

RatingsDirect®

Summary:

Berlin, Connecticut; General Obligation

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Credit Profile

US\$4.5 mil GO bnds ser 2020 due 12/01/2030

Long Term Rating

AAA/Stable

New

Berlin GO

Long Term Rating

AAA/Stable

Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating to Berlin, Conn.'s general obligation (GO) bonds, issue of 2020. At the same time, we affirmed our 'AAA' long-term rating on the town's GO debt outstanding. The outlook is stable.

The town's full faith and credit secures the bonds. Proceeds from the bonds will fund various authorized capital projects throughout the town.

Credit overview

Berlin recorded another surplus in fiscal 2019 (ended June 30), bolstering reserves to nearly \$16.6 million, or about 18% of operating expenditures. We believe the flexibility, coupled with reliance primarily on property taxes to fund the budget, somewhat insulates the town from a material deterioration in credit quality as a result of the economic effects of the pandemic and recession. However, as uncertainty remains over the ultimate economic fallout from recession, the stable outlook reflects our view of management's entrenched strong financial management policies and practices, which we believe will continue to result in positive financial results. Furthermore, the town's low fixed costs equal to 10.7% of total governmental expenditures limits debt service, pension, and other postemployment benefits from crowding out other operating costs.

We rate the town above the sovereign because we believe it can maintain better credit characteristics than the U.S. in a stress scenario, based on 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. The rating above the sovereign is based on our criteria "Ratings Above The Sovereign: Corporate And Government Ratings--Methodology And Assumptions," published Nov. 19, 2013, on RatingsDirect.

The rating reflects our view of the town's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area;
- Very strong management, with strong financial policies and practices under our financial management assessment methodology;
- Adequate budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2019;

- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 18% of operating expenditures;
- Very strong liquidity, with total government available cash at 23.4% of total governmental fund expenditures and 2.6x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability position, with debt service carrying charges at 9.1% of expenditures and net direct debt that is 76.9% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of market value and rapid amortization, with 71.8% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Environmental, social, and governance factors

We analyzed the town's environmental, social, and governance factors relative to its economy, management, budgetary and financial measures, and debt and long-term liability profile, and consider them in line with the sector.

Stable Outlook

Downside scenario

While unlikely, if the town's finances become imbalanced, leading to a draw on reserves, with no plan to correct in a timely manner, we could lower the rating.

Credit Opinion

Very strong economy

We consider Berlin's economy very strong. The town, with an estimated population of 20,569, is located in Hartford County in the Hartford-West Hartford-East Hartford metropolitan statistical area, which we consider broad and diverse. The town has a projected per capita effective buying income of 142% of the national level and per capita market value of \$153,714. Overall, the town's market value grew by 0.8% over the past year to \$3.2 billion in 2020.

Berlin is a primarily residential community that over the past several years has experienced diversification through development in the nonresidential sectors, including an Eversource training facility and relocation of an aerospace component manufacturer. Perhaps most significant is the Town Center Project, which is in the final stage of permitting and will contain residential as well as commercial space. Various recent public infrastructure projects, including upgrades to the town's train station and tracks as part of the New Haven-Hartford-Springfield regional rail service expansion project, have increased interest in development in Berlin. Consequently, a new proposed transit-oriented development project around the train station could result in appreciable mixed-use development, which would add to the tax base.

Several initiatives are underway to support the business community's recovery following the sudden stop stemming from the governor's stay-at-home order to control the community spread of COVID-19. These include various marketing campaigns to encourage residents to buy locally. The management team has regularly engaged in conversations with business owners and reports that only one local restaurant does not expect to reopen. In addition, building permit activity remains steady as a result of video inspections and officials report that no projects underway have delayed or slowed development plans. Although we believe that the town's economy may be poised to remain

stable, the macroeconomic conditions as discussed in S&P Global Economics' report "An Already Historic U.S. Downturn Now Looks Even Worse," published April 16, 2020 on RatingsDirect, may lead to some softening in the near term.

Very strong management

We view the town's management as very strong, with strong financial policies and practices under our financial management assessment methodology, indicating our view that financial practices are strong, well embedded, and likely sustainable.

Management's use of conservative budgeting assumptions to determine revenue and expenditures demonstrates Berlin's financial policies and practices. Management uses five years of historical data to identify tax collection and growth trends, and uses 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 and then prioritizes appropriations based on community needs. The town also monitors budget-to-actual performance, delivering a report to the board of finance monthly to address variances and propose budget amendments when necessary.

Management's maintenance of a rolling 10-year, long-term capital improvement plan that identifies capital project priorities and internal and external financing sources strengthens policies and practices. Management presents the plan before the board of finance to inform annual budget discussions. Although state statutes strictly limit investment instruments that the town can utilize, management maintains an investment policy for short-term holdings and interest income, mirroring state law.

The town implemented a formal, five-year financial plan that details assumptions and that feeds into the annual budget. Berlin also adopted formal debt management and reserve policies. The former outlines uses for debt, along with setting debt limits (relative to the grand list and operating budget) and amortization requirements. The reserve policy calls for maintenance of unassigned general fund reserves at no less than 11% of budgeted expenditures and includes the acceptable use of reserves to cover expenditures as well as a replenishment clause. Officials report that it protects its information technology systems from cybersecurity breaches through the use of cloud-based data management, regular backup of servers, and network firewalls to prevent breaches.

Adequate budgetary performance

Our assessment of the town's adequate budgetary performance reflects uncertainty over potential budget challenges facing the town stemming from the recession. Although the town has historically operated with surpluses, the unknown effect of the economic fallout could create weakness in fiscal 2021. The town had operating surpluses of 1.7% of expenditures in the general fund and of 4.6% across all governmental funds in fiscal 2019. General fund operating results of the town have been stable over the past three years, with a result of 0.8% in 2018 and a result of 0.3% in 2017.

We adjusted audited results to account for recurring transfers from the general fund to the capital projects fund while removing expenditures for capital projects funded with bond proceeds. Following three years of operating surpluses stemming from conservative budgeting and careful in-year monitoring, fiscal 2019 ended with a subsequent surplus resulting from one-time revenue derived from tax sales and personnel savings from unplanned vacancies.

The state has reduced intergovernmental aid to municipalities in prior periods of fiscal stress, and we expect that this could occur again in the face of the current recession. However, the town and school department previously established a working group to address the loss of state aid, and we believe these efforts position the town to undertake budgetary maneuvers to ensure fiscal balance as a result of its forward-looking planning and collaborative budgeting with the school board. Furthermore, the town's long-term financial plan includes ongoing reductions in state aid to offset the upcoming uncertainty.

Management reports that fiscal 2020 will likely end with a small surplus despite an amendment for a pension contribution from the unassigned fund balance to lower the net liability. As the budget is funded 85% with property taxes, a large portion of revenue was collected prior to March, when the stay-at-home order was implemented. Furthermore, with school facilities closed and very limited costs associated with the town's COVID-19 response, management believes that expenditure savings will offset any revenue loss or delay.

The fiscal 2021 adopted budget totals about \$91.5 million, a small decrease from the amended fiscal 2020 budget. The budget appropriates approximately \$425,000 in fund balance as revenue, primarily for debt service and pension funding. This amount is lower than in previous years, when the appropriation generally exceeded \$1 million. Intergovernmental aid is budgeted to decline to about \$13.1 million, or 13.3% of budgeted revenue, consistent with its strategy adopted in 2018. Although state budget conversations over the past several years have included shifting a portion of the teachers' pension system annual costs to local school departments, we do not believe this would materially affect Berlin's finances should it be enacted within the next several years.

Although we anticipate that uncertainty over the effect of the recession on the town's budget will remain a concern, as reflected in our publication "The COVID-19 Outbreak Weakens U.S. State and Local Government Credit Conditions," published April 2, 2020, we believe Berlin's financial management tools will result in at least adequate operating results within the outlook period.

Very strong budgetary flexibility

Berlin's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 18% of operating expenditures, or \$16.6 million.

The town has maintained what we consider very strong budgetary flexibility through the maintenance of reserves in excess of 15% of expenditures over the past several years. Despite annually appropriating fund balance in the budget, the town has consistently outperformed and contributed to reserves at year end. Management reports that the same will occur in fiscal 2020. Although we believe the town's flexibility will remain very strong, management is pursuing potentially utilizing some reserves in fiscal 2021 to support the school board's fall reopening plan to prepare facilities to ensure students are healthy and safe.

Very strong liquidity

In our opinion, Berlin's liquidity is very strong, with total government available cash at 23.4% of total governmental fund expenditures and 2.6x governmental debt service in 2019. In our view, the town has strong access to external liquidity if necessary given its regular issuance of debt over the past 20 years.

The town has no variable-rate or direct purchase debt, and management has confirmed it has no contingent liquidity

risks from financial instruments with payment provisions that change upon certain events. Investments are subject to strict state guidelines and cash is invested 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 years.

Strong debt and contingent liability profile

In our view, Berlin's debt and contingent liability profile is strong. Total governmental fund debt service is 9.1% of total governmental fund expenditures, and net direct debt is 76.9% of total governmental fund revenue. Overall net debt is low at 2.8% of market value, and approximately 71.8% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

Following this bond issue, Berlin has approximately \$79.3 million of total direct debt with no short-term debt outstanding. This also includes \$8.8 million remaining from a roughly \$10.4 million, 20-year capital lease for a multifaceted energy saving program. We note that the town expects to realize energy savings that it will use to finance the annual lease payments. Longer term, this program will help mitigate future cost increases associated with energy usage and consumption. The town also has approximately \$9.6 million in overlapping and underlying debt, primarily as a result of being a member of the Mattabassett District, which provides water pollution control.

The town continues with its debt reduction plan and may issue additional debt for ongoing school and infrastructure improvements. However, management expects to issue less than \$5 million annually and may de-authorize a portion of its authorized debt, as projects have come to completion. We do not expect the town's debt position to deteriorate given its long-term strategy to de-leverage and rapid amortization of debt.

Pension and other postemployment liabilities

We do not believe the town's pension and other postemployment (OPEB) liabilities present a credit pressure. While the funded ratio of the town's single-employer plan is very low, the plan was closed to all employees in 2000 and the town has made additional contributions to the plan from its unassigned fund balance to reduce the pension exposure. Furthermore, the combined net liabilities for pension and OPEB are approximately \$15 million, which we view as manageable relative to the size of the town's budget.

As of June 30, 2019, Berlin administers pension benefits through a single-employer, defined benefit public employee retirement system.

- The plan is essentially funded on a pay-as-you-go basis with a funded ratio of 17% and a net pension liability of \$7.4 million.
- There were 19 retirees and 13 active employees in the plan.
- Retirees may also opt for a lump-sum payment, which can create some unpredictability in costs, but management reports that it would issue notes if needed for cash flow purposes.
- Teachers and other certified personnel are eligible to participate in the Connecticut State Teachers' Retirement, a cost-sharing, multiple-employer system. The state makes contributions to the plan.

Despite the low funded ratio of the single-employer pension plan, the town contributed more than 200% of its

minimum funding and 400% of its static funding, indicating of the low costs associated with the plan. Furthermore, with the plan closed to new members and low discount rate of 3.5%, we believe the cost trajectory is manageable, particularly given the town's budgetary flexibility to absorb higher costs.

Berlin provides single-employer, self-insured OPEBs to certain eligible retirees and their spouses. Eligible retirees are required to contribute 100% to the cost of receiving OPEB medical benefits, so the town's OPEB liability is an implicit rate subsidy. As of June 30, 2019, the net OPEB obligation was \$7.7 million.

Strong institutional framework

The institutional framework score for Connecticut municipalities is strong.

Related Research

2019 Update Of Institutional Framework For U.S. Local Governments

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