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Summary:

Barnstable County, Massachusetts; General Obligation

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Credit Profile

US\$4.387 mil GO mun purp loan bnds ser 2017 dtd 09/20/2017 due 09/20/2032

Long Term Rating

AA/Stable

New

Rationale

S&P Global Ratings assigned its 'AA' long-term rating to Barnstable County, Mass.' series 2017 general obligation (GO) bonds. The outlook is stable.

A pledge of Barnstable County's full faith and credit, subject to the limitations of its charter, secures the bonds. Despite these limitations, which restrict member town assessments to 2.5% increases each year, we did not make a rating distinction for the limited-tax GO pledge due to the county's budgetary flexibility.

According to officials, bond proceeds will be used for various capital purposes such as renovations to an old jail building, software licensing, a dredge, a conservation restriction, planimetrics, and equipment replacement.

The county is concurrently issuing bond anticipation notes, which we do not rate but have factored into our analysis.

The 'AA' rating reflects our assessment of the following factors:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Adequate management, with standard financial policies and practices under our financial management assessment (FMA) methodology;
- Adequate budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2016;
- Strong budgetary flexibility, with an available fund balance in fiscal 2016 of 39% of operating expenditures, but limited capacity to raise revenues due to consistent and ongoing political resistance;
- Very strong liquidity, with total government available cash at 17.2% of total governmental fund expenditures and 2.6x governmental debt service;
- Adequate debt and contingent liability position, with debt service carrying charges at 6.7% of expenditures and net direct debt that is 91.4% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of market value and rapid amortization, with 67.5% of debt scheduled to be retired in 10 years, 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.

Very strong economy

We consider the county's economy very strong. Barnstable County, with an estimated population of 214,836, is located in the Town of Barnstable MSA, which we consider to be broad and diverse. The county has a projected per capita

effective buying income of 127% of the national level and per capita market value of \$360,668. The county unemployment rate was 4.7% in 2016.

Barnstable County spans 404 square miles on Cape Cod in southeastern Massachusetts. Known for its expansive coastline, numerous beaches, and recreational activities; the county is a popular resort destination with many second homes and small bed and breakfasts. The county consists of 15 communities, ranging in size from 2,000 to 44,000.

Given the county's proximity to Boston and its growing year-round population, we view Barnstable as largely resilient to economic swings. Therefore, we do not expect our view of the economy weaken in the near term.

Adequate management

We view the county's management as adequate, with standard financial policies and practices under our FMA methodology, indicating the finance department maintains adequate policies in some but not all key areas.

In developing the budget, Barnstable County uses conservative assumptions grounded in a historical trend analysis and an understanding of current economic conditions. We view the revenue environment as somewhat unpredictable, given that 52% of revenue comes from excise taxes, which we view as sensitive to economic swings. We understand that county officials are developing assumptions that will protect the budget from volatility in this revenue. These assumptions will likely be introduced in future budget cycles.

The county maintains strong practices in the areas of budgetary control, with quarterly budget-to-actual reports presented to the commissioners. Barnstable County does not have a long-term financial plan, capital improvement plan or debt policy, as it is an infrequent issuer of debt. However, county officials are in the process of developing an investment policy and a reserve policy.

The state auditor recently conducted an audit of the county, which highlighted several deficiencies in past management practices, including the accumulation of a capital deficit of nearly \$9 million and the improper leasing of county facilities. The audit also highlighted historical practices for funding capital from the operating budget, which left several unfinished projects. From 2013 to 2015, Barnstable approved \$6.5 million in capital projects, but was only able to finance \$2.4 million due to lack of available funds. While we view the deferment of capital as a credit risk, we recognize that county management is actively addressing the auditor's recommendations.

Adequate budgetary performance

Barnstable County's budgetary performance is adequate in our opinion. The county had operating surpluses of 1.6% of expenditures in the general fund and of 1.7% across all governmental funds in fiscal 2016. Weakening our view of the county's budgetary performance is the county's deferral of capital expenditures, and rising pension and OPEB costs that we believe will be challenge for county officials to maintain balanced operations.

The county provides a number of services to the region, including regional planning, dredging, consultation and financing of septic systems, property deeds, and information technology, among other services. The primary revenue source is excise taxes (52%), followed by county tax assessments (17%). The county tax assessments come from 15 towns, with the largest portion of the assessments coming from Barnstable (17%), Falmouth (14%), and Dennis (8%).

Originally, the county had budgeted \$2.3 million of reserves to balance the budget in 2016. However, a new

management team, which arrived midyear, introduced cost controls and spending freezes, reduced departmental budgets, and postponed non-urgent capital expenditures, eliminating the need for fund balance. County officials expect 2017 audited results to show a surplus due to revenue that exceeded expectations as well as turnbacks from various departments. The 2018 budget is balanced without the use of reserves.

With retirement costs rising at 10% annually, and revenue capped at 2.5% increases, management will have to be proactive in order ensure revenues align with expenditures. We note that the county's primary revenue source (excise taxes) is subject to economic shifts, and will likely weaken in the next recessionary period. Despite these pressures, we believe Barnstable's new management team is attuned to these challenges. Through careful planning and prudent spending, we believe the county will maintain at-least balanced operations in the near-term. Therefore, we expect our assessment of Barnstable's performance to remain at least adequate.

Strong budgetary flexibility

Barnstable County's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2016 of 39% of operating expenditures, or \$6.6 million. Negatively affecting budgetary flexibility, in our view, is Barnstable County's limited capacity to raise revenues.

Under the Barnstable County charter, member town assessments can only increase by 2.5% each year. The county is further restricted in its ability to raise revenues from excise taxes due to likely resistance from both member towns and residents. Therefore, we view the county's revenue-raising ability as limited.

Reserve levels doubled from 2015 levels (\$2.8 million or 16% of expenditures) due to a reclassification from restricted to available funds, according to county officials. Although the county has not yet introduced a reserve policy, officials have no immediate plans to spend down reserves. Therefore, we expect our assessment of the county's budgetary flexibility to remain strong.

Very strong liquidity

In our opinion, Barnstable County's liquidity is very strong, with total government available cash at 17.2% of total governmental fund expenditures and 2.6x governmental debt service in 2016. In our view, the county has satisfactory access to external liquidity if necessary.

Barnstable County last issued bonds in 1996, and therefore does not have demonstrated market access. All existing debt was issued indirectly through the Massachusetts Clean Water Trust. However, given the strength of the county's tax base and strong budgetary flexibility, we do not believe the county will have trouble accessing external liquidity. We note that the county does not have variable-rate or direct-purchase debt, nor does it have significant contingent liabilities. Therefore, we expect the town's liquidity profile to remain very strong.

The county recently settled a case with the town of Barnstable to remove chemicals from the water supply, relating to the use of perfluoroalkyl substances at the Fire and Rescue Training Academy, a county-owned facility. The county agreed to pay \$2.95 million over 20 years. Given that the case has been settled at a minimal annual cost to the county, we no longer view this as a contingent liability.

Adequate debt and contingent liability profile

In our view, Barnstable County's debt and contingent liability profile is adequate. Total governmental fund debt service is 6.7% of total governmental fund expenditures, and net direct debt is 91.4% of total governmental fund revenue. Overall net debt is low at 1.0% of market value, and 67.5% of the direct debt is scheduled to be repaid within 10 years, which are in our view positive credit factors.

Following this issue, the county will have \$30 million in debt outstanding, including \$22 million associated with its septic loan program. Barnstable County does not have any immediate plans to issue additional debt. Therefore, we expect our assessment of the county's debt profile to remain adequate.

In our opinion, a credit weakness is Barnstable County's large pension and OPEB obligation. The county's combined required pension and actual OPEB contributions totaled 15.8% of total governmental fund expenditures in 2016. Of that amount, 12.8% represented required contributions to pension obligations, and 3.1% represented OPEB payments. The county made its full annual required pension contribution in 2016. The funded ratio of the largest pension plan is 58.1%.

The county is a member of the Barnstable County Contributory Retirement Association, a cost-sharing, multiple-employer, defined benefit pension plan. Its proportionate share of the net pension liability is \$48 million. In 2016, the actuarial determined contribution was \$3.8 million. Of this cost, 34% (or \$1.3 million) is associated with the Sheriff's Office, a department that was shifted to state control in 2010. Barnstable County is in ongoing discussions with the state to transfer responsibility of the pension liability, which is 83% of the county's overall net pension liability.

Barnstable County also administers a single-employer defined benefit plan, which provides lifetime healthcare and life insurance for eligible retirees and their dependents through the county's group health insurance plan. The county pays retirement benefits on a pay-as-you go basis. In 2016, it contributed \$905,000, which is 44% percent of its annual required contribution. The current unfunded accrued liability is \$29.6 million.

Although we recognize the county is making efforts to control costs--such as negotiating a higher contribution rate for new employees and reviewing claims--we expect retirement costs to continue to rise, consuming a larger portion of Barnstable County's budget.

Strong institutional framework

The institutional framework score for Massachusetts counties is strong.

Outlook

The stable outlook reflects our view of Barnstable County's robust tax base with strong property wealth and income indicators. It further reflects the county's strong budgetary flexibility as well as recently introduced cost controls, which will likely drive positive operating performance in the near term. Therefore, we do not expect to change the rating over our two-year outlook horizon.

Upside scenario

A positive rating would depend on a reduction of Barnstable County's retirement liabilities, the introduction of more formalized policies and planning documents, and a more consistent revenue environment.

Downside scenario

We could lower the rating if retirement liabilities rise, pressuring operations and leading to a draw on reserves to levels we no longer view as very strong.

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
- 2016 Update Of Institutional Framework For U.S. Local Governments

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