

**County of Essex
Office of the Director of Corporate Services / Treasurer
Administrative Report**

To: Warden Bain and Members of County Council

**From: Robert J. Maisonville
Director of Corporate Services / Treasurer**

Subject: County of Essex - Credit Rating

Date: November 7, 2012

Report: 2012-R20-FIN-1107-RM

Purpose

To report the results of the County of Essex 2012 credit rating review conducted by Standard & Poor's (S&P), dated November 1, 2012.

Background

The S&P credit rating provides issuers, investors and intermediaries with an independent view of the creditworthiness of an entity or simply the entity's ability and willingness to meet financial obligations (principal and interest) in full and on time. Factors which influence a credit rating include: state of the economy; changes in the business climate; existing debt; significant fluctuations in capital spending; changes to cash flow and liquidity, and taxation capacity.

Recently S&P conducted its evaluation of Essex County. The evaluation included interviews with the Director of Corporate Services/Treasurer and CAO, obtaining first-hand information regarding the political, administrative and financial stewardship of the County. The analysis included: a review of the Corporation's prior period financial statements, physical asset management practices, reserve strategy, investment portfolio and budget performance; the status of residential, commercial and industrial development activities; informal discussions regarding the strengths, weaknesses and diversity of the local economy; examination of the relative strength of local municipalities, and discussions with administration regarding future challenges and opportunities, particularly concerning the management of municipal infrastructure.

Rating Opinion

As a result of their review Standard and Poor's has **affirmed** the County's credit rating at **AA-** rating for the County and improved the County's outlook from **Stable** to **Positive**. (see Appendix "A" for the media release – the full rating analysis has been delayed due to system related difficulties experienced by S&P's New York office).

As described below, there exist two distinct but equally important elements expressed in a credit rating.

First, the **AA-** rating signifies that County of Essex credit status is of a high quality, and conversely low risk. Attached as Appendix "B" is an excerpt from Standard & Poor's Guide to Credit Rating, which provides S&P's credit rating definitions.

In the current financial markets, the **AA-** rating translates into a savings from A+ of about 8-10 basis points. On a placement of \$20 million for 15 years this translates into \$220,000 to \$275,000 in interest savings over the term of the placement.

Second, the **Positive** outlook rating reflects the expectation that the County of Essex's credit rating quality could improve in the coming years. Continued improvements in regional economic performance (noting economic diversification efforts and the reduction in regional unemployment rate), maintaining the Corporation's current approach to funding capital projects with minimal debt issuance, a financially managed approach to funding capital expansion initiatives and no large unexpected borrowing undertaken by the lower-tier members were sighted as significant factors in maintaining the County's credit quality.

Equally as important as savings in the financial markets, the rating provided by S&P represents an independent testimony to the beneficial effects of the strengthening initiatives and financial stewardship practices and policies subscribed to by Council.

Specifically, Standard and Poor's noted the following performance strengths in affirming the County's credit rating to **AA-**:

- Strong financial position, derived from very low debt and debt service burdens;
- Robust liquidity, a result of the Corporation's ongoing commitment to a solid Reserve Strategy;
- Consistently strong record in terms of budgetary performance. Solid operating surpluses have provided the Corporation with the means to fund its capital expenditures largely from internal sources, reducing debt issuance needs;
- Long standing life-cycle capital program, which plans for the replacement of assets over their useful lives through contributions to and from capital/infrastructure reserves;
- Ability to fund capital expenditures largely from internal sources, validating the County's "pay-as-you-go" philosophy of funding capital/infrastructure requirements by creating capacity in the budget in a measured way and through the effective use of reserve balances, and
- Diversified economic development efforts away from automotive manufacturing towards alternative energy, medical equipment, tourism, aerospace and agri-businesses.

Conversely, Standard and Poor's noted the following key performance weakness or threats to the County's credit rating to **AA-**:

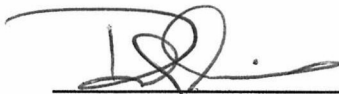
- From a peer comparison standpoint, a relatively a high reliance on the automotive sector as the region's economic driver, noting limited-but-increasing diversification; and
- Potential for rising debt issuance at the lower tier level's indirect impact over the County's overall debt-carrying capacity. Debt for both the County and lower tier are serviced from the same tax base.

Recommendation

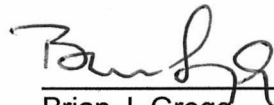
For the information of Council.

Respectfully submitted,

Concurred with,



Robert J. Maisonville
Director of Corporate Services / Treasurer



Brian J. Gregg
Chief Administrative Officer

Attachments

- Appendix A - Standard & Poor's rating - County of Essex – November 1, 2012
- Appendix B - Standard & Poor's Credit Rating Guide



County of Essex Outlook Revised To Positive On Expected Strength In Financial Risk Profile

Primary Credit Analyst:

Jennifer Love

Secondary Contact:

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Overview

- We are revising our outlook on the County of Essex to positive from stable.
- We are also affirming our 'AA-' long-term issuer credit rating on the county.
- In addition, we are assigning our 'AA-' senior unsecured debt rating to the county.
- The outlook revision reflects Standard & Poor's expectation that, in the next two years, Essex's financial risk profile will remain healthy, with very positive liquidity and strong operating performance and potentially modest after-capital deficits.
- In part, the rating reflects our view of the county's robust liquidity, strong budgetary performance, and adequate budget flexibility.

Rating Action

On Nov. 1, 2012, Standard & Poor's Ratings Services revised its outlook on the County of Essex, in the Province of Ontario (AA-/Negative/A-1+), to positive from stable. At the same time, Standard & Poor's affirmed its 'AA-' long-term issuer credit rating on the county. Standard & Poor's also assigned its 'AA-' senior unsecured debt rating to Essex.

The outlook revision reflects our view of the county's sustained very positive liquidity and strong budgetary performance.

Rationale

The ratings on Essex reflect Standard & Poor's view of the county's robust liquidity, strong budgetary performance, and adequate budget flexibility. Offsetting these factors somewhat are our views of an economy with limited-but-increasing diversification, and rising consolidated debt levels.

We believe Essex's robust liquidity bolsters its credit profile and has resulted in it maintaining its net creditor status for many years. At fiscal year-end 2011 (Dec. 31), free cash and liquid assets of almost C\$70 million represented about 64.2% of operating expenses and exceeded 25x debt service (all figures Standard & Poor's-adjusted). We expect that liquidity levels will remain very positive over the next two years.

We believe that Essex has a track record of strong operating performance and after-capital performance. At year-end 2011, the county's operating surplus was 13.3% of operating revenues and its balance after capital expenditures was an 8.4% surplus. We believe that the operating surplus will remain near its current level during our two-year outlook horizon. Essex's after capital balance has been positive in all but one year in the past five. In 2011, its capital expenditures (C\$13.8 million) were about half of the amounts it typically spent in each of the previous four years (the five-year average was C\$23.3 million). We believe the county's after-capital balance will return to its trend level while remaining strong. This could result in a return to a slightly negative balance during the next two years.

In our opinion, Essex has adequate budgetary flexibility, with 80% of operating revenue coming from modifiable revenue sources. The county's budgetary performance is average among its domestic peers, although the expected decrease in grants from upper levels of governments from levels of the past could moderately constrain its budgetary flexibility. A recent 2.26% increase in the residential tax will offset Essex's budgetary pressures somewhat, particularly for capital financing.

We believe the Essex's per capita GDP is below the provincial level of C\$47,770 due to some concentration in lower value-added employment as the county's economy is fairly concentrated within the manufacturing and agricultural sectors. This had a negative impact on Essex's economy during the recession and also prompted it to explore means to diversify its economy. Nevertheless, we are encouraged by the county's attempts at economic diversification as well as the fall in the region's unemployment rate. We expect the economy to increase during our two-year outlook horizon through economic diversification and growing employment.

Essex's consolidated debt burden (which includes debt at the lower-tier level) is forecast to increase in the next two years. We expect that stand-alone debt will remain below 30% of operating revenue, which we consider to be moderate. However, we believe that the consolidated debt burden will continue its rise, remaining above 60%.

Outlook

The positive outlook reflects our expectation that, in the next two years, the economy continues to expand and diversify and that Essex will continue to produce stable operating results with operating balances greater than 5% of operating revenues. Moreover, Standard & Poor's also expects no material increase in the county's debt. A dramatic decrease in revenues or a major economic deterioration could lead us to revise the outlook to stable. Conversely, a continuation of the current financial and economic trends during our outlook horizon could result in an upward ratings revision.

Related Criteria And Research

Methodology For Rating International Local And Regional Governments, Sept. 20, 2010

Ratings List

Outlook Revised To Positive

	To	From
Essex (County of) Issuer credit rating	AA-/Positive/--	AA-/Stable/--
Rating Assigned Senior unsecured debt	AA-	

Standard & Poor's, a part of The McGraw-Hill Companies (NYSE:MHP), is the world's foremost provider of credit ratings. With offices in 23 countries, Standard & Poor's is an important part of the world's financial infrastructure and has played a leading role for 150 years in providing investors with information and independent benchmarks for their investment and financial decisions. For more information, visit <http://www.standardandpoors.com>.

The ABCs of rating scales

Standard & Poor's credit rating symbols provide a simple, efficient way to communicate creditworthiness and credit quality.

Its global rating scale provides a benchmark for evaluating the relative credit risk of issuers and issues worldwide.

General summary of the opinions reflected by Standard & Poor's ratings

INVESTMENT GRADE	'AAA'	Extremely strong capacity to meet financial commitments. Highest rating
	'AA'	Very strong capacity to meet financial commitments
	'A'	Strong capacity to meet financial commitments, but somewhat susceptible to adverse economic conditions and changes in circumstances
	'BBB'	Adequate capacity to meet financial commitments, but more subject to adverse economic conditions
	'BBB-'	Considered lowest investment grade by market participants
SPECULATIVE GRADE	'BB+'	Considered highest speculative grade by market participants
	'BB'	Less vulnerable in the near-term but faces major ongoing uncertainties to adverse business, financial and economic conditions
	'B'	More vulnerable to adverse business, financial and economic conditions but currently has the capacity to meet financial commitments
	'CCC'	Currently vulnerable and dependent on favorable business, financial and economic conditions to meet financial commitments
	'CC'	Currently highly vulnerable
	'C'	A bankruptcy petition has been filed or similar action taken, but payments of financial commitments are continued
	'D'	Payments default on financial commitments
Ratings from 'AA' to 'CCC' may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories.		