S&P Global Ratings

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Summary:

Branford, Connecticut; General Obligation

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US$12.88 mil GO bnds issue of 2020 (Various Projects) dtd 06/04/2020 due 07/01/2037		
Long Term Rating	AAA/Stable	New
Branford GO		
Long Term Rating	AAA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating to Branford, Conn.'s issue of 2020 general obligation (GO) bonds. In addition, we affirmed our 'AAA' long-term rating on Branford's previously issued GO bonds. The outlook is stable.

Branford'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 bonds. Bond proceeds (approximately $12.9 million) will provide funding for various capital projects and refund for a net present value savings outstanding GO debt issued through the state's clean water fund.

Credit overview

Branford's forward-looking financial management practices continue to lead to positive budgetary variances, while making meaningful strides addressing capital needs and retirement liabilities. While growth in the grand list (assessed value [AV]) is generally annually less than 1% annually, continued investment and redevelopment, along with significant town planning and investment, should lead to ongoing incremental growth. However, the scope of economic and financial challenges posed by the COVID-19 pandemic remains unknown, and a prolonged downturn could weaken growth in the town's local economy, along with expected reductions state aid and excise tax revenues. (For more information, see "All U.S. Public Finance Sector Outlooks Are Now Negative," published April 1, 2020, on RatingsDirect.) We do not expect to change the rating within the outlook period, but have accounted for the revenue and expenditure uncertainty in the current economic environment into our view of the town's budgetary performance. We rate Branford higher than the 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. (See "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions," published Nov. 19, 2013.)

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);
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) 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 28% of operating expenditures;
- Very strong liquidity, with total government available cash at 42.6% of total governmental fund expenditures and 6.7x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability position, with debt service carrying charges at 6.3% of expenditures and net direct debt that is 69.1% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value; and
- Strong institutional framework score.

Environmental, social, and governance factors

Our rating incorporates our view regarding the indirect risks posed by the COVID-19 pandemic. Absent the implications of COVID-19, we consider the town's social risks in line with those of the sector. We view its governance risks as being generally in line with those of peers, although pension funding discipline and assumption choices will likely lead to elevated and volatile costs. Branford is a coastal community and we expect changing weather patterns and rising sea levels will pose a long-term threat for drainage and coastal properties. However, we do not believe a material portion of the tax base is under imminent threat, and further understand the town is working as part of a regional effort to identify and address infrastructure needs related to coastal resiliency. We do not believe the environmental risks are likely to meaningfully pressure the town's finances or tax base in the short term, and we will continue to monitor its progress in addressing its exposure over the longer term.

Stable Outlook

The stable outlook reflects our view that Branford's management will continue to modify its budget to incorporate any loss of revenues, and any long-term pressures related to infrastructure needs and addressing its retirement liabilities. Further rating stability is provided by the town's participation in the broad and diverse New Haven-Milford MSA. We incorporated the revenue uncertainty into our view of budgetary performance and the town's overall creditworthiness and do not expect a material deterioration in its credit profile. However, while not likely, if budgeted revenues significantly underperform over the next few years, leading to significant reductions in reserves, we could lower the rating.

Credit Opinion

Very strong economy

We consider Branford's economy very strong. The town, with an estimated population of 28,094, 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 151% of the national level and per capita market value of $182,201. Overall, market value was stable over the past year at $5.1 billion in 2020. The county unemployment rate was 3.9% in 2019.

We expect the town will remain a desirable location for living, visiting, and working. However, S&P Global Economics currently forecasts a recessionary period lasting six-to-12 months. Please see the article, titled "An Already Historic

U.S. Downturn Now Looks Even Worse" (published April 16, 2020), and we believe the growth rate in the tax base is likely to decrease relative to recent years, given the current economic recession. Should new growth stall, or if unexpected tax appeals arise, the town's tax base growth could approach zero or contract. We believe the town's mill rate is lower than those of neighboring communities and it has ability to raise the rate to generate additional revenue, but tax base growth is likely required to maintain long-term fiscal balance. Additionally, if the county's unemployment rate where to remain elevated, we could negatively revise our view of the town's economy.

Branford's management continues to take an active role in shaping economic development in town across residential, commercial and industrial sectors. It leverages the town's location and assets, such as ocean access along Long Island Sound, proximity to Yale University and New Haven, and sewer and train infrastructure, to market the town and generate new investment. The town has a transit-oriented development (TOD) plan, with recent efforts to redevelop properties around the train station. The station is serviced by the CT DOT Shore Line East commuter line. There are several projects either approved or in the pipeline near the station, located on former industrial sites within the TOD boundary. These include a mixed-use development with 200-units of residential and 15,000 square-feet of commercial space, an additional 150-unit residential development with 5,000 square-feet of commercial space, and a third 30-unit residential development. These should help grow the tax base when completed. Additionally, the town continues to work to leverage its coastal location and tourist assets, including three breweries and a recently approved 100-unit Hampton Inn. The town has finished an update of its master plan in 2019, which includes policies and recommendations to address coastal vulnerability and sea-level rise, helping sustain the tax base and maintain existing assets, including the coastline itself.

The town also has a history of advanced manufacturing, health care, and biotech. Management's collaboration with development organizations, notably BioCt (the state's biotech association); the University of Connecticut's TIP, a biotech incubator; ABCT, a biotech start-up program; and regional chamber of commerce and councils, promotes investment. We understand the town just approved a 20,000-square-foot office, lab, and research facility for a company that grew out of the TIP incubator, and its established firms remain stable.

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.

We expect management will continue to adopt realistic budgets, grounded in forward-looking and conservative assumptions. We previously noted that the town incorporated potential state aid cuts into prior-year budgets, as management works to adapt to changes in its operating and financial environment. It is our expectation that management will continue to monitor revenue and expenditure trends, and make adjustments accordingly. The town can amend its budget midyear, in accordance with state law.

Highlights of its financial practices include the following.

- The town's budget process incorporates several years of budget-to-actual results to identify and adjust to trends in both revenues and expenditures when developing future budgets. Additionally, an outside consultant assists in forecasting health care costs and the town incorporates forward-looking assumptions into its budget process.

- Management continuously monitors Branford's budget-to-actual performance, but only makes formal reports to the board on an as-needed basis. Individual department heads are responsible for budget reports to their respective oversight commissions.
- The annual budget incorporates a five-year capital improvement plan, which identifies funding for all future years; separately, a debt service schedule is kept to account specifically for future annual debt service. While the commentary in the town's annual budget notes management's informal goal of funding as many capital expenditures as possible on a pay-as-you-go basis, thus limiting debt, there is no formal debt management policy.
- The board maintains an informal reserve and liquidity policy of sustaining unassigned fund balance at 9% of operating expenditures.
- The town has an investment management policy that mirrors state statute.

Adequate budgetary performance

Branford's budgetary performance is adequate, in our opinion. The town had operating surpluses of 1.6% of expenditures in the general fund and 6.7% across all governmental funds in fiscal 2019. General fund operating results of the town have been stable over the last three years, with results of 1.6% in 2018 and 2.4% in 2017.

Due to the sudden rapid economic deterioration, we incorporated the uncertain revenue and expenditure risk into our assessment of performance to account for these risks over the next one-to-two fiscal years. This assessment incorporates heightened near-term uncertainty that exists due to the recessionary pressures related to the COVID-19 pandemic and resulting financial pressures. We adjusted budgetary performance to account for recurring transfers into and out of the general fund, and for one-time capital outlays.

The town's consistent past surplus operating performance reflects a predictable revenue stream along with careful budgeting of expenditures. While we expect management will continue to adjust its budget to account for changes in revenues and expenditures, we believe the current economic environment is likely to result in variable and declining revenues, particularly in state aid and excise taxes. We note that for the fiscal 2021 budget, the town revised its budgeted tax collection rate at 95%, down from 98% used in all recent budgets. It also adjusted downward anticipated state aid, building permit fees, and interest income. However, due to contractual expense growth, rising pension costs, and increased debt service, the overall 2021 budget grew about 2% to $188 million. Consequently, the budgeted use of reserves increased to about $6.9 million, from $2.8 million in fiscal 2021, although the town actually reduced its mill rate to 28.92. The town has a history of revenues and expenditures outperforming the budget, but it remains unclear if it will fully cover budgeted reserves in 2021, particularly if state aid cuts in 2022 necessitate further use of reserves. We incorporated the revenue uncertainty into our forward-looking view of performance.

In fiscal 2019, property taxes accounted for about 88% of audited revenues, while intergovernmental revenues, which include pass-through payments for the teachers' retirement system, was about 6.3%. Charges for services were 3.8%. We believe the town has accounted for potential revenue variation and reduction in the 2021 budget, which could reduce reserves. Given its history of outperforming budgeted revenues and expenditures, it could draw on less than the budgeted reserves at year-end; however, we believe uncertainty remains about how much variation and reduction towns will see in revenue and accounted for it in our view of performance.

Very strong budgetary flexibility

Branford's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 28% of operating expenditures, or $32.3 million.

Due to conservative financial management, the town has not had to use its annual budgeted reserve appropriation within the past three fiscal years, and does not anticipate reporting fund balance usage in 2020. However, given the size of the appropriation in the 2021 budget, along with the revenue uncertainty, we believe it is more likely than in recent years that the town will ultimately post a draw on its reserves at year-end. However, we anticipate it will not draw on the full budgeted amount, and we do not believe a material change in its budgetary flexibility profile is forthcoming, despite broad economic and revenue pressures.

Very strong liquidity

In our opinion, Branford's liquidity is very strong, with total government available cash at 42.6% of total governmental fund expenditures and 6.7x governmental debt service in 2019. In our view, the town has strong access to external liquidity if necessary.

We adjusted the town's available cash to exclude bond proceeds and other special revenues we believe are generally not available to support debt service. Branford is a regular market participant that issued GO debt frequently over the past several years. The town does not have any variable-rate or direct-purchase debt, nor does it have any contingent liquidity risks from financial instruments with payment provisions that change on the occurrence of certain events. It maintains an investment policy that limits its investments to U.S. government securities, state short-term investment funds, and other short-term investments such as CDs and money market funds. The policy expressly prohibits investment in derivative securities and other riskier investments. The town elected to implement the state's three-month property tax collection delay. Management examined cash flows and does not anticipate any need for cash-flow borrowing. We do not expect significant pressure on its liquidity profile at this time.

Strong debt and contingent liability profile

In our view, Branford's debt and contingent liability profile is strong. Total governmental fund debt service is 6.3% of total governmental fund expenditures, and net direct debt is 69.1% 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.

Management is continually re-evaluating its capital plans and balancing infrastructure needs against budgetary realities, while weighing interest rates against future projections. Currently, management may issue up to $7.5 million over the next year to address capital needs. If debt service as a percentage of revenues were to increase following the current or future debt over the next several years, we could negatively revise our view of the debt profile.

Pension and other postemployment benefits

- We do not view pension and other postemployment benefit (OPEB) liabilities as an immediate source of credit pressure for Branford.
- While the use of an actuarially determined contribution (ADC) is positive, we believe some of the assumptions used to build the pension ADC reflect what we view as weak assumptions and methodologies, which, in our opinion, increases the risk of unexpected contribution escalations.
- Although OPEB costs are paid on a pay-as-you-go basis, the town is prefunding its liability and expects to report a

significant increase in its OPEB funded ratio at the close of 2020.

As of June 30, 2019, the town participated in the following pension plan:

- Municipal Employees' Retirement System (MERS): 73.6% funded, $29.3 million net pension liability (NPL)
- Police Employees' Retirement Plan: 71.2% funded, $10.5 million NPL
- Volunteer Fire Department Pension Plan: 76.3% funded, $346,000 NPL

Branford's combined required pension and actual OPEB contributions totaled 4.1% of total governmental fund expenditures in 2019. Of that amount, 2.8% represented required contributions to pension obligations, and 1.3% represented OPEB payments. The town made 113% of its annual required pension contribution in 2019, which included payments in excess of the ADC to the police and fire plans. The town also overfunded its OPEB required contribution, largely through a transfer from the internal services health care fund.

MERS recently revised its discount rate for calculating the liability to 7.0% from 8.0%, which resulted in an approximately $21 million increase in the town's MERS NPL. We believe the 7.0% discount rate remains somewhat elevated, and given the change in assumptions costs, is likely to increase. However, we believe the town has the ability to absorb the increased cost into its budget. The plan also uses a level-dollar amortization method, which should limit cost growth, along with 21 years remaining on the amortization period. The local plans use a 6.5% discount rate, which we believe will limit cost fluctuation, but the level-percent basis could increase costs. The police plan has 16 years remaining and the fire plan 10 on their amortization schedules, which we believe will lead to progress in address the liabilities. We note that the police plan was closed to new entrants as of Jan. 1, 2012. However, in 2019, the town created a second tier within the police pension plan to improve hiring and retention. As previously noted, we will continue to monitor how this affects the town's carrying costs and financial results.

The town transferred approximately $5 million from its internal services fund in 2019, and in 2020 expects to transfer approximately $6.8 million, to the OPEB trust. This is likely to result in an OPEB funded ratio approaching 100%, given the outstanding OPEB liability of about $6.8 million. At this time, we do not believe retirement costs are pressuring the town's budget, nor are they likely to in the near future.

Strong institutional framework

The institutional framework score for Connecticut municipalities is strong.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019

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