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Summary:

Orleans, Massachusetts; General Obligation; Note

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Credit Profile

US\$17.694 mil GO BANs due 02/05/2021

<i>Short Term Rating</i>	SP-1+	New
Orleans Twn GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Orleans Twn GO		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings assigned its 'SP-1+' short-term rating to the Town of Orleans, Mass.' series 2020 general obligation (GO) bond anticipation notes (BANs).

S&P Global Ratings also affirmed its 'AAA' long-term rating, with a stable outlook, on the town's existing GO debt and its 'SP-1+' short-term rating on Orleans' existing GO BANs.

Security and the use of BAN proceeds

The town's full-faith-and-credit pledge secures the BANs, with a portion of the BANs subject to Proposition 2 1/2 limitations, and the rest excluded from these limitations.

The short-term rating reflects our criteria for evaluating and rating BANs. In our view, Orleans maintains a very strong capacity to pay principal and interest when the BANs come due. The town maintains what we view as a low market-risk profile because it has strong legal authority to issue long-term debt to take out the BANs and it is a frequent issuer that regularly provides ongoing disclosure to market participants.

Officials plan to use series 2020 BAN proceeds to fund various capital projects townwide, including water-resource-and-quality management, as well as renewing existing BANs.

Credit summary

We rate Orleans higher than the sovereign because we believe the town can maintain better credit characteristics than the nation in a stress scenario based on its predominantly locally derived revenue base and our view that pledged revenue supporting debt service is at limited risk of negative sovereign intervention. In 2019, local property taxes generated 81% of revenue, demonstrating a lack of dependence on central government revenue.

The town's credit quality reflects our view of Orleans' very strong economy, supported by a healthy real estate market and access to the Barnstable metropolitan statistical area (MSA). In addition, in our view, the town's very strong management and strong budgetary flexibility, with available reserves at 13.7% of expenditures in fiscal 2019, provide

further rating stability. In our opinion, the town has a very weak debt and contingent liability profile; however, we believe its current debt and expected future debt issuance will likely remain affordable due to its very strong and wealthy tax base, as well as management's commitment to adjust the tax levy accordingly. While not expected, due to Orleans' very strong financial management, the rating could be pressured if overall budgetary flexibility were to decline substantially.

The long-term rating also reflects our opinion of the town's:

- 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 operating surpluses in the general fund and at the total governmental fund level in fiscal 2019;
- Strong budgetary flexibility, with an available fund balance in fiscal 2019 of 13.3% of operating expenditures;
- Very strong liquidity, with total government available cash at 21.0% of total governmental fund expenditures and 115.0% of governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability profile, with debt service carrying charges at 18.3% of expenditures and net direct debt that is 151.8% of total governmental fund revenue, and a large pension and other postemployment benefit (OPEB) obligation, but low overall net debt at less than 3.0% of market value; and
- Strong institutional framework score.

Very strong economy

We consider Orleans' economy very strong. The town, with an estimated population of 6,090, is located in Barnstable County in the Barnstable Town MSA, which we consider to be broad and diverse. It has a projected per capita effective buying income of 148% of the national level and per capita market value of \$672,533. Overall, the town's market value grew by 3.3% in 2018 to \$4.1 billion in 2019. The county unemployment rate was 4.3% in 2018.

Orleans is primarily a residential resort community with a substantial portion of second homes owned by seasonal summer residents. Residential properties make up about 95% of the town's property tax base, accounting for a seasonal population of 22,000. Market value, which has remained stable, has grown by an average of 3.3% annually in the past three fiscal years. Officials indicate the real estate market has remained relatively stable during the past few years. Leading employers include Super Stop & Shop, Cape Cod Five Cents Savings, and Shaw's Market.

The town's economic profile will likely remain very strong as it continues to benefit from a robust real estate environment in and around Barnstable County. In addition, the town plans to invest in infrastructure and utility in the downtown area to promote further economic development. Although we believe a regional economic slowdown could have an effect on local economic activity, we believe the local economy will likely remain very strong due to Orleans' desirable location with ample waterfront and coastline properties and continued high-end residential waterfront development.

Very strong management

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

We believe Orleans maintains best practices we consider critical to supporting credit quality; we recognize these well-embedded practices in the government's daily operations and practices. Formal policies support many of these activities, adding to the likelihood they will continue and transcend changes in the operating environment and personnel.

In our opinion, strengths include management's:

- Strong revenue and expenditure assumptions in the budgeting process;
- Strong oversight of monitoring progress compared to the budget during the year;
- Long-term financial plan; and
- Five-year capital improvement plan.

Orleans also maintains debt-management and reserve policies that essentially fix available reserves at 5% of general fund expenditures, with surpluses above 5% returned to taxpayers to reduce subsequent-year tax bills.

The town has notably taken steps to mitigate exposure to cyber-related risks, including daily backups of servers in two separate locations offsite and acquiring cyber insurance.

While the town continues to plan and support climate risk mitigation efforts, we do note that Orleans, as do other Cape Cod communities, receives state and federal support in planning and implementing resiliency projects.

Strong budgetary performance

Orleans' budgetary performance is strong in our opinion. The town had operating surpluses of 2.0% of expenditures in the general fund and of 5.6% across all governmental funds in fiscal 2019.

Fiscal 2019 results include adjustments for recurring transfers and one-time capital expenditures paid for with bond proceeds. Management indicates that it had exceeded revenue and expenditure projections for fiscal 2019 but that it elected to use some reserves for tax-rate-stabilization purposes. Property taxes generate 81.2% of general fund revenue, followed by charges for services at 5.9%.

The fiscal 2020 budget totals \$39.3, a 5.6% increase over fiscal 2019. Management indicates budget-to-actual results are currently tracking favorably, and it does not expect negative financial results from operations. However, officials also indicate the town may elect to use reserves for tax rate stabilization, as it has in the past, in accordance with established policies, if financial operations were to outperform the budget significantly. Therefore, we believe Orleans' budgetary performance assessment should remain strong overtime.

Over the long term, we believe pension and OPEB costs could become a budgetary pressure due to below-average funding ratios and what we view as aggressive assumptions of the county-administered pension plan. However, we note management proactively manages these liabilities and makes budgetary adjustments to absorb this growing expense. We note that Orleans is funding the actuarially determined contribution and that it has established policies to

begin prefunding OPEB in a prudent manner. Notably, the town recently approved a Proposition 2 1/2 operating override dedicated to funding this liability over the long term. We believe this dedicated revenue should help to keep OPEB costs manageable. However, should economic or business conditions worsen and negatively affect annual contributions, we believe the town's budget could be pressured.

Strong budgetary flexibility

Orleans' budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2019 of 13.3% of operating expenditures, or \$5.2 million.

Notably, the town's millage rate, currently at \$7.40 per \$1,000 of assessed value (AV), is on the lower end compared to that of other Massachusetts communities. The median residential tax rate for the state is approximately \$15 per \$1,000 of AV. Therefore, the town has additional capacity to increase property tax in the future should it need to do so.

The town traditionally uses reserves for tax-rate stability. However, due to its current reserve policies and history of maintaining high general fund balances in several fiscal years, we expect Orleans' budgetary flexibility assessment will likely remain strong. The town has a formal policy that sets minimum free cash at 5%, but it continually manages well above those thresholds. In addition, the town maintains about \$1.05 million, or approximately 2.7% of general fund revenues of unused levy capacity in fiscal 2020. We believe this provides additional flexibility within the limits of Proposition 2 1/2 without having to seek voter approval.

Very strong liquidity

In our opinion, Orleans' liquidity is very strong, with total government available cash at 21.0% of total governmental fund expenditures and 115.0% of governmental debt service in 2019. In our view, the town has strong access to external liquidity if necessary.

We do not currently expect any deterioration in cash; therefore, we expect liquidity will likely remain very strong. The town is a frequent issuer of GO debt. Orleans confirmed it does not currently have any contingent liquidity risk from financial instruments with payment provisions that change on the occurrence of certain events. The town's portfolio is not aggressive in its investment use.

Very weak debt and contingent-liability profile

In our view, Orleans' debt and contingent liability profile is very weak. Total governmental fund debt service is 18.3% of total governmental fund expenditures, and net direct debt is 151.8% of total governmental fund revenue. Overall net debt is low at 1.7% of market value, which is in our view a positive credit factor.

With this issuance, the town will have about \$65.6 million in total direct debt outstanding. Officials currently expect to issue approximately \$15 million of additional debt during the next two years.

Pension and other postemployment benefits

- In our opinion, a credit weakness is Orleans' large pension and OPEB obligation, particularly given the pension systems' low funded ratio. While the town is currently managing these costs, we believe it has a limited ability to control future pension liability growth.
- We believe some of the assumptions used to build the town's pension actuarially determined contribution are built from what we view as weak assumptions and methodologies, which we believe increases the risk of unexpected

contribution escalations.

- Although OPEB liabilities are funded on a pay-as-you-go basis, costs remain low despite the large liability and we expect the town will continue adding to its OPEB trust fund.

Orleans participates in the following plans as of June 30, 2019:

- Barnstable County Contributory Retirement System: 61.9% funded, with a net pension liability of \$25.8 million.
- A defined-benefit health care plan that provides lifetime healthcare and life insurance for eligible retirees and their spouses: 3.9% funded with a net OPEB liability of about \$19.1 million.

The town's combined required pension and actual OPEB contributions totaled 7.8% of total governmental fund expenditures in 2019. Of that amount, 5.0% represented required contributions to pension obligations and 2.8% represented OPEB payments. The town makes its ADC annually. Contributions are expected to increase by 5.28% per year on a level percent-of-pay amortization basis. The adopted funding schedule achieves full funding in a 16-year closed period, ending in 2035. The annual increase, combined with a discount rate of 7.375%, adds risk of cost escalation due to market volatility. In addition, the town participates in the Massachusetts Teachers' Retirement System. The state recognizes the fully liability and makes all payments on behalf of the town for the school department. We do not anticipate the state passing costs or liabilities on to local governments at this time.

Orleans pays OPEBs on a pay-as-you-go basis. In 2018, the town voted in favor of a permanent override to fully fund the OPEB liability over 30 years. The amount was for \$450,000, which the town will contribute annually to the trust in excess of normal costs. As of January 2020, the balance of this fund totaled approximately \$2.2 million; Orleans' net OPEB liability is \$19.1 million. We believe management's proactive approach to funding OPEB mitigates costs from substantially increasing and affecting budgetary performance.

Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

Outlook

The stable outlook on the long-term rating reflects S&P Global Ratings' opinion of Orleans' very strong economy, supported by the town's access to the Barnstable MSA. We believe Orleans' very strong management and liquidity profile further support the rating. While we expect finances to remain relatively stable, we think the town's recent history of drawing down reserves and very weak debt and contingent liability profile currently pressure the rating. We view Orleans' current debt and planned debt issuance as remaining affordable due to the town's mature and wealthy tax base, coupled with a continued willingness and ability to tap into the tax base and raise revenue, as necessary, to pay for capital projects. Therefore, we do not expect to change the rating within the two-year outlook period.

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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