction and improvements related to two elementary school projects.

The rating reflects our opinion of the following factors for Stonington, specifically its:

- Strong economy, with market value per capita of \$217,835 and projected per capita effective buying income at 146% of the national level;
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with an operating surplus in the general fund and a slight operating surplus at the total governmental fund level in fiscal 2017;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 24% of operating expenditures;
- Very strong liquidity, with total government available cash at 19.1% of total governmental fund expenditures and 2.5x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability position, with debt service carrying charges at 7.5% of expenditures and net direct debt that is 105.5% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value; and
- Strong institutional framework score.

Strong economy

We consider Stonington's economy strong. The town, with an estimated population of 18,166, encompasses roughly 43 square miles in New London County. The town has a projected per capita effective buying income of 146% of the national level and per capita market value of \$217,835. Overall, the town's market value grew by 4.6% over the past year to \$4 billion in 2019.

Stonington is a primarily residential shoreline community in southeastern Connecticut, about 16 miles east of New London and 48 miles southwest of Providence, R.I. Interstate Highway 95 and State Route 1 traverse the town, connecting residents with regional employment opportunities. Although the state has struggled to regain its economic footing and the Norwich-New London metropolitan statistical area's gross domestic product (GDP) contracted by approximately 1.8% between 2010 and 2018, Stonington's overall economic and employment conditions have remained stable relative that of the regional labor market and the state. Historically, we believe that Stonington has maintained a local unemployment rate (estimated at 3.8% in 2017) that trends lower relative to county (4.5%), state (4.7%), and national (4.4%) averages.

The town's economy and employment base are anchored by the tourism and hospitality, manufacturing, and commercial retail sectors. Stonington's leading employers include the town and board of education (450 employees), Davis Standard (401), Mystic Seaport (346), Mystic Aquarium (256), and Stoneridge Retirement Community (230). The town reports overall stability among its leading employers and taxpayers in recent years. Due to its largely residential composition, its 10 leading taxpayers account for 6% of total AV, representing a very diverse tax base in our opinion.

Historically, Stonington's net taxable grand list has risen modestly over the past five years, and increased by 4.62%

following a property revaluation this past year. Residential property make up about 74.1% of the net taxable grand list, while commercial and industrial property account for 14.2%. Despite a slight weakening of income metrics in recent years, Stonington has maintained a stable economic base that supports overall strong income levels. According to management, the community is poised for new development as a local developer is undertaking a mixed-use development that will include 121 multifamily housing units, 50 town homes, and professional medical office space.

Given the town's continued slow, but steady, market value improvement and steady job market, we do not expect to change our view of the town's strong economic profile in the near term.

Strong management

We view the town's management as strong, with good financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Key budget development and monitoring practices include management's use of three years of historical data to build annual revenue and expenditure assumptions. In preparation of its annual budget, management reviews each department's annual operation requests and prioritizes operating expenditures. Due to uncertainty of state aid over the past several years, finance officials closely monitor state budget information to conservatively estimate revenue from statutory aid. It also monitors grand list growth to estimate changes in local tax revenue and mill rate. During each fiscal year, Stonington monitors the budget regularly, reporting budget-to-actual results to the first selectman on a monthly basis and the Board of Finance quarterly. Furthermore, the town maintains a formal investment policy adheres to state statutes governing investments and the town reports earnings and holdings in its annual audit.

Stonington maintains a strong focus on capital planning, evidenced by a five-year capital improvement plan (CIP) that identifies projects and costs across all departments. The town updates its CIP annually and details pay-as-you-go funding, intergovernmental grants, and bond financing of all capital projects.

Furthermore, management has historically met and sustained reserves in accordance with its fund balance policy. The formal policy calls for unassigned fund balance to be maintained at a minimum of two months, or 16.7% of annual operating expenditures. The policy indicates that this minimum reserve target assists with managing cash flows in the event of a revenue shortfall and unexpected changes in expenditures. The town also adopted a formal debt management policy that sets forth guidelines for issuing debt and measurable debt affordability benchmarks.

Although the town does not currently maintain a long-term financial forecast, it does incorporate forward- looking projections for debt service and other budget items in its annual budget.

Strong budgetary performance

Stonington's budgetary performance is strong in our opinion. The town had surplus operating results in the general fund of 2% of expenditures, and slight surplus results across all governmental funds of 1.4% in fiscal 2017. General fund operating results of the town have been stable over the last three years, with a result of 1.9% in 2016 and a result of 1.2% in 2015. Our analysis accounts for net transfers out of the general fund to other government funds, and adjusts for capital expenditures paid with bond proceeds.

We expect Stonington to maintain strong budgetary performance over the next several years, largely due to its

embedded budgeting development and monitoring framework, coupled with its manageable expenditure and fixed-cost profile. Like many municipalities in Connecticut, the school budget accounts for a significant portion of Stonington's operating budget; we understand that Stonington has a collaborative relationship between its board of education and municipal government to develop, monitor, and make timely adjustments to the budget in a less predictable state aid environment. As we note in our commentary, titled "Not Just An Academic Exercise: New England School Districts, Municipalities Benefit From Integrated Financial Reporting," published Sept. 20, 2018, we generally view active collaboration between school district and local municipalities positively.

Furthermore, the town benefits from an overall stable and strong property tax base, which generated approximately 86% of general fund revenue in fiscal 2017. In addition, tax collections have remained strong with collections exceeding 98.5% over the past five years. Intergovernmental (state) sources represent the second-highest share of general fund revenue at 9%, while charges for services constitute about 5%. Although statutory aid makes up less than 10% of the town's general fund revenue, we believe the town would still be somewhat more susceptible to performance volatility during an extended period of state fiscal uncertainty and moderate-to-severe state aid reductions, particularly education cost sharing (ECS) grants.

Stonington reported positive year-end general fund performance for fiscal 2017, which management attributed to better-than-budgeted local tax receipts and charges for services. Increases in these locally derived revenue sources offset a \$124,364 decline in statutory aid. At the same time, the town recognized expenditure savings, totaling \$1 million, from unexpended department appropriations from its sanitation, public safety, and general government line items.

The state's budget impasse last year, which extended four months into the 2018-2019 biennium had a harmful effect on municipal finances entering fiscal 2018. While the likelihood of statutory aid cuts affects all local governments in the state, we believe Stonington demonstrated ample capacity within its budget in fiscal 2018 to raise local revenue and reduce expenditures to stabilize operations. Based on estimated statutory aid reductions for 2018, the town reduced spending through a combination of expenditure savings and hiring freezes in the town and school budget. Due to these tight controls of spending throughout the year and conservatively budgeting of property taxes and charges for services, officials expects better-than-budgeted operating results. The town estimates an approximately \$500,000 surplus at fiscal year-end.

The town adopted a balanced \$67.74 million fiscal 2019 budget. The budget includes an expected \$1.79 million increase in debt service, but due to identified expenditure reductions and growth in the net taxable grand list, Stonington was able to reduce its mill rate to 22.68 mills from 22.98. Although early in the current budget year, officials generally expect local revenues to outperform the budget, and the town will continue to identify and adjust expenditures as necessary to produce at least balanced results at fiscal year-end.

We also note that the town's collective bargaining contracts are current, with earliest contract expiration as of June 30, 2019, reducing a potential area of cost uncertainty. Despite potential state fiscal challenges entering the next biennium, which could contribute to future cuts to statutory aid to municipalities, we believe Stonington is likely to maintain stable and strong performance over our two-year outlook period.

Very strong budgetary flexibility

Stonington's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 24% of operating expenditures, or \$15.9 million. In our view, the town has maintained very strong reserves over the past three years; the total available fund balance has remained at a consistent level overall, totaling 23% of expenditures in 2016 and 23% in 2015.

Stonington has upheld the historical practice of appropriating fund balance in its annual general fund budget, but with revenue and expenditures outperforming the budget at fiscal year-end. Unaudited year-end results estimate that the town will maintain positive operating performance in fiscal 2018, and we understand that available reserves could be approximately 26% of general fund expenditures. Based on management's general expectation that Stonington will maintain at least balanced operations for fiscal 2019, with no planned draws on reserves over the next two years, we do not expect its available fund balance to fall below current levels.

Furthermore, the town's formal reserve policy stipulates that it maintain an unassigned fund balance of at least two months of annual operating expenditures. While we generally expect the town's flexibility to remain very strong over the next two years, if the state significantly reduces statutory aid or requires municipalities to comply with unfunded mandates—leading to stress on the town's finances and reserves—we could modify our view of the town's flexibility.

Very strong liquidity

In our opinion, Stonington's liquidity is very strong, with total government available cash at 19.1% of total governmental fund expenditures and 2.5x governmental debt service in 2017. In our view, the town has strong access to external liquidity if necessary.

With the majority of Stonington's cash invested in money market funds and certificates of deposit, we believe the town's investments are not aggressive. Furthermore, the town is a regular market participant that has issued debt periodically over the past 20 years, including GO bonds and notes.

Finance officials also confirmed that the town does not currently have any contingent liquidity risks from financial instruments with payment provisions that change on the occurrence of certain events. In addition, it does not currently have any variable-rate or direct-purchase debt. For these reasons, and given the strong and stable budgetary environment, we believe the town's liquidity profile should remain very strong.

Strong debt and contingent liability profile

In our view, Stonington's debt and contingent liability profile is strong. Total governmental fund debt service is 7.5% of total governmental fund expenditures, and net direct debt is 105.5% of total governmental fund revenue. Overall net debt is low at 2.1% of market value, which is in our view a positive credit factor.

With the issuance of the series 2018 bonds and notes, the town will have approximately \$80 million in total direct debt outstanding, including \$72.3 million in bonds and \$6.5 million in notes. As its debt is structured, the town expects annual carrying charges to peak in 2020 and drop steadily in subsequent years. At the same time, we understand the town does not plan to issue more new-money debt over the near term. The town increased its mill rate over several years to manage anticipated increases in expenses associated with the school construction, and while state fiscal pressures may potentially lead to future tax increases, we believe the town has the ability to manage an increase in

annual debt service.

Stonington's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 2.5% of total governmental fund expenditures in 2017. Of that amount, 1.9% represented required contributions to pension obligations, and 0.6% represented OPEB payments. The town made 107% of its annual required pension contribution in fiscal 2017, and has made at least 100% of its actuarially determined contribution over the last three fiscal years.

The town contributes to the Stonington Retirement Plan, a locally administered pension plan for general town employees, as well as the Connecticut Municipal Employees Retirement System (MERS) for public safety employees. The town's plan has a net pension liability of \$4.68 million and was 87.2% funded as of June 30, 2017. The assumed discount rate is 6.75%, which we view as low relative to national trends. At the same time, Stonington has net pension asset of \$1.26 million for the MERS plan as of June 30, 2017. The state's MERS funded ratio was 88.3% as of June 30, 2016. Educational staff are part of the state Teachers' Retirement System (TRS) and the state contributes to the TRS plan on behalf of the town.

The town has prefunded part of its OPEB liability in the past. The town's net OPEB liability totaled \$5.45 million as of July 1, 2016, with a funded ratio of 17.8%. The town also maintains a defined-contribution retiree health care plan, established for police officers in 2004.

Strong institutional framework

The institutional framework score for Connecticut municipalities is strong.

Outlook

The stable outlook reflects our expectation that Stonington's will likely maintain strong economic indicators and very strong liquidity and flexibility despite economic and fiscal headwinds at the state level. While the town may potentially experience statutory revenue pressure over the next two years, we believe the town maintains overall capacity to adjust expenditures and revenue to maintain balanced operations. Therefore, we do not expect to change the rating within the two-year outlook period.

Upside scenario

If Stonington maintains consistently positive financial performance that supports sustained improvement in its reserves, while implementing more robust management practices and policies, and exhibiting improved wealth and income levels that are commensurate with those of higher-rated peers, we could raise the rating.

Downside scenario

We could lower the rating if the town were to experience a substantial weakening of budgetary performance, due to significant state aid reductions or otherwise, leading to a material decline of available reserves or constrained liquidity.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015

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