

RatingsDirect®

Summary:

Orleans (Town of), Massachusetts; General Obligation; Note

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Credit Profile

US\$14.442 mil GO BANs due 02/07/2020

| | | |
|--------------------------|-------|-----|
| <i>Short Term Rating</i> | SP-1+ | New |
|--------------------------|-------|-----|

US\$4.42 mil GO muni purpose loan of 2019 bnds ser 2019 due 02/01/2029

| | | |
|-------------------------|------------|-----|
| <i>Long Term Rating</i> | AAA/Stable | New |
|-------------------------|------------|-----|

Orleans Twn GO

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|-------------------------|------------|----------|
| <i>Long Term Rating</i> | AAA/Stable | Affirmed |
|-------------------------|------------|----------|

Rationale

S&P Global Ratings assigned its 'SP-1+' short-term rating to Orleans, Mass.' series 2019 general obligation (GO) bond anticipation notes (BANs) and its 'AAA' long-term rating and stable outlook to the town's series 2019 GO municipal-purpose loan bonds.

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 the town's existing GO BANs.

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.

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

We rate the limited-tax GO debt on par with our view of Orleans' general creditworthiness because the ad valorem tax is not derived from a measurably narrower property tax base and there are no limitations on the fungibility of resources, supporting our view of Orleans' overall ability and willingness to pay debt service.

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 bond debt service is at limited risk of negative sovereign intervention. In 2018, local property taxes generated 80% of revenue, demonstrating a lack of dependence on central government revenue.

Officials plan to use series 2019 BAN proceeds to fund various capital projects townwide, including water-resource-and-quality management, as well as renewing existing BANs. Officials plan to use series 2019 bond proceeds to finance a portion of BANs outstanding permanently and fund various capital improvement projects.

The town's credit quality reflects our view of its 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 13.8% of expenditures in fiscal 2018, provide further rating stability. In our opinion, the town has a very weak debt-and-contingent-liability assessment; 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 the town's very strong financial management, the rating could be pressured if overall budgetary flexibility were to decline substantially.

The rating reflects our opinion of the town's:

- Very strong economy, with access to a broad and diverse MSA;
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with a slight drawdown in the general fund but a slight operating surplus at the total governmental-fund level in fiscal 2018;
- Strong budgetary flexibility, with available fund balance in fiscal 2018 of 13.8% of operating expenditures;
- Very strong liquidity, with total government available cash at 22.8% of total governmental-fund expenditures and 1.8x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt-and-contingent-liability position, with debt service carrying charges at 12.8% of expenditures and net direct debt that is 163.6% of total governmental-fund revenue, and significant medium-term debt plans and a large pension and other-postemployment-benefit (OPEB) obligation, but low overall net debt at less than 3% of market value; and
- Strong institutional framework score.

Very strong economy

We consider Orleans' economy very strong. The town, with an estimated population of 5,676, is in Barnstable County in the Barnstable Town MSA, which we consider broad and diverse. The town has a projected per capita effective buying income of 156% of the national level and per capita market value of \$721,587. Overall, market value has grown by 3.3% during the past year to \$4.1 billion in fiscal 2019. County unemployment was 4.7% in 2017.

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 during 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 strong as it continues to benefit from a strong 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 the town 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.

Adequate budgetary performance

Orleans' budgetary performance is adequate, in our opinion. The town had a slight drawdown in the general fund of 1.1% of expenditures but slight surplus results across all governmental funds of 1.3% of expenditures in fiscal 2018.

Fiscal 2018 results include adjustments for recurring transfers and one-time capital expenditures paid for with bond proceeds. Officials primarily attribute the fiscal 2018 general fund decline to a planned drawdown to maintain a stable tax rate. Management indicates that it had exceeded revenue and expenditure projections for fiscal 2018 but that it elected to use some reserves for tax-rate-stabilization purposes. Property taxes generate 80% of general fund revenue, followed by charges for services at 6.7%.

The fiscal 2019 budget totals \$36.5 million, an 8.2% increase over fiscal 2018. 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 adequate, if not improve, 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 during the long term. We also believe adjustments to more-conservative

assumptions could materially affect annual contributions, pressuring the bottom line, particularly if economic or business conditions worsen.

Strong budgetary flexibility

Orleans' budgetary flexibility is strong, in our view, with available fund balance in fiscal 2018 of 13.8% of operating expenditures, or \$4.8 million.

Fiscal 2018 available reserves (assigned and unassigned general fund balances) experienced a slight decrease due to the town's planned reserve drawdown. For fiscal 2019, although officials indicate budget-to-actual results are on target and they do not expect negative financial operations, the town could use reserves again for tax-rate stability. However, due to its current reserve policies and history of maintaining high general fund balances during several fiscal years, we expect the town's budgetary flexibility assessment will likely remain strong. The town's formal policy sets minimum free cash at 5% of expenditures, but it continually manages well above those thresholds. In addition, the town maintains about \$1.5 million, or approximately 4.3% of general fund revenue, of unused levy capacity in fiscal 2019.

The town's unused levy capacity provides additional flexibility within Proposition 2 1/2 limits, allowing it to increase the levy beyond the statutory limitation without voter approval.

Very strong liquidity

In our opinion, Orleans' liquidity is very strong, with total government available cash at 22.8% of total governmental-fund expenditures and 1.8x governmental debt service in fiscal 2018. 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 upon the occurrence of certain events. Orleans' 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 12.8% of total governmental-fund expenditures, and net direct debt is 163.6% of total governmental-fund revenue. Negatively affecting our view of the town's debt profile is its significant medium-term debt plans, but we note that the town will pay much of its future debt through betterments and fees and that debt will not be fully tax-supported. Favorably, overall net debt is low at 1.6% of market value, which is, in our view, a positive credit factor, supporting our view that the debt is affordable.

With this issuance, the town will have about \$67.7 million in total direct debt outstanding. Officials currently expect to issue approximately \$54 million of additional debt during the next two years: about \$41 million for a continued sewer-expansion and treatment-plant project. The town plans to levy betterment fees to pay for this project's debt. The majority of remaining authorized debt will fund the town's share of a new high school for Nauset Regional School District because the town is a district member. While we expect these new debt issuances will likely further weaken debt metrics, we believe additional debt will likely remain relatively affordable due to the town's inherently very strong and wealthy tax base, coupled with its plan to continue to tap into this base as necessary to pay capital costs.

In our opinion, Orleans' large pension and OPEB obligation is a credit weakness; we, however, believe the town actively mitigates these costs from accelerating. Orleans' combined required pension and actual OPEB contribution totaled 7.1% of total governmental-fund expenditures in fiscal 2018: 5.2% for required contributions to pension obligations and 1.9% for OPEB payments. The town made its full annual required pension contribution in fiscal 2018. The largest pension plan's funded ratio is 64.2%.

Orleans contributes to Barnstable County retirement system, a cost-sharing, multiemployer, defined-benefit pension plan. Using updated reporting standards in accordance with Governmental Accounting Standards Board Statement Nos. 67 and 68, the town's proportionate share of the net pension liability was about \$22.5 million with 61.86% funded at Dec. 31, 2017, based on an assumed rate of return of 7.375%. Due to the funded ratio, we believe contributions will likely continue to increase during the next few fiscal years. While the town is currently managing these costs, we believe it has a limited ability to control future pension-liability growth.

Orleans also provides OPEB to retirees. At June 30, 2018, the most recent actuarial valuation, Orleans reported a \$14.5 million OPEB liability. The town has traditionally funded OPEB through pay-as-you-go financing. It paid \$712,767, or 1.9% of expenditures, which was 55.7% of the actuarially determined contribution, in fiscal 2018. The town also maintains an OPEB trust fund to prefund the liability. The current OPEB fund balance at June 30, 2018, was \$1.1 million, or a 7.5% funded ratio. The town recently approved an operating override dedicated to funding this liability. The amount was for \$450,000, which the town will contribute annually to the trust in excess of normal costs. 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 its 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 the town's current debt and planned debt issuance as remaining affordable due to its mature and wealthy tax base, coupled with the town's continued willingness and ability to tap into its 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
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- Local Government Pension And Other Postemployment Benefits Analysis: A Closer Look, Nov.8, 2017

- 2018 Update Of Institutional Framework For U.S. Local Governments

| Ratings Detail (As Of January 24, 2019) | | |
|---|------------------|----------|
| Orleans Twn GO BANs | | |
| <i>Short Term Rating</i> | SP-1+ | Affirmed |
| Orleans Twn GO | | |
| <i>Unenhanced Rating</i> | AAA(SPUR)/Stable | Affirmed |
| Many issues are enhanced by bond insurance. | | |

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