

RatingsDirect®

Summary:

Harwich, Massachusetts; General Obligation

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Credit Profile

US\$3.76 mil GO rfdg bnds due 02/15/2029

Long Term Rating

AAA/Stable

New

Rationale

S&P Global Ratings assigned its 'AAA' long-term rating to the Town of Harwich, Mass.' general obligation (GO) refunding bonds. The outlook is stable.

Security and use of proceeds

Securing debt service on the bonds is the town's full faith and credit. Debt service on the refunding bonds is excluded from the limits of Proposition 2 1/2. Proceeds from the sale of bonds will be used to refund those originally issued in 2009, to lower annual debt service costs for an estimated net present value savings of approximately 9% of the refunded principal.

Credit overview

The rating reflects our view of Harwich's consecutive years of positive operating results leading to very strong reserves stemming from increased operating revenue, which is in turn based on its favorable location along southeast Cape Cod with high-end development and redevelopment. Although the coastal community is exposed to sea level rise and potential weather events, the management team is planning for resiliency through various efforts, including vulnerability assessments and mitigation plans. Despite challenges facing the Barnstable County retirement plan, in which the town participates, management continues to raise taxes to offset higher required contributions and allocate funding to its trust fund for future other postemployment benefit payments, and we believe that these actions are consistent with the rating action.

We rate the town above the sovereign because we believe it can maintain better credit characteristics than the U.S. 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. The rating above the sovereign is based on our criteria "Ratings Above The Sovereign: Corporate And Government Ratings--Methodology And Assumptions," published Nov. 19, 2013, on RatingsDirect.

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

- Very strong economy, with access to a broad and diverse metropolitan statistical area;
- Strong management, with good financial policies and practices under our financial management assessment 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 2018;

- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 17% of operating expenditures;
- Very strong liquidity, with total government available cash at 28.1% of total governmental fund expenditures and 7.8x governmental debt service, and access to external liquidity we consider strong;
- Very strong debt and contingent liability position, with debt service carrying charges at 3.6% of expenditures and net direct debt that is 32.3% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of market value and rapid amortization, with 86.2% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Very strong economy

We consider Harwich's economy very strong. The town, with an estimated population of 12,929, is located in Barnstable County in the Barnstable Town metropolitan statistical area, which we consider broad and diverse. The town has a projected per capita effective buying income of 142% of the national level and per capita market value of \$439,593. Overall, the town's market value grew by 7% over the past year to \$5.7 billion in 2019. The county unemployment rate was 4.3% in 2018.

Located on the southeast corner of Cape Cod on Nantucket Sound about 80 miles from Boston, Harwich thrives as a second-home community and is evolving into a year-round destination. With redevelopment of high-end homes continuing, new commercial and office space expansion is ongoing. Management reports that with federal transportation money available to improve Route 28, which traverses the town's east side, the town will benefit from better accessibility that facilitates additional development over the long term. Although seasonal employment--such as retail trade, accommodations, and food services--accounts for a large portion of the local employment base, we believe the town's economy will remain very strong with diversification driving tax base growth and a greater base of full-time residents.

Strong management

We view the town's management as strong, with good financial policies and practices under our financial management assessment methodology, indicating our view that financial practices exist in most areas.

The town's tenured management team provides stability in its operations while adhering to policies and procedures that are regularly monitored and reviewed. Management employs conservative budget assumptions when creating the revenue and expenditure forecast and reviews the budget performance through monthly budget-to-actual reports provided to the board of selectmen 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% to 8% of general fund expenditures in reserve. Furthermore, the town is building its general fund reserves toward 18% of expenditures, which it remained modestly below at fiscal year-end 2018. There is a strong focus on capital planning, evidenced by Harwich's six-year capital improvement plan that is updated annually and identifies funding sources. The town also annually updates a five-year budget forecast. Finally, the town utilizes its investment policy to guide decisions, mirroring commonwealth guidelines. Harwich maintains a formal debt management policy that limits general fund debt service to 10% to 12% of expenditures.

Strong budgetary performance

Harwich's budgetary performance is strong, in our opinion. The town had a slight surplus operating result in the general fund of 0.6% of expenditures and a surplus result across all governmental funds of 6.2% in fiscal 2018. General fund operating results have been stable over the past three years, with a result of 1.1% in 2017 and a result of 0.9% in 2016.

The town's budgetary performance includes adjustments to audited financial statements for transfers in and out of the general fund as well as removal of one-time capital expenditures from the town's total governmental fund results.

Fiscal 2018 results were as expected and consistent with those of prior years, with a slight surplus in the general fund (\$345,000 or about 0.6% of expenditures). The town's budget benefits from its very stable primary funding source with property taxes accounting for about 77% of general fund revenue and with a high collection rate of nearly 100% of the net levy.

Management reports that preliminary results for fiscal 2019 show break-even operations despite expenditures trending slightly above budget given a larger-than-anticipated number of retirements and some shortfalls in various departments. However, given a 50% increase in building permit fees (as a result of an increase in the base fee) and other positive revenue trends, management reports that higher revenue collections offset the expenditure variances.

The fiscal 2020 budget totals about \$72.3 million (including school expenses), representing an increase of about 7.7% over the prior year. It is balanced, and the town strives to maintain the current level of services and support technology staffing needs and wage increases to remain competitive with other Cape Cod communities. Based on a property tax levy increase of 8.2% (consisting of tax base growth and a levy increase), we believe the town's budgetary performance will remain strong with operating revenue fully covering higher expenditures.

Very strong budgetary flexibility

Harwich's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 17% of operating expenditures, or \$10.3 million.

Reserves have grown over the past several years. Fiscal 2018 results reflect a reallocation of general fund reserves between committed, assigned, and unassigned fund balances, with available reserves growing to \$10.2 million from \$9.2 million in fiscal 2017 (showing a reduction in committed reserves to \$656,000 from \$1.4 million). With no draw on reserves projected for fiscal 2019 and a goal to maintain or increase reserves to 18% of expenditures, we believe the town's flexibility will nominally improve and provide further cushion to absorb unexpected weather events or variations in revenue collections should an economic downturn affect tourism or the pace of development.

Very strong liquidity

In our opinion, Harwich's liquidity is very strong, with total government available cash at 28.1% of total governmental fund expenditures and 7.8x governmental debt service in 2018. 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 has no liquidity risks from private-placement or direct-purchase obligations. In addition, we do not expect deterioration in liquidity during the next two fiscal years based on unexpected liquidity contingencies.

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 3.6% of total governmental fund expenditures, and net direct debt is 32.3% of total governmental fund revenue. Overall net debt is low at 0.9% of market value, and approximately 86.2% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

Following the current transaction, Harwich will have about \$39 million in debt outstanding. The town continues to make progress in the design phase of its sewer construction project, which includes replacement of the septic system with sewer infrastructure. Other Cape Cod communities are undergoing the same process, and the town anticipates supporting the costs of this project with about \$25 million of additional debt over the next couple of years, which we have factored into our analysis. The amounts and timing of additional debt issuance are not yet determined, but we anticipate that, with the rapid repayment of existing principal, the town could layer in the additional debt without significant deterioration in its debt profile.

Harwich's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 7.6% of total governmental fund expenditures in 2018, with 4.2% representing required contributions to pension obligations and 3.4% representing OPEB payments. The town made its full annual required pension contribution.

Harwich contributes to a cost-sharing, multiple-employer 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 \$30.6 million with about a 62% funded ratio at June 30, 2018, based on an assumed rate of return of 7.375%. Given the funded ratio and the state's requirement for pension systems to be fully funded by 2040, we believe contributions will continue to rise during the next few fiscal years.

Harwich also provides OPEB to retirees but created a trust to prefund the liability, which we view positively. At June 30, 2018, based on the most recent actuarial valuation on June 30, 2016, management reported a net OPEB liability of \$40.7 million. In fiscal 2018, the town paid \$2.2 million towards its obligation, including \$203,000 allocated to the trust. The trust balance as of June 30, 2019 totaled \$2.4 million.

We believe future pension and OPEB costs could become a budgetary pressure (outside of our two-year outlook period) as a result of below-average funding ratios, particularly if economic conditions were to worsen, if management does not continue fully funding the actuarially determined contribution for the pension plan, or if funding assumptions are inadequate at current levels. However, given the town's strong management team, we believe the team will actively make budget adjustments, when needed, to constrain growth in these liabilities.

Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

Outlook

The stable outlook reflects our expectation that Harwich's very strong economy and management team will continue its proactive approach to supporting improved funding of the town's long-term liabilities. The stable outlook also

reflects our view that the town's improved reserve position insulates it from unexpected weather events or economic disruptions that could dampen revenue or economic trends. As a result, we do not expect to change the rating during the two-year outlook period.

Although unlikely, we could lower the rating if the town's long history of strong budgetary performance were to reverse and lead to declining reserves or if the sewer improvement project required significantly more debt than expected, resulting in deterioration in the town's debt position.

Related Research

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

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