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Summary:

Harwich Town, Massachusetts; General Obligation; Note

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Credit Profile

US\$10.75 mil GO BANs dtd 12/15/2017 due 07/13/2018

Short Term Rating SP-1+ New

Harwich GO

Long Term Rating AA+/Stable Affirmed

Rationale

S&P Global Ratings assigned its 'SP-1+' short-term rating to Harwich Town, Mass.' series 2017 general obligation (GO) bond anticipation notes (BANs), payable on July 13, 2018, and affirmed its 'AA+' long-term rating, with a stable outlook, on the town's existing GO debt.

The short-term rating reflects our view of the town's very strong capacity to pay principal and interest when the BANs come due. The town maintains a low market-risk profile with 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. The town's ability to raise taxes is subject to limitations of Proposition 2 1/2, which has a 2.5% ceiling on total property taxes annually, as well as the 2.5% limit on property tax increases plus the value of new growth. Despite limitations imposed by the commonwealth-levy-limit law, we did not make a rating distinction for the limited-tax-GO pledge due to the town's flexibility under the levy limit. We understand town voters have chosen to exclude the series 2017 BANs from the Proposition 2 1/2 levy limit.

Officials plan to use series 2017 BAN proceeds to fund various capital improvement projects, including marina improvements and boardwalk construction.

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

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with a slight operating surplus in the general fund and an operating surplus at the total-governmental-fund level in fiscal 2016;
- Strong budgetary flexibility, with an available fund balance that we expect will improve in the near term from its fiscal 2016 level of 7.9% of operating expenditures;
- Very strong liquidity, with total government available cash at 31.8% of total-governmental-fund expenditures and 5.7x governmental debt service, and access to external liquidity we consider strong;
- Very strong debt-and-contingent-liability position, with debt service carrying charges at 5.5% of expenditures and net direct debt that is 44.6% of total-governmental-fund revenue, as well as low overall net debt at less than 3% of

market value and rapid amortization, with 65.7% of debt scheduled to be retired within 10 years, but significant medium-term debt plans; and

- Strong institutional framework score.

Very strong economy

We consider Harwich's economy very strong. The town, with an estimated population of 12,304, 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 123% of the national level and per capita market value of \$405,010. Overall, market value grew by 3.5% over the past year to \$5 billion in fiscal 2017. The county unemployment rate was 4.7% in 2016.

Harwich is a residential community on the southeast corner of Cape Cod on Nantucket Sound, about 80 miles from Boston. Due to the substantial number of seasonal second homes, population estimates double in the summer. While Harwich has been evolving into more of a year-round community, its economy continues to depend on second-home owners and summer visitors. Seasonal employment--such as retail trade, accommodations, and food services--accounts for a large portion of the local employment base.

Strong management

We view the town's management as strong, with good financial policies and practices under our FMA methodology, indicating financial practices exist in most areas but that governance officials might not formalize or monitor all of them on a regular basis.

Highlights include management's conservative budget assumptions and regular monitoring of budget performance with monthly reports on budget-to-actual results to the board of selectman and finance committee. The town's free cash policy outlines reserves, free cash, and stabilization funds with the goal of maintaining no less than 7%–8% of general fund expenditures in reserve. The town was not compliant in fiscal 2016, but officials expect to close fiscal 2017 in-line with the reserve policy. There is a strong focus on capital planning, evidenced by Harwich's six-year capital improvement plan that it updates annually and that identifies funding sources. The town also maintains a five-year budget forecast, which it updates annually.

The town adheres to its formal investment-management policy, which mirrors commonwealth guidelines. Harwich maintains a formal debt-management policy that limits general fund debt service to 10%-12% of expenditures.

Strong budgetary performance

Harwich's budgetary performance is strong, in our opinion. The town had slight surplus operating results in the general fund of 0.9% of expenditures and surplus results across all governmental funds of 1.5% of expenditures in fiscal 2016.

Management indicates fiscal 2016 closed with a surplus due to higher-than-budgeted motor vehicle, hotel, and ambulance revenue, along with expenditure turnbacks. Officials expect fiscal 2017 to close with a surplus of about \$900,000 due to higher-than-budgeted local receipts and expenditure turn backs. The fiscal 2018 general fund budget is \$61 million, an increase of 3.2% from fiscal 2017. Management expects operating revenue and expenditures to remain on target.

Property taxes remain the primary revenue source, accounting for about 76% of general fund revenue, followed by intergovernmental receipts at approximately 2.8%. Tax-collection receipts remain consistent for fiscal 2017: They are

continually about 99%. We expect budgetary performance to remain strong.

However, we believe future pension and other-postemployment-benefit (OPEB) costs could become a budgetary pressure due to below-average funding ratios. We note management is actively making adjustments, when needed, for these liabilities. Harwich is funding the actuarially determined contribution, and it has begun prefunding OPEB. We believe these liabilities could strain future operations, particularly if economic or business conditions worsen, if management does not meet actuary assumptions, or if the assumptions are inadequate at current levels.

Strong budgetary flexibility

Harwich's budgetary flexibility is strong, in our view, with an available fund balance we expect could improve in the near term from its fiscal 2016 level of 7.9% of operating expenditures, or \$4.5 million.

Management is projecting fiscal 2017 will close with a surplus of about \$900,000, which will increase available reserves to, what we consider, strong levels. For fiscal 2018, management states that it does not currently have any immediate plans to spend down reserves and that it will work to maintain fund balance at the current level. Therefore, we expect budgetary flexibility to remain strong.

Very strong liquidity

In our opinion, Harwich's liquidity is very strong, with total government available cash at 31.8% of total-governmental-fund expenditures and 5.7x governmental debt service in fiscal 2016. In our view, the town has strong access to external liquidity if necessary.

We believe Harwich's frequent debt issuance, including GO bonds, supports its strong access to external liquidity. The town does not have any liquidity risks from private-placement or direct-purchase obligations. In addition, we do not expect deterioration in the town's liquidity metrics over the next two fiscal years. Therefore, we expect Harwich will likely maintain very strong liquidity.

Very strong debt-and-contingent-liability profile

In our view, Harwich's debt-and-contingent-liability profile is very strong. Total-governmental-fund debt service is 5.5% of total-governmental-fund expenditures, and net direct debt is 44.6% of total-governmental-fund revenue. Overall net debt is low at 1.2% of market value and approximately 65.7% of direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors. Negatively affecting our view of the town's debt profile is its significant medium-term debt plans.

After this issue, Harwich will have \$37.2 million in overall net debt outstanding, \$18 million of which is BANs. Overall net debt includes \$7.9 million in self-supporting water debt. Officials indicate the town could issue an additional \$33.4 million of debt for sewer-system and fire-station construction, as well as road repairs. While the timing and final amounts could vary, based on these plans, we expect Harwich's net direct debt to increase; we have incorporated this into our view of its debt profile.

Harwich's combined required pension and actual OPEB contribution totaled 7.3% of total-governmental-fund expenditures in fiscal 2016. Of that amount, 3.8% represented required contributions to pension obligations and 3.5% represented OPEB payments. The town made its full annual required pension contribution in fiscal 2016.

Harwich contributes to a cost-sharing, multiemployer, defined-benefit plan administered by Barnstable County Contributory Retirement Board. 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 \$26.6 million with 58% funded at June 30, 2016, based on an assumed rate of return of 7.75%. Due to the funded ratio, we believe contributions will continue to rise over 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.

Harwich also provides postemployment benefits to retirees. Harwich, however, has set up an OPEB trust to prefund the liability, which we view positively. At June 30, 2014, the most recent actuarial valuation, management reported a \$42.4 million OPEB liability. The town has traditionally funded OPEB through pay-as-you-go financing. It paid \$2.1 million, or 3.5% of expenditures, toward OPEB, or 71.7% of the annual required contribution, in fiscal 2016.

The town's OPEB trust currently has a balance of \$841,927. The town is projecting to add about \$100,000 to the trust by fiscal year-end 2018. Officials plan to include an OPEB contribution in the fiscal 2019 budget, which it will fund through the operating budget and the annual appropriation of surplus. While we consider the practice of prefunding the OPEB liability positively, Harwich's large and growing pension and OPEB liabilities could pressure the budget.

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 Harwich's very strong economy, supported by strong management with good financial management policies and practices. We do not expect to change the rating during our two-year outlook period due to our expectation that Harwich will likely maintain its strong budgetary performance and flexibility.

Upside scenario

We could raise the rating if Harwich were to take meaningful steps to mitigate pension and OPEB liabilities, coupled with an increase in available reserves to levels we believe would enhance budgetary flexibility.

Downside scenario

Although unlikely during the two-year outlook period, we could lower the rating if budgetary performance and flexibility were to experience significant pressure due to rising pension and OPEB costs.

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
- 2017 Update Of Institutional Framework For U.S. Local Governments

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