

**Summary:**

## **Berlin, Connecticut; General Obligation; Note**

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### Credit Profile

US\$6.5 mil GO bonds ser 2019 due 12/01/2029

<i>Long Term Rating</i>	AAA/Stable	New
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US\$0.931 mil GO BANs ser 2019 dtd 06/26/2019 due 01/29/2020

<i>Short Term Rating</i>	SP-1+	New
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Berlin GO

<i>Long Term Rating</i>	AAA/Stable	Upgraded
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## Rationale

S&P Global Ratings raised to 'AAA' from 'AA+' its long-term rating on Berlin, Conn.'s outstanding general obligation (GO) debt. At the same time, we assigned our 'AAA' long-term rating to the town's 2019 GO bonds. Additionally, we assigned our 'SP-1+' short-term rating to the town's GO bond anticipation notes (BANs) dated June 26, 2019 and due Jan. 29, 2020. The outlook, where applicable, is stable.

The rating change reflects several years of positive operating performance, leading to sustained high reserve levels, despite an unpredictable operating environment. We believe this demonstrates the entrenched strong financial management policies and practices, which we believe will continue to result in positive financial results.

Securing the bonds is the town's full faith and credit. Proceeds from the bonds will permanently finance outstanding BANs and provide new-money funding to several capital projects. The new BANs will refund outstanding BANs.

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 long-term rating reflects our view of the following factors for the town:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong 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;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 16% of operating expenditures;
- Very strong liquidity, with total government available cash at 26.1% of total governmental fund expenditures and

2.9x governmental debt service, and access to external liquidity we consider strong;

- Strong debt and contingent liability position, with debt service carrying charges at 8.9% of expenditures and net direct debt that is 79.7% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 74.5% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

### **Very strong economy**

We consider Berlin's economy very strong. The town, with an estimated population of 20,505, is in Hartford County, approximately 15 miles southwest of Hartford, immediately adjacent to New Britain. It is in the Hartford-West Hartford-East Hartford MSA, which we consider to be broad and diverse. The town has a projected per capita effective buying income of 140% of the national level and per capita market value of \$154,194. Overall, market value grew by 0.8% over the past year to \$3.2 billion in 2020. The county unemployment rate was 4.2% in 2018.

Berlin is a primarily residential community. Over the past several years, the town has seen development in the non-residential sectors, including an Eversource training facility and relocation of an aerospace component manufacturer. Management is working through the local chamber of commerce on regional development issues.

Although much of the developed land in Berlin is residential, several major employers are located in town, including Eversource (1,138 employees) and Comcast Cable Systems (502). There continues to be an appreciable aerospace and high-technology manufacturing sector in the region. Berlin is also home to several manufacturers including Assa Abloy (377 employees), B&F Machine (240), TOMZ Corp. (205), Budney Industries (185), and Parker Hannafin (179).

Perhaps most notably is the current Town Center Project. 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-used development, which would add to the tax base.

Given potential new development and our expectation that residential and commercial/industrial properties will make investments in existing properties, along with a stable tax base and stable wealth and income metrics, we expect that Berlin's economy, buoyed by access to the Hartford MSA, will remain very strong.

### **Very strong management**

We view the town's management as very strong, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology, indicating financial practices are strong, well embedded, and likely sustainable.

We revised our view of Berlin's financial management practices under our FMA methodology to strong from standard and the overall management environment to very strong from adequate. The change follows adoption of formal policies and practices that we believe are well embedded and result in a material effect on the town's budgeting practices and financial outcomes.

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 board of finance monthly to address variances and propose budget amendments when necessary.

Management's maintenance of a rolling ten-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 board of finance to inform annual budget discussions. Although state statutes strictly limit investment instruments the town can use, management maintains an investment policy for short-term investment holdings and interest income and which mirrors state law.

The town has implemented a formal, five-year financial plan that details assumptions into the annual budget submission. Berlin has 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, as well as targets for amortization. The reserve policy calls for maintenance of unassigned general fund reserves no less than 11% of budgeted expenditures. It also outlines acceptable uses for reserve expenditures and has a replenishment clause.

### **Strong budgetary performance**

Berlin's budgetary performance is strong, in our opinion. The town had slight surplus operating results in the general fund of 0.8% of expenditures, and surplus results across all governmental funds of 2.4% in fiscal 2018. General fund operating results of the town have been stable over the last three years, with results of 0.3% in 2017 and 0.7% in 2016.

We adjusted budgetary performance to account for recurring transfers from the general fund to the capital projects fund and the expenditure of nonrecurring revenues in the capital projects fund. Over the past three years, Berlin's management team has produced three operating surpluses, despite an uncertain state operating environment. Management identifies conservative budgeting and careful in-year monitoring and expenditure adjustments as the reasons for the results. We note that in fiscal 2018, facing uncertain state aid and likely intergovernmental aid reductions relative to prior years and the adopted budget, the town and school department developed a working group to address the loss of state aid. We believe the town was positioned to undertake budgetary maneuvers to ensure fiscal balance due to its forward-looking planning and inherent collaborative budgeting and in-year monitoring process. Given recent results, despite likely flat state aid increases, we expect management will continue to make necessary adjustments to ensure fiscal balance. We expect the town's budgetary performance to remain strong.

Management reports that fiscal 2019 is currently tracking according to budget; a 1% operating surplus is currently projected, which is in line with recent results. The fiscal 2020 budget was adopted. It totals approximately \$90.2 million, an increase from \$87.9 million in fiscal 2018. The budget appropriates approximately \$1.2 million in fund balance as a revenue, consistent with prior years. As the town has a history of outperforming the budget, we do not believe reserves will be expended at year-end. State aid in the 2020 is held approximately flat, despite a 3% overall increase in the budget, demonstrating management's efforts to reduce the town's reliance on state aid. In fiscal 2018, local property taxes accounted for nearly 77% of total general fund revenue, while intergovernmental aid was about

18% (\$17.1 million), which includes nearly \$8.8 million in on-behalf payments for the teachers' retirement system. State budget conversations over the past several years have included shifting part of the teachers' pension system annual costs to local school departments, although we do not believe it would have a material effect on Berlin's finances should it be enacted within the next several years.

We believe the biggest obstacle facing Berlin's financial performance over both the short and long term is its relationship with the state. While we believe management can and will incorporate approximately flat state aid payments into a growing budget over the next several years, should cost-shifting or declining aid accelerate, it could have a material effect on the town's budgetary performance. At this time, however, we believe Berlin's financial management tools will result in at least balanced 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 2018 of 16% of operating expenditures, or \$14.9 million. Over the past three years, the total available fund balance has remained at a consistent level overall, totaling 15% of expenditures in 2017 and 16% in 2016.

The town has maintained what we consider very strong budgetary flexibility through the maintenance of reserves levels in excess of 15% over the past several years. Despite annually appropriating fund balance in the budget, the town has consistently outperformed and grown its reserves. We expect this to continue and we expect budgetary flexibility will remain very strong.

### **Very strong liquidity**

In our opinion, Berlin's liquidity is very strong, with total government available cash at 26.1% of total governmental fund expenditures and 2.9x governmental debt service in 2018. 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 20 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. 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 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 8.9% of total governmental fund expenditures, and net direct debt is 79.7% of total governmental fund revenue. Overall net debt is low at 2.8% of market value, and approximately 74.5% 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 \$81 million of total direct debt, including \$931,000 in BANs that management expects to pay in full at maturity. This also includes \$9.3 million remaining from 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.

The town also has approximately \$10.3 million in overlapping and underlying debt, primarily due to being a member of the Mattabassett District, which provides water pollution control. According to its capital plan, the town may issue approximately \$4 million in debt over the next two years. We do not expect this to have a material effect on our view of the debt profile. Longer term, if larger debt issuances were to slow the amortization schedule or increase debt above 3% of market value, we could revise our view of Berlin's debt profile.

Berlin's pension contributions totaled 1.5% of total governmental fund expenditures in 2018. The town made its full annual required pension contribution in 2018.

Berlin administers pension benefits through a single-employer, defined-benefit, public-employee retirement system. 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. Management reports there is no plan to reopen the pension plan.

The plan is essentially funded on a pay-as-you-go basis, as the funded ratio is less than 1%. As of June 30, 2018, there were 21 retirees and 13 active employees in the plan. In fiscal 2018, the town paid lump sums to several retirees, which increased costs to twice those paid in the previous two fiscal years. However, costs remain very low and the town has successfully incorporated these costs into the budget. As lump-sum retirements remain uncertain, the town's costs under this funding plan are also somewhat unpredictable. Management notes that it would issue notes if needed for cash-flow purposes, but is unlikely to issue longer-term pension obligation bonds. The total liability is \$8.8 million, calculated using a 3.5% discount rate. We do not believe the pension plan presents a short- or long-term credit risk, despite the uncertainty.

Teachers and other certified personnel are eligible to participate in the Connecticut State Teachers' Retirement, a cost-sharing multiple-employer system. Contributions into the plan are made by the state. Recent state budget negotiations have included shifting a portion of the costs to local governments and school departments, by as much as one-third, or approximately \$2.9 million of the fiscal 2018 state on-behalf contribution. We understand this is unlikely to happen in the immediate future, but could pressure the town's budget should it pass.

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. The net OPEB obligation, as of June 30, 2018, was \$6 million. We do not believe the town's pension and OPEB liabilities present a credit pressure at this time. While there is uncertainty in both the town's pension system and at the state level with the teachers' retirement system, we believe Berlin has the financial planning tools and budgetary flexibility to incorporate modest costs increases into the budget.

### **Strong institutional framework**

The institutional framework score for Connecticut municipalities is strong.

## Outlook

The stable outlook reflects our opinion that Berlin's well-embedded financial management practices will continue to produce at least balanced operating results, despite potential pressures in state aid and pension costs, leading to maintenance of very strong reserves. Providing additional stability is the very strong economy with access to the Hartford MSA. 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.

## 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

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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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