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Ratings

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Summary:

Stonington Town, Connecticut; General Obligation

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Credit Profile		
US$5.2 mil GO bnds ser 2019 due 10/15/2039		
Long Term Rating	AAA/Stable	New
Stonington Twn GO bnds		
Long Term Rating	AAA/Stable	Upgraded

Rationale

S&P Global Ratings raised its long-term rating to 'AAA' from 'AA+' on Stonington Town, Conn.'s general obligation (GO) debt outstanding. At the same time, we assigned our 'AAA' long-term rating to the town's series 2019 GO bonds. The outlook is stable.

Credit overview

The rating action reflects our view of Stonington's consecutive years of positive operating results, leading to very strong reserves stemming from its strong overall budget monitoring framework, and its location along the shoreline, with an economy anchored by the tourism and hospitality, manufacturing, and commercial retail sectors. In addition, management conditions are strong with good policies in several areas key to credit stability. Although the coastal community is vulnerable to sea-level rise and potential weather events, the management team is planning for resiliency through various efforts, including vulnerability assessments and mitigation plans. Moreover, while local governments in the state remain susceptible to medium-term pressures from a less predictable state fiscal environment, the town is somewhat insulated given it does not receive much in state aid. As a result, we anticipate stable operating trends and maintenance of very strong reserves and liquidity to guard against unexpected events.

We rate Stonington higher than the federal sovereign because we believe the town can maintain better credit characteristics than the U.S. in a stress scenario, due to its predominantly locally derived revenue base and our view that pledged revenue supporting debt service on the bonds is at limited risk of negative sovereign intervention. In 2018, local property taxes generated approximately 89% of general fund revenue, demonstrating a lack of dependence on central government revenue. (See "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions," published Nov. 19, 2013, on RatingsDirect.)

Security and use of proceeds

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 2019 bonds. We understand that officials intend to use proceeds from the bonds to provide permanent financing for construction and improvements related to two elementary school projects.

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

- Strong economy, with market value per capita of $221,516 and projected per capita effective buying income (EBI) 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 2018;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 25% of operating expenditures;
- Very strong liquidity, with total government available cash at 16.5% of total governmental fund expenditures and 1.9x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges at 8.6% of expenditures and net direct debt that is 80.7% 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, a primarily residential shoreline community with an estimated population of 17,950, is in New London County, about 16 miles east of New London and 48 miles southwest of Providence, R.I. It has a projected per capita EBI of 146% of the national level and per capita market value of $221,516. Overall, market value was stable over the past year at $4.0 billion in 2020. The county unemployment rate was 4.0% in 2018.

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 (MSA) gross domestic product (GDP) contracted by approximately 1.8% between 2010 and 2018, Stonington's overall economic and employment conditions have remained stable relative those of the regional labor market and the state. Historically, we believe that the town has maintained a local unemployment rate (estimated at 3.3% in 2018) that remains lower relative to the MSA (4.0%), and state averages (3.6%).

Anchoring the town's economy and employment base are the tourism and hospitality, manufacturing, and commercial retail sectors. The region maintains several industry clusters that provide employment opportunities for residents. Defense technology, engineering, and advanced manufacturing are anchored by General Dynamics Electric Boat (EB) division, which has reported contracts worth $966 million, with a potential additional workload of over $8 billion. Many residents employed in this field live in Stonington. Moreover, tourism is a big component of this region's economy and local economy. The town reportedly attracts 4 million visitors annually to Mystic Aquarium and Mystic Seaport museum, benefiting local businesses.

Stonington's leading employers include the town and board of education (429 employees), Davis Standard (401), Mystic Seaport (348), Mystic Aquarium (254), and Stoneridge Retirement Community (232). 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 assessed value (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 in fiscal 2019. Residential property makes up about 74.2% of the net taxable grand list, while commercial and industrial property accounts for 14.1%. 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 additional development that should underpin future growth, albeit in line with years past.

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 rates. 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 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 flow 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 incorporates forward-looking projections for debt service and other budget items into 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 2.0% of expenditures, and slight surplus results across all governmental funds of 0.5% in fiscal 2018. General fund operating results of the town have been stable over the last three years, with results of 2.0% in 2017 and 1.9% in 2016.

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 the town 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 2018. 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%. Much of the state aid the town receives involves pass-through monies from the state of Connecticut to fund teacher pensions. Excluding this amount, the town receives less than 2%, which somewhat mitigates its susceptibility to state aid fluctuations.

Stonington reported positive year-end general fund performance for fiscal 2018, which management attributed to better-than-budgeted local tax receipts and charges for services. The town is projecting a slight fund balance decline in 2019 of $650,000, largely reflecting transfers to the capital projects fund to support its CIP. Notably, its capital nonrecurring fund balance has increased over the past several years from such general fund transfers, and now has a balance greater than $5 million.

The town adopted a balanced $70.5 million fiscal 2020 budget, an increase of approximately 1.8% over the previous year. Stonington increased its mill rate to 23.36 mills from 22.68. Despite the increase, the overall mill rate remains below those of regional peers. Although it's still 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 largely all settled through 2020, reducing a potential cost uncertainty. Despite possible 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 2018 of 25% of operating expenditures, or $17.9 million.

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 budgetary performance in fiscal 2019, although the general fund balance will decline slightly, as the town transferred monies into its capital nonrecurring fund, which maintains a healthy balance. Based on management's general expectation that Stonington will maintain at least balanced operations for fiscal 2020, with no significant planned draws on reserves over the next two years, we do not expect its available fund balance to deteriorate. Furthermore, the town's formal reserve policy stipulates that it maintain an unassigned fund balance of at least two months of annual operating expenditures.

Very strong liquidity

In our opinion, Stonington's liquidity is very strong, with total government available cash at 16.5% of total governmental fund expenditures and 1.9x governmental debt service in 2018. 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 its 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.

Adequate debt and contingent liability profile

In our view, Stonington's debt and contingent liability profile is adequate. Total governmental fund debt service is 8.6% of total governmental fund expenditures, and net direct debt is 80.7% of total governmental fund revenue. Overall net debt is low at 1.9% of market value, which is, in our view, a positive credit factor.

With the issuance of the series 2019 bonds, the town will have approximately $72.9 million in total direct debt outstanding. As its debt is structured, it expects annual carrying charges to peak in 2020 and drop steadily thereafter. At the same time, we understand the town does not plan to issue more new-money debt over the near term. The town raised its mill rate over several years to manage anticipated increases in expenses associated with the school construction.

Stonington's combined required pension and actual other postemployment benefit OPEB contributions totaled 2.3% of total governmental fund expenditures in 2018. Of that amount, 1.8% represented required contributions to pension obligations, and 0.5% represented OPEB payments. The town made 99% of its annual required pension contribution in 2018.

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 $4.1 million and was 88% funded as of June 30, 2018. The assumed discount rate is 6.75%, which we view as low relative to national trends. At the same time, Stonington has net pension assets of $1.7 million for the MERS plan as of June 30, 2018. The state's MERS funded ratio was 91.8% as of June 30, 2018. 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. Its net OPEB liability totaled $5.01 million as of July 1, 2018, with a funded ratio of 26.2%. 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 will likely maintain strong economic indicators and very strong liquidity and flexibility despite a slowing economy and fiscal headwinds at the state level. While the town may potentially experience statutory revenue pressure over the next two years, we believe it 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.

Downside scenario

We could lower the rating if the town were to experience a weakening of budgetary performance leading to a decline of available reserves below established policy targets for a sustained period or if liquidity were constrained. Additional consideration for a lower rating would be if the town's debt and liability metrics were to weaken.

Related Research

2018 Update Of Institutional Framework For U.S. Local Governments