

RatingsDirect®

Summary:

Chatham, Massachusetts; General Obligation

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US\$4.425 mil GO mun purp loan of 2021 bnds due 11/15/2040

<i>Long Term Rating</i>	AAA/Stable	New
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Chatham GO

<i>Long Term Rating</i>	AAA/Stable	Affirmed
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Chatham GO muni purpose loan of 2020 bnds

<i>Long Term Rating</i>	AAA/Stable	Affirmed
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Rating Action

S&P Global Ratings assigned its 'AAA' rating to the Town of Chatham, Mass.' \$4.4 million series 2021 general obligation (GO) municipal-purpose loan bonds. At the same time, S&P Global Ratings affirmed its 'AAA' rating on the town's existing GO debt. The outlook on all ratings is stable.

As the town voted to exempt a portion of this debt from Proposition 2 1/2 limitations, Chatham's full-faith-and-credit pledge secure the 2021 bonds. The town's outstanding debt is subject to Proposition 2 1/2 limitations, but we do not make a rating distinction, as we rate the limited obligation at the same level with our view of Chatham's general creditworthiness as expressed in our rating on the unlimited-tax GO bonds. We rate the limited-tax GO debt based on the application of our "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" criteria (published Nov. 20, 2019).

Chatham's GO bonds are eligible to be rated above the sovereign because we believe the town can maintain better credit characteristics than the nation in a stress scenario. Under our criteria, titled "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions," published Nov. 19, 2013, the town has a predominately locally derived revenue source, with about 80% of general fund revenue derived from property taxes with independent taxing authority and treasury management from the federal government.

Officials intend to use series 2021 bond proceeds to finance the town's fish pier and waterfront facilities project, sewer, and wastewater collection facilities and systems.

Credit overview

The rating reflects the town's continued stable performance with an anticipation of surplus performance for fiscal 2020, a third consecutive surplus. In addition, Chatham maintains a very strong economy with continued growth in market values of nearly 3.8% annually and continued development of waterfront attractions and dining experiences for visitors and residents. The stable outlook reflects the very strong liquidity and stable revenue mix, with the predominant revenue stream of property taxes, which have historically been collected upward of 97% annually. However, these strengths are partially offset by the town's rising unfunded liabilities, with increasing costs posing a potential long-term

credit risk, particularly if costs escalate. However, we believe Chatham has the financial wherewithal to absorb any increases in required pension contributions and pay-as-you-go health care costs into the annual levy and the town has demonstrated a willingness to increase the tax levy and when needed, exceed the limitations of Proposition 2 1/2 through voter-approved exclusions and has established a dedicated funding source for the other postemployment benefits (OPEB) through a 1.5% surcharge on tax bills. Overall, we anticipate the town outlook will remain stable during our two-year outlook period.

The rating further reflects our opinion of Chatham's:

- Very strong economy, with market value per capita of \$1.2 million and projected per capita effective buying income at 154% of the national level;
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with an operating surplus in the general fund and a slight operating surplus at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 28% of operating expenditures;
- Very strong liquidity, with total government available cash at 25.7% of total governmental fund expenditures and 1.8x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability profile, with debt service carrying charges at 14.7% of expenditures and net direct debt that is 148.8% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of market value; and
- Strong institutional framework score.

Environmental, social, governance (ESG) factors

Given the coastal nature of the town along the Atlantic Ocean, we consider Chatham's environmental risks to be elevated, relative to the sector as a whole but in line with peer coastal communities. The town is proactively managing these risks with the hiring of an exclusive director of natural resources to assist with resiliency efforts including hazard mitigation planning, investment waterfront infrastructure, and grants to assist with elevation planning flood reduction. We consider Chatham's social risks in line with that of the sector. Furthermore, we view the town's governance risks, relative to Chatham's economy, management, financial measures, and debt and liability profile, as being in line with the sector.

Stable Outlook

Downside scenario

Should the town's performance deteriorate, leading to reductions in available fund balance levels no longer consistent with that of other 'AAA' municipalities, coupled with pressure from rising fixed costs, we could lower the rating.

Credit Opinion

Very strong economy

We consider Chatham's economy very strong. The town, with an estimated population of 6,002, is located in Barnstable County. Chatham has a projected per capita effective buying income of 154% of the national level and per capita market value of \$1.2 million. Overall, the town's market value grew by 1.0% over the past year to \$7.5 billion in 2021.

Chatham is about 90 miles south of Boston, at the elbow of Cape Cod. The town is over 90% residential, consisting of beachfront property on both the ocean and the bay and is primarily an affluent summer resort and second-home community. However, management noted that due to the COVID-19 pandemic the community has seen more year-round residents. Historically, Chatham's population increases in the summer to approximately 30,000. Because of the town's 67 miles of coastline and desirable location, Chatham continues to experience high-end residential waterfront development. The town's real estate market remains strong, with a 14.8% increase in values and average home prices above \$700,000. This strong market continues the trend of growth in market values, with the property values rising an average of 3.8% annually over the past five years.

The town's 10 largest taxpayers represent less than 3% of total assessed value, which we view as very diverse, and are mainly residential, with the two largest being a resort and a country club. Management noted they are not seeing a trend of increased abatement requests despite the impacts of the pandemic. Chatham continues to collaborate with neighboring Cape Cod communities on ensuring safe and effective reopening efforts. Given the seasonal nature of the county employment base, the unemployment rate rose to 21.8% in April 2020; however, it recovered to 8.6% as of December 2020. Overall, despite the economic slowdown resulting from the pandemic, we believe Chatham's economy remains well-positioned to remain very strong during our outlook period.

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.

Highlights of the town's financial management policies include a strong focus on financial and capital planning as evidenced by its five-year, annually updated capital needs budget and 10-year facilities replacement plan. Chatham conducts financial forecasting to identify future revenue and expenditure trends and to complement the capital budget. In building the budget, the town does a trend analysis, looking back at five years of historical data. Budget assumptions are conservative and budget performance is monitored monthly. Chatham's reserve policy sets the town's unassigned fund balance at a level of at least 10%-15% of total annual expenditures. Chatham has a formal debt management policy, which limits debt to 5% of equalized valuation and total debt service to 10% of expenditures.

Furthermore, Chatham has demonstrated its commitment to planning around climate resiliency and risk, in particular through leveraging expertise from the Center for Coastal Studies and enhancing its eligibility for state and federal grant funds. The town continues to refer to its 2018 hazard mitigation plan to guide its overall climate resiliency efforts. In addition, an assessment mapping storm tide pathways was completed in August 2018 to plan for and mitigate inland flooding; and in July 2019, a coastal resiliency and management assessment was completed to assist the town in

proactively planning for projects to improve resiliency along Chatham's east-facing mainland. In September 2019, the town was designated a Municipal Vulnerability Preparedness Community by the state's Office of Energy and Environment Affairs due to the town's completion of its community resiliency building planning process; this designation allows Chatham to apply for State grants to fund implementation of its priority projects. The town's five-year capital improvement plan incorporates numerous projects addressing coastal resiliency across departments including its harbormaster, natural resources, and coastal resiliency departments. Overall, Chatham is in the preliminary planning and assessment stages of its climate resiliency efforts, and it is continuing to identify future project funding to mitigate these risks, which we view as positive. We will continue to monitor Chatham's progress in climate resiliency planning and projects.

Strong budgetary performance

Chatham's budgetary performance is strong in our opinion. The town had surplus operating results in the general fund of 1.9% of expenditures, and slight surplus results across all governmental funds 1.4% in fiscal 2019.

The town's revenue base is stable, in our opinion, with property taxes generating almost 80% of total general fund revenue and excise tax revenue accounting for about 7.5% of general fund revenues. The town's fiscal year-end is June 30.

For analytical consistency, we adjusted fiscal 2019 general fund and total governmental fund results to account for recurring transfers and large one-time capital expenditures paid for with bond proceeds. Management attributes the fiscal 2019 results to conservative budgeting and a growing economy that continues to support positive local-receipts and property-tax budgetary variances.

For fiscal 2020, the town is completing its final audit. Preliminary internal figures show a continued trend of surplus performance, a third consecutive in the general fund for the town. Management noted this favorable performance was driven by spending freezes in light of the governor's emergency declaration in March 2020. Chatham provided taxpayers with property tax relief in the form of delaying the second half payment to June 1, from May 1, and waved associated interest penalties. Tax collections were slightly lower than previous years at 97% collection rate compared with 99 but remain strong.

Chatham approved a \$41.2 million budget, an approximate 2% increase over the fiscal 2020 budget. The final budget approved in June 2020 included a \$1.5 million reduction in operating and capital spending to account for the economic uncertainty; in addition, the town revised local excise tax revenue projections, namely occupancy and meals tax, to be 57% of current year estimates, which we already consider conservative. Chatham's performance compared to budget continues to return favorable with management noting through the third quarter, expenses are in line at 75% of budget and revenues coming in at approximately 108% of budget. The town is eligible to receive approximately \$590,000 in direct aid from the American Rescue Plan Act. Chatham does not anticipate including this funding in their budgets (for more information, see "Economic Outlook U.S. Q2 2021: Let The Good Times Roll," published March 24, 2021, on RatingsDirect). With continued stable performance, we anticipate the town's performance to remain strong during our outlook period.

Very strong budgetary flexibility

Chatham's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 28% of operating expenditures, or \$12.4 million.

The town's available reserves have grown steadily by almost \$10 million in the past 10 years, providing Chatham with meaningful budgetary flexibility. Management does not anticipate the need to use the fund balance in the near term, as fiscal 2020 results show the continued surplus performance trend and fiscal 2021 performance is coming in favorable to budgeted expectations. Therefore, we believe fund balance levels will remain very strong.

Very strong liquidity

In our opinion, Chatham's liquidity is very strong, with total government available cash at 25.7% of total governmental fund expenditures and 1.8x governmental debt service in 2019. In our view, the town has strong access to external liquidity if necessary.

We believe liquidity will likely remain very strong, as there is no expectation of significantly deteriorated cash balances. The town also maintains strong access to external liquidity by frequently issuing debt for capital projects. In addition, Chatham is not aggressive with its investments. The town does not currently have any variable-rate or direct-purchase debt, reducing its contingent liquidity risk exposure.

Adequate debt and contingent liability profile

In our view, Chatham's debt and contingent liability profile is adequate. Total governmental fund debt service is 14.7% of total governmental fund expenditures, and net direct debt is 148.8% of total governmental fund revenue. Overall net debt is low at 1.1% of market value, which is in our view a positive credit factor.

Following this issue, Chatham will have about \$88 million of total direct debt outstanding. The town's debt profile is elevated based on debt issued under its wastewater management plan. As have all communities on Cape Cod, Chatham faced pressure from the state and the Environmental Protection Agency to replace existing private septic systems with a public wastewater system to reduce nitrogen levels in the ecosystem. Beginning in 2009, the town embarked on a \$210 million plan to install sewer lines throughout the community and expand its treatment plan. Chatham frontloaded much of the debt to take advantage of financing options under recent economic stimulus packages. The complete project is on pace to reach completion in 2040. The town anticipates issuing future debt; however, it will look to match issuances to debt rolling off to keep debt service consistent.

Pension and OPEB:

- We view the town's pension and OPEB obligations as currently manageable, but believe they could present a budgetary challenge in the medium term given the county retirement system's below-average funded ratio, the pension actuarially determined contributions built from what we view as weak assumptions and methodologies, and the expectation that costs will increase over the next few years.
- Although, OPEB liabilities are funded on a pay-as-you-go basis, which given claims volatility as well as medical cost and demographic trends, is likely to lead to escalating costs, the town has legal flexibility to alter OPEB benefits, which we view as a potential means to mitigate escalating costs should they modify benefits.

Chatham participated in the following plans as of June 30, 2019:

- Barnstable County Contributory Retirement System: 57.6% funded, with a net pension liability of \$25.6 million.
- A defined-benefit health care plan that provides health and dental insurance benefits for eligible retirees, and their dependents and beneficiaries: 4.94% funded, with a net OPEB liability of about \$19.2 million.

Chatham's combined required pension and OPEB contributions totaled 6.3% of total governmental fund expenditures in 2019. Of that amount, 4.3% represented required contributions to pension obligations, and 2.1% represented OPEB payments. The town makes its actuarial determined contribution annually. Contributions are expected to increase by 5.28% per year on a level percentage-of-pay amortization basis. The adopted funding schedule achieves full funding in a 16-year closed period, ending in 2035. While still elevated above our 6% guideline, the Barnstable County Contributory Retirement System reduced the discount rate from 7.375% to 7.150%. The annual increase, combined with, in our opinion, an aggressive discount rate of 7.15%, adds risk of cost escalation due to market volatility.

The town also provides OPEBs to retirees. As of June 30, 2018, the most recent actuarial valuation, it reported a \$19.2 million total OPEB liability. Chatham's OPEB trust fund valuation is currently \$1.5 million. The town made full contributions in fiscal 2020. In addition, Chatham approved a 1.5% surcharge on tax bills that is dedicated to fund the OPEB liability with the first payment coming in fiscal 2021, adding an indicative estimate of \$553,000 to the OPEB trust.

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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