

Research Update:

County of Essex 'AA+' Ratings Affirmed; Outlook Remains Stable

November 14, 2019

Overview

- We expect the County of Essex will continue using internal funding and a pay-as-you-go strategy to address rising capital spending requirements, while preserving a superior budgetary performance and exceptional liquidity.
- Although the county has seen a gradual improvement in economic indicators and diversification in the past few years, its economy remains fairly concentrated in the auto sector.
- We are affirming our 'AA+' long-term issuer credit and senior unsecured debt ratings on the County of Essex, and maintaining our stable outlook.

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Rating Action

On Nov. 14, 2019, S&P Global Ratings affirmed its 'AA+' long-term issuer credit and senior unsecured debt ratings on the County of Essex, in the Province of Ontario. The outlook is stable.

Outlook

The stable outlook reflects our expectations that, in the next two years, Essex will efficiently use its pay-as-you-go strategy to finance its growing capital program with no recourse to debt issuance, while maintaining sound budgetary performance and robust liquidity. It also reflects our belief that local economic growth will continue gradually, and the new council's priorities will continue reflecting a balanced fiscal environment.

Upside scenario

All else equal, we could raise the ratings in the next two years if the local economy substantially strengthened, supported by higher-than-expected growth and notable sector diversification; and if management's response to this growth fully met the increased complexity of the county's needs.

Downside scenario

Although we do not expect it, weakening economic activity, due to, for instance, loss of major employers or demographic trends, could lead to lower-than-expected tax revenue collections. This, combined with the county's difficulty to scale back capital projects or enact offsetting property tax increases, could further erode the county's financial performance. Under this scenario, we could lower the ratings in recognition of the county's weakened budget flexibility.

Rationale

We expect Essex will continue generating superior budgetary performance despite higher capital expenditures. In addition, its strategy to pay-as-you-go and use reserves for financing its capital plan should mitigate the need to issue additional debt, and support continued generation of robust operating and moderate after-capital surpluses. Despite Essex's efforts to gradually diversify its economy, we believe it remains concentrated in the auto sector, which we consider a key rating constraint.

Economic growth to remain moderate while the county gradually diversifies.

We believe Essex's nominal GDP per capita is close to national and provincial levels, given its fairly high median household income. This is primarily based on our assumption that most of the county's population (about 60%) lives in municipalities forming the Windsor Census Metropolitan Area (excluding the city), which has a household income close to that of Ontario. Essex's local economy was relatively stable in 2018, with an unemployment rate close to 6%, higher property assessment values, and steady construction activity, as reflected in the value of building permits and housing starts. The economy has historically focused on the manufacturing (primarily auto) and agricultural sectors; it also includes large public-sector employers. Essex is increasing its efforts to diversify its economy into service-based sectors (including tourism, agro-business, health care and social assistance, and education), which we believe could contribute to slow-but-positive medium-term growth prospects. Nevertheless, we estimate that the auto sector, which tends to be volatile, still accounts for close to 20% of the county's employment. In our opinion, Essex's competitive tax rates versus those of peers and measures to attract retirees could stimulate the local economy and increase the population, but also raise the dependent population, which could put pressure on services such as emergency medical services. Located in the southwest corner of Ontario, Essex is composed of seven lower-tier municipalities and has a population of over 181,000. It neighbors the City of Windsor and borders the City of Detroit across the Detroit River.

We believe Essex demonstrates strong financial management practices and broad political consensus on fiscal policies. Essex's council is composed of the mayors and deputy mayors of the seven lower-tier municipalities within the county; members serve a four-year term. Unlike Canada's members of federal or provincial parliaments, municipal councilors do not operate under a political party system. We believe the management team is well qualified and largely stable; it has demonstrated its ability to find cost efficiencies to adhere to the council's fiscal decisions. The county produces consolidated one-year operating budgets and actual variations from budget are moderate. It prepares an annual asset management plan allowing it to ensure better cost effectiveness and efficiencies for its corporate infrastructure and assets. In our opinion, financial information is sufficiently detailed and comprehensive. We also believe that debt and liquidity management is prudent.

Like other Canadian municipalities, Essex benefits from a very predictable and well-balanced local and regional government framework that has demonstrated high institutional stability. Although provincial governments mandate a significant proportion of municipal spending, they also provide operating fund transfers and impose fiscal restraint through legislative requirements to pass balanced operating budgets.

The county to continue to use pay-as-you-go funding to meet its rising capital spending.

Essex continues to effectively control spending. We expect its budgetary performance to remain superior in our 2017-2021 base-case forecast period, with sound operating balances averaging over 23% of operating revenues. In addition, by our estimate, despite a planned increase in capital spending in the medium term, after-capital balances will be close to 8% of total operating revenues, on an average basis. We expect the county will continue addressing its capital needs at a faster pace in the near future. Essex has historically maintained its tax rates below 2%, despite incorporating its 1.5% capital tax levy associated with infrastructure expansion and new funding for the New Windsor-Essex Hospital System (NWEHS). On average, rates rose an annual 1.3% in the past 17 years, consistently below inflation; the tax increase for 2019 was 1.43%. We do not expect provincial cuts will materially affect Essex's budgetary performance because the county relies moderately on transfers from senior levels of government and has significant revenue-raising tools such as property taxes and user fees. With the construction of the NWEHS, the county may be required to increase rates more, and we believe it has the ability to do so. The new health system's cost is an estimated C\$2 billion, for which municipalities are required to fund 10%. This would translate to close to C\$100 million funding provided by the county, and a similar contribution from Windsor. Although the construction timing has not been finalized, Essex's preliminary funding strategy includes an upfront commitment of C\$50 million, funded via annual levies for 10 years, as well as commitment transfers, with the balance potentially being covered through debt issuance.

In our view, Essex benefits from exceptional internal liquidity support and satisfactory access to external liquidity for refinancing needs. In addition, we believe its strong operating balances point to robust cash flow generation capability and boost its liquidity profile. We estimate that its free cash will total about C\$180 million in the next 12 months and cover more than 28x estimated debt service for the period.

We estimate that the tax-supported debt ratio will decrease slowly to below 30% of total consolidated operating revenues in the next two years, as the county funds its capital plan primarily with internal resources. Tax-supported debt outstanding includes debt borrowed under Essex's name on behalf of its lower-tier municipalities and on behalf of Windsor. Because the county has no debt prospects in the next two years, we expect these items to total about C\$56 million at the end of 2021, or about 29% of consolidated operating revenues. S&P Global Ratings recognizes that there is a lower credit risk associated with the debt on-lent to these self-supporting entities. The overall debt burden (excluding the on-lent debt) is 19% of consolidated operating revenues and we believe that it will continue to decline in the next two years. In addition, tax-supported debt is less than five years of operating surpluses, which together with very low interest costs (about 2 % of operating revenues on average for 2018-2020), supports our assessment of the very low debt burden.

Key Statistics

Table 1

County of Essex -- Selected Indicators

Mil. C\$	-- Fiscal year ended Dec. 31 --					
	2016	2017	2018	2019bc	2020bc	2021bc
Operating revenues	153	161	170	177	184	192
Operating expenditures	121	126	130	136	141	148
Operating balance	32	35	40	42	43	44
Operating balance (% of operating revenues)	20.8	21.7	23.4	23.4	23.3	23.0
Capital revenues	8	7	10	9	8	8
Capital expenditures	21	35	34	36	33	34
Balance after capital accounts	18	7	15	15	18	19
Balance after capital accounts (% of total revenues)	11.3	4.3	8.5	7.8	9.3	9.3
Debt repaid	2	2	2	3	3	3
Gross borrowings	0	0	0	0	0	0
Balance after borrowings	16	5	13	12	15	15
Direct debt (outstanding at year-end)	69	67	65	62	59	56
Direct debt (% of operating revenues)	45.3	41.8	38.1	35.1	32.0	29.2
Tax-supported debt (outstanding at year-end)	69	67	65	62	59	56
Tax-supported debt (% of consolidated operating revenues)	45.3	41.8	38.1	35.1	32.0	29.2
Interest (% of operating revenues)	2.8	2.6	2.4	2.2	2.1	1.9
National GDP per capita (single units)	56,169	58,607	59,879	61,413	63,082	65,120

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. dc--Downside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with a downgrade. uc--Upside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with an upgrade.

Ratings Score Snapshot

Table 2

County of Essex -- Ratings Score Snapshot

Key rating factors	Assessment
Institutional framework	2
Economy	2
Financial management	2

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Table 2

County of Essex -- Ratings Score Snapshot (cont.)

Key rating factors	Assessment
Budgetary performance	1
Liquidity	1
Debt burden	1
Stand-alone credit profile	aa+
Issuer credit rating	AA+

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "Methodology For Rating Local And Regional Governments Outside Of The U.S.," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

Key Sovereign Statistics

- Sovereign Risk Indicators, Oct. 10, 2019. Interactive version available at <http://www.spratings.com/sri>

Related Criteria

- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Guidance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- Institutional Framework Assessments For International Local And Regional Governments, July 4, 2019
- Public Finance System Overview: Canadian Municipalities, July 18, 2018

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

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The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed

Essex (County of)

Issuer Credit Rating	AA+/Stable/--
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Senior Unsecured	AA+
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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 for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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