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County of Essex

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County of Essex

Major Rating Factors

Strengths:

- Robust liquidity
- Strong budgetary performance
- Adequate budgetary flexibility

Weaknesses:

- Low-but-improving economic diversification
- Rising consolidated debt levels

Issuer Credit Rating

AA-/Positive/--

Rationale

The ratings on the County of Essex, in the Province of Ontario (AA-/Negative/A-1+), reflect Standard & Poor's Ratings Services' 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.

Comparative Analysis

Essex's immediate peer group consists of the Canadian municipalities of Wellington (AA/Stable/--), Oxford (AA-/Positive/--) and Simcoe (AA-/Stable/--); and the Canadian cities of Windsor (AA/Stable--) and Regina (AA+/Stable/--). All are in Ontario, except for Regina, which is the capital of Saskatchewan (AAA/Stable/A-1+).

Economic comparisons with peers at the local municipal level in Canada tend to come from indicators such as demographic and labor market data, as well as construction trends. For several years, Essex's unemployment has been higher than some of its immediate peer group. We believe that the county's economy is less diversified than that of its peers.

Essex's financial performance is average among its peers. Its average three-year operating performance for 2009-2011 was in the middle of peers, as was its after-capital balance. Moreover, it has average capital spending as a percent of total expenditures, and average modifiable revenues as a percent of adjusted operating revenues were about average for the peer group. Like most Canadian municipalities, the county maintains what we view as a strong liquidity position, and its debt burden was also average for the peer group.

Ontario Municipalities Benefit From A Well-Balanced And Predictable Institutional Framework

We view the Canadian provincial-municipal intergovernmental system as being "well-balanced and predictable" because of its maturity and stability, low-to-moderate degree of mismatching of revenues and expenditures, moderate levels of transparency and accountability, and strong likelihood of extraordinary support from provincial governments.

Provincial-municipal relationships have proven to be more dynamic than the federal-provincial one, largely because the municipal governments are established through provincial statute and not the constitution. Historically, the provinces have taken a more active role in municipal affairs than the federal government in provincial matters. Although there have been long periods of relative stability, provincially imposed large-scale changes to municipal revenue powers and expenditure responsibilities have occurred.

Provinces mandate a significant proportion of municipal spending and, through legislation, require municipalities to pass balanced operating budgets (although they also provide operating fund transfers). Nevertheless, municipalities generally have the ability to match expenditures well with revenues, except for capital spending, which can be intensive for some. Many have been limited in their ability to renew their infrastructure, roads, water, and wastewater, due to constraints on fee and property tax increases. Property taxes are the primary source of own-source revenues for Canadian municipalities, followed by fees and transfers from both the provincial and federal governments. Chief expenditure categories of Canadian municipalities are transportation services, which include roads and transit; environmental services, which include water distribution and treatment and wastewater collection; protection services such as fire and police; and recreation and cultural services. Small and rural municipalities generally receive higher provincial transfers, for both operating and capital programs, compared with those of their more urban counterparts, but there are no formal equalization schemes.

We believe financial information is quite timely. National accounting standards are strong and improving, in our view, although adoption can vary somewhat. Statutes require audited statements. While there are no national standards that apply to budgeting practices, a five-year capital budgeting process is usually the minimum. In addition, only current-year budgeting is required generally for operations.

The provinces have an established history assisting their distressed municipalities through grants.

A Less-Diversified Economy Than That Of Peers

Essex is in the southwest corner of Ontario. It neighbors the City of Windsor (AA/Stable/--) and borders the City of Detroit across the Detroit River. The county has a population of about 180,000 and is composed of seven lower-tier municipalities. Population growth has been slow-but-positive in Essex. From 2006-2011, growth was 0.6%. The county is one of the key agricultural centers in Ontario and it also has large manufacturing base. Its GDP is not available; however, we believe its per capita GDP is below the provincial level of C\$47,770, due to some concentration in lower value-added employment.

The economic slowdown in manufacturing, particularly the auto sector, has affected Essex, where the area's exposure is high compared with that of similarly rated peers; remaining employment is largely rural. The county, in conjunction with Windsor, has employed and is investigating a number of diversification initiatives, which have already begun to show some success. Sectors of interest include the renewable energy sector, biomedicine, and higher education. Manufacturers have begun to diversify their customers and markets, reducing their reliance solely on the auto sector or toward sectors such as alternative energy, medical equipment, aerospace, and pure and applied research and development. Some examples include announcements by alternative energy providers of wind and solar energy to

build plants in the area and the new satellite medical school.

Unemployment in the region is improving. The unemployment rate for the region, which includes Windsor, fell below 10.0% in 2012, down from a peak of 13.8% in 2009 (see table 1). Employment is not concentrated within any one employer.

We believe that Essex's economy benefited from the receipt of significant grants from the provincial and federal governments as part of stimulus funding. Recent trends in leading economic indicators such as unemployment rates and building permit values indicate a moderately improving local economy. Essex's assessment base increased in 2011 by 2.4%. Although the value building permits fell 58% to C\$286 million, this is an anomaly owing to exceptionally strong growth the previous year. Housing starts fell 3.3%. In addition, the county projects growth in income support caseloads to decline year-over-year almost 1%.

Table 1

County of Essex--Economic Statistics					
	Total population*	% aged 14 years or younger*	% aged 65 years or older*	Median age§	
Population summary	177,720	8.3	14.6	40.8	
Economic statistics (%)	2011	2010	2009	2008	2007
Population growth	0.1	0.1	0.1	0.1	0.1
Unemployment rate	9.8	11.8	13.8	9.0	9.3
Assessment base growth (% change)	2.35	2.18	0.64	1.73	1.96

*Based on 2011 results from Census excluding Windsor and Pelee Township. §Based on the 2011 Census including Windsor and Pelee Township.

Financial Management Does Not Affect Credit

We consider Essex's financial management to have a neutral impact on its credit profile. We believe the management team is well-qualified and has been largely stable. Its financial statements have an adequate level of transparency and disclosure and have been independently audited with no qualifications. The county produces consolidated budgets and actual variations from budget are moderate. Essex provides a one-year operating and five-year capital budgets. In our view, information is sufficiently detailed and comprehensive. We also believe that the county's debt and liquidity management are prudent.

Average Budgetary Flexibility

In our opinion, Essex has adequate budgetary flexibility, with 80% of operating revenue coming from modifiable revenue sources (see chart 1). The county's budgetary performance is average among its domestic peers. Like most Ontario municipalities, tax increases greater than inflation can be difficult to achieve politically and many of the services that Essex provides are provincially mandated. In addition, declining surpluses and the expected decrease in grants from upper levels of governments could also moderately constrain budgetary flexibility.

Essex had capital expenditures of about C\$13.8 million in 2011, or about 11.3% of total expenditures (see chart 2). The

majority of that went to maintaining and expanding road infrastructure. We expect the county's main capital expense to continue being ongoing roadwork. We expect road expansion expenditure to escalate significantly in the next 10 years to more than C\$150 million (before the use of reserves), unless Essex receives provincial and federal government support. Standard & Poor's believes the county's capital expenditure plan is well within its means, because it primarily funds its capital requirements on a pay-as-you-go basis through reserve management and a 2.29% annual levy increase. We believe that the ability to generate sizable operating surpluses is a key credit strength, because it provides Essex with the financial flexibility to maximize pay-as-you-go financing and limit debt issuance.

Chart 1

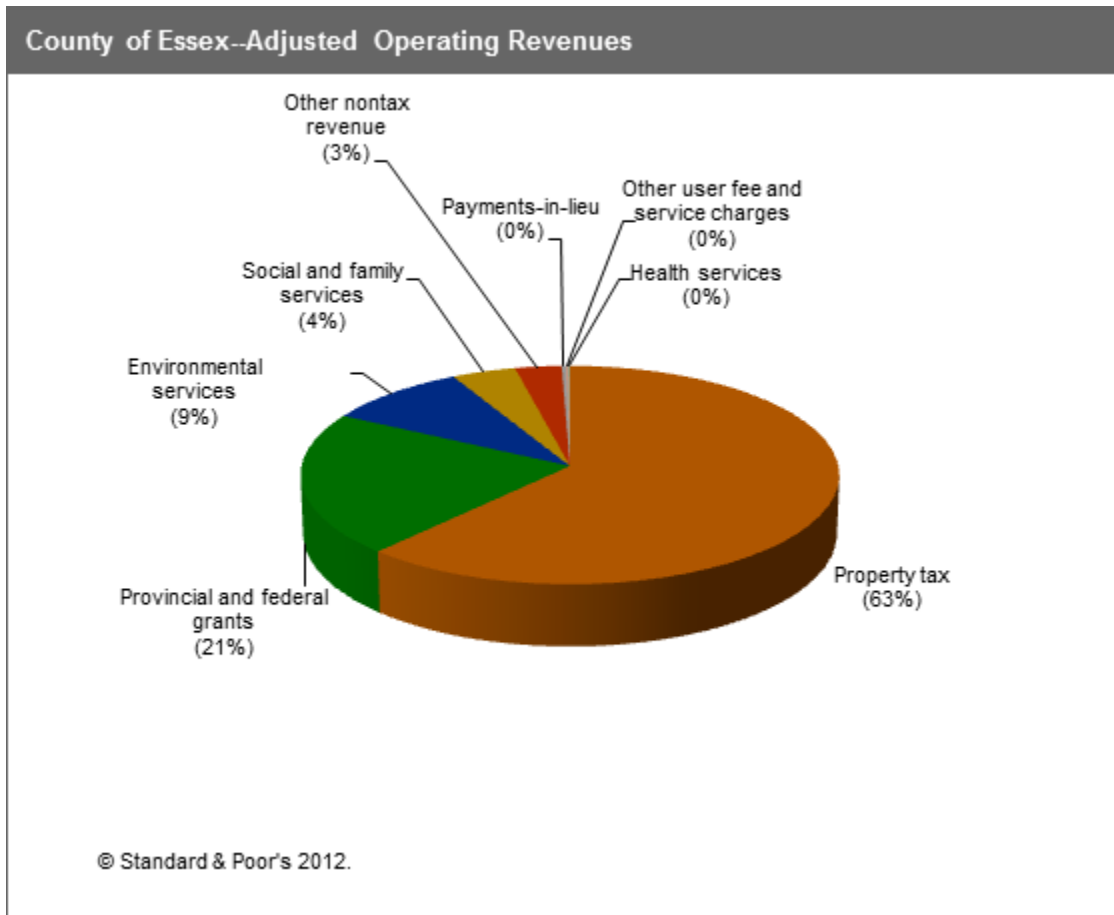
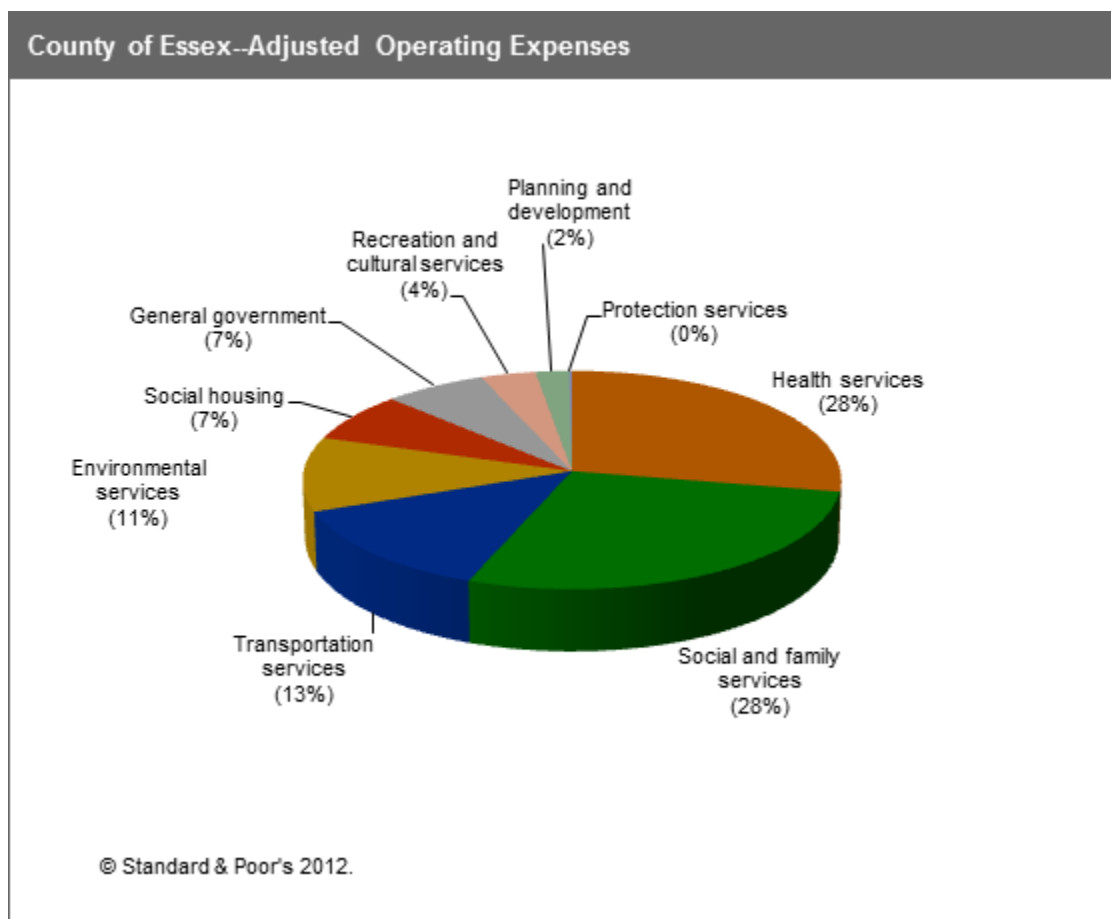


Chart 2



Strong Budgetary Performance

To improve comparability across local and regional governments globally, Standard & Poor's adjusts the published figures of all municipalities to reflect their budgetary balances on a cash basis. This includes adjusting for major accruals; restating capital spending to a cash basis by removing the influence of capital amortization and net income of certain government business enterprises; and adjusting for one-time revenues.

Essex's budgetary performance is strong, and places it in the middle of its peers. The county's operating balance in 2011 was 13.3% of operating revenues, up from 9.1% in 2010. The county's overall budgetary position, which includes capital revenues and expenditures, improved: its after-capital spending surplus in 2011 represented about 8.4% of total revenues (compared with a small surplus of 0.6% in 2010). We expect Essex's operating balance will remain near its 2011 levels across our two-year rating horizon. Nevertheless, increasing capital expenditure requirements could put pressure on Essex's after-capital performance in the next five years.

Robust Liquidity Contributes To Strong Financial Risk Profile

In our opinion, the county maintained its strong liquidity position at year-end 2011. Free cash and liquid assets amounted to about 72% of operating expenditure (C\$69.4 million by Standard & Poor's estimates) and more than 25x of debt service. Further bolstering Essex's liquidity position is its C\$8.0 million line of credit. At year-end 2011, its net creditor position stood at about 27% of operating revenues. The county's consolidated net creditor position includes tax- and rate-supported debt (such as for solid waste management), less discretionary reserves, and cash and liquid assets. We expect that Essex will maintain its net creditor position in the next two years through maintaining reserve balances.

Moderate Debt Levels Year-Over-Year

The county's debt burden remains what we view as moderate, because it has defrayed the issuance of debt through pay-as-you-go financing to fund capital expenditures. Direct debt remained relatively stable year-over-year. It amounted to 30% of operating revenue at fiscal year-end 2011, or C\$35.7 million, compared with C\$36.2 million the previous year. As a result, we don't expect its stand-alone debt level to increase greatly as a result of the capital expenditure plan; stand-alone direct debt should remain below 30% of operating revenue in the next two years.

While the county's stand-alone debt level is low and likely to remain low by peer comparison, debt issuance from its seven lower-tier municipal members indirectly affects its financial risk profile. Lower-tier-member debt (issued in their own names) necessarily influences Essex's own debt-carrying capacity, because the lower-tier members provide for their debt service from the same taxes paid by the same ratepayers. In 2011, the county's combined debt burden (including both its own debt and that of its lower-tier members) was noticeably higher than its own debt burden, and was estimated at 63.2% of combined operating revenue. Because the lower-tier municipalities are responsible for water and sewer infrastructure, a major expenditure among Ontario municipalities in recent years, there is potential for this to create indirect financial pressure on Essex. Capital expenditure programs at the lower-tier level will necessitate debt issuance. As a result, we expect the combined burden to rise to above 66% of combined operating revenue in the next two years.

Relatively minor contingent liabilities

Essex's contingent liabilities are relatively minor, in our opinion. They consist of Essex's share of the Windsor-Essex County Health Unit, non-pension related employee benefits and the regional landfill's post closure costs.

Table 2

County of Essex--Financial Statistics					
(%)	2011	2010	2009	2008	2007
Capital expenditure/total expenditure	11.3	20.6	20.5	19.1	19.2
Modifiable revenue/operating revenue	80.2	80.9	79.8	80.1	80.4
Operating balance/operating revenue	13.3	9.1	1.2	13.0	15.0
After-capital balance/total revenue	8.4	0.6	(3.6)	6.0	1.6
Free cash and liquid assets/debt service	2,581.6	1,714.3	2,242.5	2,565.0	2,290.6
Tax-supported debt/consolidated operating revenue	28.6	30.0	32.5	32.8	34.0

Table 2

County of Essex--Financial Statistics (cont.)					
Interest/operating revenue	1.7	1.8	1.7	1.9	2.0

Related Criteria And Research

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

Ratings Detail (As Of November 9, 2012)	
Essex (County of)	
Issuer Credit Rating	AA-/Positive/--
Senior Unsecured	AA-
Issuer Credit Ratings History	
01-Nov-2012	AA-/Positive/--
05-Aug-2005	AA-/Stable/--
24-Mar-2004	A+/Positive/--
*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.	

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