

RatingsDirect®

Summary:

Cheshire, Connecticut; General Obligation

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US\$13.75 mil GO bonds issue of 2019 due 07/15/2038

Long Term Rating AAA/Stable New

Cheshire GO bonds

Long Term Rating AAA/Stable Affirmed

Rationale

S&P Global Ratings has assigned its 'AAA' rating to Cheshire, Conn.'s series 2019 general obligation (GO) bonds and affirmed its 'AAA' rating on the town's GO debt outstanding. The outlook is stable.

The town's unlimited GO pledge secures its bonds to levy ad valorem taxes without limit as to rate or amount on all taxable property within its borders. We understand bond proceeds are being used to fund various sewer, school construction, and other general-purpose capital projects.

Supporting the 'AAA' rating are the town's strong operating results and consistent budget reserves that have been maintained over several years. Despite credit pressures related to weak growth in the region and pressures related to state funding, management has done well budgeting conservatively and producing several years of general fund surplus. Underpinning this has been prudent financial management and adherence to its long-established reserve policies. Debt service costs have risen in recent years but remain manageable, in our view, given the town's rapid debt amortization and low overall net debt to market values. Pension and other postemployment benefit (OPEB) costs continue to grow as a percentage of budget, but we anticipate the town will continue to manage these higher costs while sustaining its operating flexibility at the same time, as has been the case recently. The town's financial profile is stable, in our view, and we expect its financial position to remain in line with that of previous years.

Cheshire's GO bonds are eligible to be rated above the sovereign because we believe the town can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions" (published Nov. 19, 2013, on RatingsDirect), the town has a predominantly locally derived revenue source, with about 74% of governmental activity revenue derived from property taxes with independent taxing authority and independent treasury management from the federal government.

The rating reflects our view of the town's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA), although we acknowledge growth within the MSA has remained below national averages;
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with a slight operating surplus in the general fund and an operating surplus at the

total governmental fund level in fiscal 2018;

- Strong budgetary flexibility, with an available fund balance in fiscal 2018 of 10.7% of operating expenditures;
- Very strong liquidity, with total government available cash at 26.4% of total governmental fund expenditures and 3.2x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges at 8.2% of expenditures and net direct debt that is 77.4% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 67.9% of debt scheduled to be retired in 10 years, but a large pension and other postemployment benefit (OPEB) obligation; and
- Strong institutional framework score.

Very strong economy

We consider Cheshire's economy very strong. The town, with an estimated population of 29,626, is in New Haven County in the New Haven-Milford MSA, which we consider to be broad and diverse. It has a projected per capita effective buying income of 135% of the national level and per capita market value of \$133,995. Overall, market value grew by 0.5% over the past year to \$4.0 billion in 2019. The county unemployment rate was 5.0% in 2017.

The town's unemployment remains well below state and national averages. However, the regional MSA, while we consider it broad and diverse, has seen little employment growth when measured against the national level. If employment growth remains muted over time, this could negatively affect our view of the economy and pressure the town's credit. Cheshire has experienced about 1% growth in market values in each of the past two years, which is consistent with neighboring communities. Bozzuto's Inc., a wholesale food distributor, is the town's largest employer, followed by the town itself, the State of Connecticut--which maintains a correctional facility within town limits--and Macy's, which also maintains a local warehouse.

The town experienced healthy year-over-year growth in the value of residential building permits in 2018, exceeding its five-year average. Despite the maturity of the town, more than half of the land remains undeveloped, the vast majority of which is zoned for residential use.

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.

The town uses performance-based budgeting in the preparation of its budget with at least three years of trend data considered in projecting revenues and expenditures. The town council reviews monthly budget-to-actuals and maintains the ability to adjust and amend the budget as necessary. Cheshire also maintains a five-year capital plan that is rolling with identified funding sources and uses. The town recently began the practice of budget forecasting, particularly as a response to potential volatility in non-locally derived revenues. It follows state guidelines regarding investments and provides council with an update on these periodically. It also maintains a policy limiting debt service to no more than 10% of expenditures and has recently revised its formal reserve policy to maintain its unassigned general fund balance at 9.25% of the previous year's audited expenditures, up from 8%.

Strong budgetary performance

Cheshire's budgetary performance is strong, in our opinion. The town had slight surplus operating results in the general fund of 0.5% of expenditures, and surplus results across all governmental funds of 1.8% in fiscal 2018. General fund operating results of the town have been stable over the last three years, with results of 0.4% in 2017 and negative 0.4% in 2016.

Our calculation of the town's performance includes adjustments for recurring transfers, deferred pension costs, and capital spending paid for with bond proceeds. In fiscal 2018, Cheshire finished with an increase to fund balance, which is notable given the uncertainty related to state aid. Its conservative budgeting of revenues and expenditures has supported consistent operating results, even when factoring the town's use of reserves to support capital investment, which has been a practice for a number of years.

The 2019 budget totals \$110.9 million. The town is projecting a budgetary surplus in fiscal 2019 prior to transfers out of the general fund. Local derived revenues are the predominant general fund revenue sources; property taxes alone represent nearly three-quarters of general fund revenue, limiting exposure to state and federal revenue sources. Property tax collections have historically exceeded 99.5% on a current-year basis. State aid was about 14% of revenue in fiscal 2018.

One area of uncertainty entering the next fiscal year involves state aid. We note that the state has not adopted its budget, but town officials have expressed ongoing concern over the potential loss of state aid funds. Nevertheless, management continues to be proactive in identifying adjustments in revenue and expenditures, allowing it to keep budgetary alignment. Given the town's recent performance history, including the practice of using operating surpluses for capital and other reserve set-asides to maintain some flexibility, we believe it will be able to generate adequate-to-strong performance over the near term.

Strong budgetary flexibility

Cheshire's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2018 of 10.7% of operating expenditures, or \$12.9 million.

The town has a formal reserve policy of maintaining at least 9.25% of the previous year's expenditures in unassigned fund balance, which helps guide its decision-making on increasing funding levels for capital, pension, and OPEB purposes. We note that our calculation of available reserves does not include \$4.7 million in committed funds in the town's debt service reserve, which may be made available for operations contingent on council approval. These funds are currently intended to be used over time to offset higher debt service costs related to the town's wastewater treatment plant. Given the town's formal reserve policy and strong oversight of performance, we do not anticipate changing our view of its budgetary flexibility over the near term.

Very strong liquidity

In our opinion, Cheshire's liquidity is very strong, with total government available cash at 26.4% of total governmental fund expenditures and 3.2x governmental debt service in 2018. In our view, the town has strong access to external liquidity if necessary.

Cheshire has issued GO debt regularly over the past 15 years, which supports our view of its strong access to external

liquidity. The town does not have investments we view as aggressive as it holds funds in mutual funds and certificates of deposit. We do not anticipate changing our view of the liquidity profile over the near term.

Adequate debt and contingent liability profile

In our view, Cheshire's debt and contingent liability profile is adequate. Total governmental fund debt service is 8.2% of total governmental fund expenditures, and net direct debt is 77.4% of total governmental fund revenue. Overall net debt is low at 2.6% of market value, and approximately 67.9% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

We calculate the town's total direct debt to be \$102.7 million. Debt service carrying charges, including this debt, is manageable at between 8% and 9% over the next several years. Notably, a portion of the debt service comes from water and sewer charges and is not general fund-supported. Tax-supported debt service carrying charges are only 5.3% of general fund expenditures, which is down from previous years. Based on Cheshire's five-year capital improvement plan, the town may issue an additional \$42.6 million of debt over the next five years. However, given its rapid principal amortization, it will retire roughly \$37 million of debt over the same time horizon. Overall, we anticipate debt metrics could weaken slightly but not at a level that would weaken the factor score.

In our opinion, a credit weakness is Cheshire's exposure to rising costs related to pension and OPEB obligation; however, we believe overall costs are low and manageable and the town has been active in managing the overall liability. Cheshire's combined required pension and actual OPEB contributions totaled 3.7% of total governmental fund expenditures in 2018. Of that amount, 2.8% represented required contributions to pension obligations, and 0.9% represented OPEB payments. The town made 95% of its annual required pension contribution in 2018.

Cheshire administers three defined-benefit pension plans for town employees, police, and volunteer firefighters. The town and police plans are closed to new employees, who may join a defined-contribution plan. As of the reporting period, the fiduciary net position as a percentage of the total pension liability was 76.3% for the town plan, 56.4% for the police plan, and 48.7% for the fire plan, as of June 30, 2018. In total, the net pension liability was \$36.5 million.

Despite the closure of its defined-benefit plans, the town reduced its interest rate assumption from 8.5% to 7.5% after the recession, which doubled its combined actuarially determined contributions (ADCs) across all plans. As a result, it has adopted a phase-in for reaching 100% of the ADC for each of the three plans; during 2018, the police plan was the only remaining plan in which the town did not make 100% of contributions. While not ideal, we note the dollar value of the pension deferral was nominally low at \$178,000. Town officials note Cheshire remains committed to reach 100% of contributions for the police plan over the next several years.

The town's OPEB plans were 3% funded with a liability of just under \$2 million. The police OPEB plan was 3% funded with an unfunded liability of \$8.7 million.

Strong institutional framework

The institutional framework score for Connecticut municipalities is strong.

Outlook

The stable outlook reflects our view of Cheshire's strong budgetary performance and flexibility, coupled with a very strong underlying economy and a strong debt profile. We do not expect to change the rating over our two-year outlook horizon due to our expectation that management will continue to adhere to its formal and sustainable policies and practices in managing its finances.

However, if our view of the town's economic factor weakens because of below-average employment growth within the MSA, as measured against the national average, the rating would be pressured. Furthermore, if the town's performance and reserves were to weaken or the town can't maintain its pension funding strategy, particularly due to potential reductions in state aid over the near term, we could lower the rating.

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