

RatingsDirect®

Summary:

Orleans, Massachusetts; General Obligation; Note

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Credit Profile

US\$18.473 mil GO BANs ser 2021 dtd 02/14/2021 due 02/04/2022

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

Many issues are enhanced by bond insurance.

Rating Action

S&P Global Ratings assigned its 'SP-1+' short-term rating to the Town of Orleans, Mass' \$18.5 million 2021 general obligation (GO) bond anticipation notes (BAN). At the same time, S&P Global Ratings affirmed its 'AAA' long-term rating, with a stable outlook, on the town's existing GO debt and the 'SP-1+' short-term rating on the existing 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 is a frequent issuer that regularly provides ongoing disclosure to market participants.

Orleans' full-faith-and-credit pledge secures the BAN and existing GO debt. The town's debt outstanding is subject to Proposition 2 1/2 limitations; however, we do not make a rating distinction because we rate the limited obligation at the same level as our view of Orleans' general creditworthiness. We rate the limited-tax GO debt based on the application of our criteria "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness," published Nov. 20, 2019.

In addition, under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions" (Nov. 19, 2013), we rate Orleans higher than the sovereign because we think 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 on the bonds is at limited risk of negative sovereign intervention. In 2020, local property taxes generated 83% of revenue, which demonstrates a lack of dependence on central government revenue.

Officials plan to use the proceeds to refinance existing BANs issued for capital projects and to provide new money for additional capital projects.

Credit overview

The town's credit quality continues to reflect our view of Orleans' very strong economy, supported by a healthy real estate market and access to the Barnstable metropolitan statistical area (MSA). We believe the town's very strong management and strong budgetary flexibility, with available reserves at 14.2% of expenditures in fiscal 2020, 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 future debt issuance will likely remain affordable, because of Orleans' very strong and wealthy tax base, as well as management's commitment to adjusting the tax levy accordingly.

Although the full effect of the COVID-19 pandemic on Orleans remains unknown, the stable outlook reflects our view of the town's strong reserves, conservative budgeting, and very strong management; this should provide it with a cushion to absorb unexpected revenue decreases or economic stagnation as a result of an uncertain economic recovery or pandemic-related events. Our outlook is generally for two years, but we continue to see some risks because of COVID-19 during the next six-to-12 months.

The rating also reflects our opinion of Orleans':

- 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 operating surplus in the general fund and an operating surplus at the total governmental fund level in fiscal 2020;
- Strong budgetary flexibility, with an available fund balance in fiscal 2020 of 14.2% of operating expenditures;
- Very strong liquidity, with total government available cash at 20.8% of total governmental fund expenditures and 117.8% 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 17.7% of expenditures and net direct debt that is 139.7% 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.

Environment, social, and governance factors

Our rating incorporates our view regarding the indirect risks posed by the COVID-19 pandemic. Absent the implications of COVID-19, we consider the town's social risks in line with those of the sector. We view Orleans' governance risks as being generally in line with those of peers, although pension funding discipline and assumption choices will likely lead to elevated costs for the town. Environmental risks are higher than average for the sector, in our opinion, because of Orleans' location on Cape Cod. We expect rising sea levels, ongoing stormwater management needs, and related environmental risks stemming from the town's location could potentially pressure finances or the tax base in the long term.

Stable Outlook

Downside scenario

We could lower the rating if the town's general economic conditions, including but not limited to unemployment rates, deteriorate below that of similarly rated peers or if budgetary performance were to decrease, leading to weakened flexibility or reduced liquidity to levels we no longer consider commensurate with the rating.

Credit Opinion

Very strong economy

We consider Orleans' economy very strong. The town, with an estimated population of 5,663, is in Barnstable County in the Barnstable Town MSA, which we consider to be broad and diverse. The town has a projected per capita effective buying income of 132% of the national level and per capita market value of \$743,420. Overall, the town's market value grew by 2.8%, to \$4.2 billion in 2020. The county unemployment rate was 3.9% in 2019.

Orleans is primarily a residential resort community with a substantial portion of second homes owned by seasonal summer residents. Residential properties make up 92% of the town's property tax base, accounting for a seasonal population of 22,000. 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. In line with the region, the unemployment rate in the area spiked during the pandemic to a high of 21.5% in June; however, has tempered over the past few months to 6.8% as of November. We will continue to monitor the impact of the unemployment rate on the town's general economic condition.

Before the pandemic, economic and tax base growth was robust, particularly in residential renovation and new development. Since 2016, Orleans' assessed value (AV) has grown 13%. Building permit values decreased in fiscal 2020 due to construction slowdowns as a result of the pandemic. However, the town has a healthy real estate market, which officials report has not experienced any slowdowns during the pandemic as houses continue to be bought and sold at record prices. In addition, management noted that there was an uptick in residents who were typically seasonal residents seeking to become more permanent residents as the pandemic continued. We do not expect a material deterioration in Orleans' tax base, despite the uncertain economic environment. For more information, see "Staying Home For The Holidays," published Dec. 2, 2020, on RatingsDirect.

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, and 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 with the budget during the year;
- Long-term financial plan; and
- A five-year capital improvement plan.

The town has recently updated its reserve policy, which now targets minimum general operating reserve balances of 13%-17% of the general fund annual operating budget. Orleans also maintains a debt management policy that targets debt-to-expenditures at 15% and net general fund debt service to expenditures at 10%.

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

Adequate budgetary performance

Orleans' budgetary performance is adequate, in our opinion. The town had slight surplus operating results in the general fund of 0.6% of expenditures and surplus results across all governmental funds of 5.1% in fiscal 2020. General fund operating results of the town have been stable over the past three years, with a result of 2.0% in 2019 and a result of negative 0.7% in 2018.

Fiscal 2020 results include adjustments for recurring transfers and one-time capital expenditures paid for with bond proceeds. According to management, the town experienced savings in most of its departments as it kept a tight control on expenses amid the start of the pandemic. Although property taxes and penalties and interest on taxes came in lower than budgeted, overall revenues exceeded estimates. On the expenditure side, results included departmental turnbacks of \$1.4 million and turnbacks of \$2.9 million in unappropriated free cash. The town incurred pandemic-related costs of about \$82,000, and officials indicate the town has been reimbursed \$50,000 from Coronavirus Aid, Relief and Economic Security (CARES) Act funds. The town plans to submit the remainder for reimbursement from the Federal Emergency Management Agency and apply for CARES Act funding and use other local grant receipts to cover fiscal 2021 pandemic-related expenses.

The fiscal 2021 budget totals \$39.3 million, a 2.3% increase over fiscal 2020, with no appropriation of the fund balance. Through early January 2021, management indicates budget-to-actual results are currently tracking favorably, and it does not expect negative financial results from operations. Officials indicate the town took a very conservative approach to the fiscal 2021 budget, reducing expenses across the board and postponing certain smaller capital projects. Therefore, while we believe management will continue to make the necessary budgetary adjustments toward maintaining balanced operations, we imagine the unprecedented widespread effects of COVID-19 will have an impact on state revenue and many local economies, including Orleans, which could potentially result in weaker budgetary performance for fiscal 2021 and beyond. If management were to maintain balanced financial results during our outlook period, or until we think the threat of stagnating or decreasing revenue as a result of negative economic shocks has subsided, we could revise our view of budgetary performance to strong. However, in the long term, we believe future increases in pension and OPEB costs could become a budgetary pressure, given below-average funding ratios and large liabilities.

Strong budgetary flexibility

Orleans' budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2020 of 14.2% of operating expenditures, or \$5.7 million.

Notably, the town's tax rate, currently at \$7.84 per \$1,000 of AV, is on the lower end compared with that of other Massachusetts communities. The median residential tax rate for the state is approximately \$15 per \$1,000 of AV.

The town traditionally uses reserves for tax-rate stability. However, because of 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. Recently, the town revised its fund balance policy so reserves must be in the range of 13%-17% of expenditures, instead of 5%. In addition, Orleans maintained about \$1.05 million, or approximately 2.7% of general fund revenues, of unused levy capacity in fiscal 2020. We believe this provides some 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 20.8% of total governmental fund expenditures and 117.8% of governmental debt service in 2020. 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 17.7% of total governmental fund expenditures and net direct debt is 139.7% of total governmental fund revenue. Overall net debt is low at 1.6% of market value, which is in our view a positive credit factor.

With this issuance, the town will have about \$63.8 million in total direct debt outstanding. In the medium term, officials plan to issue debt to finance items in their capital plan. However, amounts have not been finalized.

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 based on 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.

The town participates in the following plans as of June 30, 2020:

- Barnstable County Contributory Retirement System: 62.3% funded, with a net pension liability of \$22.7 million.
- A defined benefit health care plan that provides lifetime health care and life insurance for eligible retirees and their spouses: 10.1% funded, with a net OPEB liability of about \$19.04 million.

Orleans' combined required pension and actual OPEB contributions totaled 7.9% of total governmental fund expenditures in 2020. Of that amount, 4.6% represented required contributions to pension obligations and 3.3% represented OPEB payments. The town made 100% of its annual required pension contribution in 2020. Contributions are expected to increase by 5.80% per year on a level percent-of-pay amortization basis. The adopted funding schedule in 2020 extended the period to achieve full funding to 2037 from the original 2035. In addition to changing the contribution rate, the discount rate was updated as well to 7.15% from 7.375%, which remains above our guideline of 6% and, in our opinion, adds risk of cost escalation because of market volatility. In addition, the town participates in the Massachusetts Teachers' Retirement System. The state recognizes the full liability and makes all payments on behalf of the town for the school department. We do not currently anticipate the state passing costs or liabilities on to local governments.

Orleans pays OPEB 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 June 2020, the balance of this fund totaled approximately \$2.1 million; Orleans' net OPEB liability is \$19.04 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.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 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
- 2020 Update Of Institutional Framework For U.S. Local Governments

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