

CREDIT OPINION

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Nantucket (Town of) MA

Update to credit analysis following upgrade to Aaa

Summary

Nantucket (Aaa stable), Massachusetts benefits from a large tax base with very strong home values and above average resident wealth and incomes. The economy is driven by seasonal tourism which increases the population more than 4 fold to around 45,000. The financial position is stable and has strengthened in recent years with strong reserves and liquidity that are above average for the region. The town's debt burden and long term pension and OPEB liabilities are manageable.

On October 23, we upgraded the town's issuer rating and general obligation bond ratings to Aaa with a stable outlook.

Credit strengths

- » Sizeable tax base with strong home values and equalized value per capita
- » Stable and healthy financial position with ample reserves
- » Strong fiscal management

Credit challenges

- » Large number of seasonal and second homes
- » Economy largely driven by tourism
- » Island community

Rating outlook

The stable outlook reflects our expectation that the town's strong fiscal management will maintain a healthy financial position and moderate debt burden and pension liability. The outlook also incorporates the strength of the large tax base and robust housing demand that trends suggest will continue for at least the near term.

Factors that could lead to an upgrade

- » Not applicable

Factors that could lead to a downgrade

- » Significant decline in reserves and cash
- » Deterioration of the tax base

- » Decline in the demand for housing
- » Material increase in the debt burden or pension liability

Key indicators

Exhibit 1

| Nantucket (Town of) MA | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|--------------|--------------|--------------|--------------|--------------|
| Economy/ Tax Base | | | | | |
| Total Full Value (\$000) | \$18,041,019 | \$17,816,255 | \$17,816,255 | \$21,682,664 | \$21,682,664 |
| Population | 10,414 | 10,556 | 10,694 | 10,298 | 10,298 |
| Full Value Per Capita | \$1,732,381 | \$1,687,785 | \$1,666,005 | \$2,105,522 | \$2,105,522 |
| Median Family Income (% of USMedian) | 147.4% | 165.1% | 161.9% | 161.9% | 161.9% |
| Finances | | | | | |
| Operating Revenue (\$000) | \$78,059 | \$82,466 | \$88,987 | \$103,845 | \$108,089 |
| Fund Balance (\$000) | \$24,855 | \$25,807 | \$22,868 | \$38,378 | \$39,693 |
| Cash Balance (\$000) | \$25,686 | \$26,993 | \$25,081 | \$42,296 | \$43,604 |
| Fund Balance as a % of Revenues | 31.8% | 31.3% | 25.7% | 37.0% | 36.7% |
| Cash Balance as a % of Revenues | 32.9% | 32.7% | 28.2% | 40.7% | 40.3% |
| Debt/Pensions | | | | | |
| Net Direct Debt (\$000) | \$164,125 | \$159,692 | \$175,863 | \$206,737 | \$197,094 |
| 3-Year Average of Moody's ANPL (\$000) | \$118,676 | \$114,374 | \$117,994 | \$123,046 | \$141,780 |
| Net Direct Debt / Full Value (%) | 0.9% | 0.9% | 1.0% | 1.0% | 0.9% |
| Net Direct Debt / Operating Revenues (x) | 2.1x | 1.9x | 2.0x | 2.0x | 1.8x |
| Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%) | 0.7% | 0.6% | 0.7% | 0.6% | 0.7% |
| Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x) | 1.5x | 1.4x | 1.3x | 1.2x | 1.3x |

As of June 30 fiscal year-end

Source: Moody's Investors Service and Nantucket's audited financial statements

Profile

Nantucket is an island community located approximately 30 miles south of Cape Cod, Massachusetts. The town is primarily residential and has a year-round population of 10,298, although this number can grow to around 45,000 during the summer months.

Detailed credit considerations

Economy and tax base: Sizeable tax base supported by high-end housing stock

Nantucket tax base will likely continue to grow given increased home values and strong new growth and building permits. Massachusetts' fourth largest tax base totaling \$23.8 billion (2019-20 equalized value) is primarily residential (96% of 2018 assessed value) and has a year-round population of 10,298 which expands to around 45,000 during the summer months. Reflecting its status as a highly desirable seasonal resort community, assessed value has grown for four consecutive years including 2.2% in 2018, bringing five year compound growth to 4.8%. The assessed value trend has contributed to the 2017-18 equalized value increasing 21% from 2015, and the most recent increase of 9.7% for the 2019-20 equalized value resulting in a historic high above its pre-recession level of \$22.2 billion.

New development projects include a Cumberland Farms, two grocery stores and several housing developments including mixed use and affordable housing. New growth revenue in 2018 was \$1.3 million and the town will continue to conservatively budget for \$800,000 in annual new growth. Other projects include a \$120 million new campus at the Nantucket Cottage Hospital, a top employer. Longer term, the town is focused on a \$1 billion redevelopment of Harbor Place, in downtown adjacent to the boat basin. The project will be mixed-use including a parking garage and transportation center.

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The median home value of \$966,600 (2016) is significantly above the state and national median and contributes to an equalized value per capita of \$2.3 million, reflecting the high-end housing stock and limited year-round population. Income levels on the island are also above the national average, with a median family income of 162% of the US median. Notably, year round residences make up 15% of the town's residential tax base with seasonal homes making up the remaining 85%. A high percentage of seasonal home owners are extraordinarily wealthy.

Storm risk is a concern for the island. The recent increase in financial reserve levels and satisfactory disaster mitigation planning adequately prepares the town to address a significant storm event. Additionally, the demand for housing in the town and economic incentives of private industry helps to ensure strong rebuilding efforts. Although over the long term sea level rise could be a key credit risk, housing sales for the last three years have been at historic highs, totaling over \$1 billion. We will monitor this trend and any change in demand for property due to storm risk or sea level change will be reflected in the town's overall credit profile.

Financial operations, reserves and coverage: Strong financial position expected to continue

Nantucket's financial position will remain stable over the near term due to conservative fiscal management and multi-year planning. Budget growth will be driven by rising costs of healthcare, retirement contributions and salaries. Over the last two years, the town has increased its general fund reserves and liquidity to over 35% of revenues. The increase is attributable to both the town's efforts to strengthen the financial profile through a positive operating trend and consolidation of the nursing home fund and solid waste fund into the general fund.

Fiscal 2018 audited financials reflect an operating surplus of \$1.1 million due to positive variance in revenues primarily from local receipts as well as expenditure savings. The available general fund balance increased to \$39.7 million or a very healthy 36.7% of revenues.

The fiscal 2019 budget increased by 0.9% or \$752,000, leveraging savings in health insurance from plan design changes. Management expects to balance the budget with a 4-5% tax levy increase. The levy increase includes a \$1.5 million general capital exclusion voted by the town to support capital replacements and infrastructure upgrades townwide. The town will also use \$625,900 of free cash for other capital needs.

The town's financial forecast reflects balanced operations through 2023 including budgeting funds for capital, reserves and the OPEB trust. The primary revenues are property taxes representing 72% of 2018 general fund revenues. The largest expenditures are education representing 26% of total expenses, followed by pension and fringe benefits at 22% and public works at 12%.

LIQUIDITY

Cash and investments at the end of fiscal 2018 represented \$43.6 million or 40.3% of revenues. The town's liquidity provides over 3.4x coverage on the amount of bond anticipation notes outstanding.

Debt and pensions: Debt and long term liabilities will remain manageable

The direct debt burden of 0.9% of equalized value and 1.9 times revenues will likely remain manageable over the near term given sufficient structuring and taxpayer support by excluding a large portion of projects from the tax levy limit. Additionally, operations in the town enterprise funds for water and sewer continue to improve and could meet our definition of self supporting over the near term that would result in lower debt burden metrics. Future capital needs will include water and sewer projects and a debt exclusion vote for around \$12 million in road and infrastructure improvements. The debt burden includes \$17.5 million in outstanding Nantucket Islands Land Bank (A1) bonds that the town supports with a pledge of its full faith and credit. The bonds are paid with a 2% tax on the purchase price of all real estate transfers. The tax provides strong debt service coverage. The town also expects to incorporate strategic projects related to climate resiliency into the capital plan in the coming year.

DEBT STRUCTURE

The entire debt portfolio is fixed rate with principal amortization of 59% of all debt outstanding over the next ten years. The town's debt policy requires general fund supported debt to amortize 65% of principal in ten years. Fiscal 2018 debt service totaled \$8.3 million representing 7.8% of general fund expenditures.

DEBT-RELATED DERIVATIVES

Nantucket is not party to any interest rate swaps or other derivative agreements.

PENSIONS AND OPEB

The town participates in the Barnstable County Contributory Retirement System, a multi-employer, defined benefit retirement plan for all town employees other than teachers and certain school administrators who are covered under the state teachers' plan. The town made its 2018 actuarially determined contribution of \$5.8 million representing 5.4% of general fund expenditures. The 2018 three-year average Moody's Adjusted Net Pension Liability, under Moody's methodology for adjusting reported pension data, is \$141.8 million, a moderate 1.3 times general fund revenues and low 0.7% of equalized value.

The town contributed \$3.7 million on a pay-as-you-go basis towards its annual OPEB cost in fiscal 2018. Additionally, the town makes annual deposits of \$500,000 into an OPEB trust which had a balance of \$2.4 million at the end of fiscal 2018. The net OPEB liability is currently \$93 million based on the July 1, 2016 valuation report.

Total fixed costs in fiscal 2018, including debt service, required pension contributions and retiree healthcare payments, represented \$17.8 million, or 16.6% of expenditures.

Management and governance: Strong fiscal management bolsters credit profile

Town management has consistently demonstrated conservative fiscal management. In fiscal 2016 the town formalized its management policies including debt, financial and reserve policies and long-range financial and capital planning requirements. The financial planning includes a seven year operating forecast with adequate budget assumptions. All together, the formal adoption of these management policies positions the town to maintain their strong credit profile over the long term.

Massachusetts towns have an Institutional Framework score of Aa, which is high. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. Massachusetts towns major revenue source, property taxes, are subject to the Proposition 2 1/2 cap which can be overridden with voter approval only. However, the cap of 2.5% still allows for moderate revenue-raising ability. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally greater than 25% of expenditures. However, Massachusetts has public sector unions, which can limit the ability to cut expenditures. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

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