

RatingsDirect®

Summary:

Chatham, Massachusetts; General Obligation

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US\$3.5 mil GO muni purpose loan of 2020 bnds due 06/01/2040

Long Term Rating AAA/Stable New

Chatham GO

Long Term Rating AAA/Stable Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' rating to Chatham, Mass.' series 2020 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 this debt from Proposition 2 1/2 limitations, Chatham's full-faith-and-credit pledge secure the 2020 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, on RatingsDirect).

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, on RatingsDirect, the town has a predominately locally derived revenue source with roughly 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 2020 bond proceeds, totaling roughly \$3.7 million, to finance its fish pier and waterfront facilities project.

Credit overview

Chatham enters the national recession triggered by the outbreak of COVID-19 with strong reserves and liquidity and well-embedded financial management policies, particularly in the areas of budgeting and planning. While significant economic uncertainty remains, we understand management has taken measures to cushion the effects of potential revenue shortfalls and has additional measures at its disposal that it could implement if necessary. Lending further stability to the rating and the outlook are the town's very strong liquidity and stable revenue mix, with the predominant revenue stream of property taxes, which have historically been collected upward of 98% during the fiscal year payable. While unfunded retirement liabilities may pose a long-term credit risk, particularly if costs escalate, we believe the town has the financial wherewithal to absorb any increases in required pension contributions and pay-as-you-go health

care costs into the annual levy; 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. While much economic uncertainty caused by the pandemic still remains, we expect Chatham's overall credit quality to remain stable; however, we will continue to monitor for any material adverse effects on the region and town. (For more information on S&P Global Ratings latest economic forecast, see the article "An Already Historic U.S. Downturn Now Looks Even Worse," published April 16, 2020.)

Environmental, social, governance factors

Our rating action incorporates our view regarding the health and safety risks posed by the COVID-19 pandemic. Absent the implications of COVID-19, we consider the town's social risks in line with that of the sector. Environmental risks are elevated for the town, relative to the sector as a whole, due to its location along the Atlantic Ocean and thus its direct exposure to rising sea levels. The town is proactively managing these risks via resiliency studies, hazard mitigation planning, and capital waterfront projects, among other endeavors. Furthermore, we view the town's governance risks as being in line with the sector.

Stable Outlook

Downside scenario

Should the town's performance deteriorate, leading to declined available fund balance levels no longer consistent with that of other 'AAA' municipalities, coupled with a lack of compliance with financial policies and practices, we could lower the rating. In addition, given the location of the town and its outsized exposure to environmental hazards, we could lower the rating should the town withdraw from its climate resiliency efforts.

The rating further reflects our opinion of Chatham's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment methodology;
- Adequate 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 position, with debt service carrying charges at 14.7% of expenditures and net direct debt that is 152.0% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value, but a large pension and other postemployment benefit (OPEB) obligation and the lack of a plan to sufficiently address the obligation; and
- Strong institutional framework score.

Credit Opinion

Very strong economy

We consider Chatham's economy very strong. The town, with an estimated population of 5,886, is located in Barnstable County in the Barnstable Town, Mass. MSA, which we consider to be broad and diverse. The town has a projected per capita effective buying income of 174% of the national level and per capita market value of \$1.3 million. Overall, the town's market value grew by 4.7% over the past year to \$7.4 billion in 2020. The county unemployment rate was 3.9% in 2019, which we expect will increase given recent labor market deterioration resulting from the COVID-19 pandemic.

Chatham is about 90 miles south of Boston, at the elbow of Cape Cod. The town is over 90% residential, and contains beachfront property on both the ocean and the bay and is primarily an affluent summer resort and second-home community, though decreasingly so, as the community has seen more year-round residents. Still, Chatham's population multiplies in the summer to approximately 30,000. Because of its 67 miles of coastline and its desirable location, it continues to experience high-end residential waterfront development. While selling prices for individual residential properties did decrease in the recession, total market value has remained high.

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. The town is collaborating with neighboring Cape Cod communities on re-opening efforts. Overall, despite the economic slowdown resulting from the COVID-19 pandemic, we believe Chatham's economy remains particularly insulated due to its strong and stable residential tax base.

Very strong management

We view the town's management as very strong, with strong financial policies and practices under our Financial Management Assessment 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 evidenced by its five-year, annually-updated capital needs budget and 10-year facilities replacement plan. The town 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% to 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 its climate resiliency planning and projects.

Adequate budgetary performance

Chatham's budgetary performance is adequate, in our opinion. This assessment incorporates our belief that heightened uncertainty exists relative to the recessionary pressures related to the COVID-19 pandemic. The town had surplus operating results in the general fund of 1.9% of expenditures, and slight surplus results across all governmental funds of 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, Chatham's approved budget was balanced at \$40.3 million, 1.18% increase over the fiscal 2019 budget. The COVID-19 stay-at-home orders have had minimal impact on the town's fiscal year 2020 finances, as property tax collections and local receipt revenues, which in general are budgeted conservatively and with the latter being most robust in the summer months, have outperformed budgeted estimates through April 2020. As such, the town expects for year-end results to be positive.

Chatham's fiscal 2021 budget proposed in January projected an almost 6% increase over the current year budget, at \$42.7 million. Given recent events, management has revised local excise tax revenue projections, namely occupancy and meals tax, to be 57% of current year estimates, which we already consider conservative. Accordingly, to bridge the budget gap management has proposed departmental expenditure cuts, select deferrals and expenditure reductions for capital projects, and an increase in the tax rate, the first in several years. The board of selectmen voted unanimously to recommend approval, with the town meeting scheduled to be held for final approval in late June. While considerable economic uncertainty remains, we expect the town to maintain financially balanced operations overall, given its recent adjustments to revenue and expenditure assumptions, as well as management's general history of conservative budgeting.

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 over the past 10 years, providing the town with meaningful budgetary flexibility. Management does not anticipate the need to utilize fund balance in the near-term, as fiscal 2020 results are projected to be at least balanced and management has applied contingencies in its budgetary assumptions to budgetary balance fiscal 2021. As such, 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 152.0% 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 roughly \$83 million of total direct debt outstanding. Chatham's debt profile is elevated based on debt issued under its wastewater management plan. Like all communities on Cape Cod, Chatham was facing 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. In 2009, the town embarked on a \$210 million plan to install sewer lines throughout the community and expand its treatment plan. The town frontloaded much of the debt to take advantage of financing options under recent economic stimulus packages. Going forward, the town plans to issue \$10 million-\$15 million every two years until the project is complete in 2040. All of the debt for the wastewater project is being done through debt exclusions, which requires a two-thirds vote of Chatham residents. Other capital needs are limited as Chatham has recently completed updates on all of its major public buildings. The town is scheduling to retire about 50% of its current debt within the next 10 years, which we view as average amortization. Chatham expects to issue about \$3 million in new money debt over the next one-to-two years, which we do not expect to change its debt profile.

Chatham's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 7.2% of total governmental fund expenditures in 2019. Of that amount, 4.3% represented required contributions to pension obligations, and 3.0% represented OPEB payments. The town made its full annual required pension contribution in 2019.

We view the town's pension and OPEB obligations as currently manageable, but believe they could present as a budgetary challenge in the medium-term given the county retirement system's below-average funded ratio and the expectation that costs will increase over the next few years.

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, 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 7.2% of total governmental fund expenditures in 2019. Of that amount, 4.3% represented required contributions to pension obligations, and 3.0% 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. The annual increase, combined with a discount rate of 7.375%, 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 \$1.3 million, with \$150,000 contributed in the 2019 fiscal year.

Strong institutional framework

The institutional framework score is strong.

Related Research

- 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

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