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Ratings

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Summary:

Southampton, New York; General Obligation

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Credit Profile		
US$17.26 mil pub imp bnds ser 2020 due 04/01/2040		
Long Term Rating	AAA/Stable	New
Southampton Twn GO		
Long Term Rating	AAA/Stable	Affirmed

Rating Action

S&P Global Ratings has assigned its 'AAA' long-term rating to the Town of Southampton, N.Y.'s $17.2 million general obligation (GO) public improvement bond. At the same time, we affirmed our 'AAA' rating on the town's existing GO debt. The outlook is stable.

The town's faith-and-credit pledge to levy ad valorem taxes on all the taxable real property within its borders, subject to certain statutory limitations, secures its GO bonds. The series 2020 bonds will be used to finance various capital projects.

Credit overview

The rating action and affirmation reflect Southampton's deep and diverse economic base. With a tax base anticipated to grow to $73.7 billion, and a market value per capital of over $1 million, the town has access to a deep tax base to support its operations. Its strong financial policies and practices have supported strong operations since 2008. Additionally, the town has taken steps to mitigate the environmental risks given its extensive shoreline along the Atlantic Ocean. It has maintained strong performance through conservative budgeting and financial forecasting.

Despite being a popular tourist destination, we believe the town's stable, property-tax based revenue source is unlikely to result in materially delayed collections or revenue volatility amid the spread of COVID-19 (referred to as Coronavirus). While we continue to monitor events related to COVID-19, we do not currently expect it to affect the town's ability to maintain budgetary balance and pay debt service costs. For more information, see our article "COVID-19's Potential Effects In U.S. Public Finance Vary By Sector" (published March 5,2020, on RatingsDirect).

The rating also reflects the following:

- 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 (FMA) methodology;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2018;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 41% of operating expenditures;

- Very strong liquidity, with total government available cash at 28.3% of total governmental fund expenditures and 2.4x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability position, with debt service carrying charges at 12.0% of expenditures and net direct debt that is 63.1% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 83.7% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Southampton's GO bonds are eligible to be rated above the sovereign because we believe the town can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "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 55.5% of governmental activity revenue derived from property taxes with independent taxing authority and independent treasury management from the federal government.

The above-mentioned stable factors inform our opinion that we do not anticipate changing the town's rating during our two-year outlook period.

Two-Year Stable Outlook

Downside scenario

Although unlikely, in our view, financial pressure that management is unable to respond to in a timely manner, or an aggressive or overly optimistic budgeting approach leading to a more-than-nominal reserve decline, could pressure the ratings.

Credit Opinion

Very strong economy

We consider Southampton's economy very strong. The town, with a population of 57,542, encompasses approximately 138 square miles in eastern Suffolk County on the South Fork of Long Island. It is in the New York-Newark-Jersey City MSA, which we consider broad and diverse. The town has a projected per capita effective buying income of 134% of the national level and per capita market value of $1.3 million. Overall, market value grew by 9.5% over the past year to $73.4 billion in 2020. The county unemployment rate was 3.9% in 2018.

With significant water access, the town remains a popular resort area, with the local economy augmented by farming and fishing.

The town continues to see growth in property values due to its desirability as an Atlantic beachfront community. Over the past year, it experienced additional non-residential developments, including restoration of the Canoe Place Inn and a 37-unit townhouse development in the hamlet of Hampton Bays, the construction of the Sandy Hollow Workforce Housing project, and the construction of the Ponquogue Beach Pavilion, all of which should continue to add to the tax base. The town is also anticipating a $150 million expansion of its hospital through its Stony Brook Southampton Hospital Affiliation. Additional developments are anticipated in the Shinnecock Canal Maritime Park, Ludlam Avenue

Park, and Speonk Commons. We expect the town's very strong economy will continue over the two-year 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.

We have included the following factors in our assessment, specifically the town's:

- Conservative revenue and expenditure assumptions that use at least five years of historical trend analysis and outward-looking projections for operations;
- Monthly reporting of general fund and major fund budget-to-actuals to town council, which it may revise over the course of the year;
- Presentation of a two-year budget model that estimates expected revenues and expenditures for all major funds;
- Annual review and adoption of a five-year capital improvement plan with listed projects and funding sources;
- Investment policy consistent with state guidelines, with holdings and earnings reviewed monthly by the town comptroller and deputy comptroller;
- Formal debt management policy limiting uses of debt to capital financing, adopting state guidelines on maximum indebtedness, and limiting debt service expenditures supported by local real property taxes to no more than 15% of aggregate budgetary appropriations, as well as the establishment of a debt reduction policy for capital projects (March 2017); and
- Formal reserve policy to maintain a fund balance in its general fund at the end of each fiscal year equal to no less than 17% of the total respective ensuing year's operating budget for cash-flow purposes and any economic contingencies.

Resiliency in Southampton

As an oceanfront community, Southampton continues to monitor the effects of rising sea levels and how they affect its tax base, beach, infrastructure, and equipment. The town maintains four special taxing districts--beach erosion control districts (BECDs), the two largest being Bridgehampton and Sagaponack. Taxpayers in these specific districts have approved two bond issues to combat beach erosion, which is paid from a tax levy on said taxpayers. The town works in conjunction with the Army Corps of Engineers to improve its beaches. Additionally, since 1998, Southampton has maintained a community preservation fund (CPF), which is a conservation program to preserve open space and farmland within the town. The fund is funded by a 2% tax on a majority of real estate sales within the town's jurisdiction. The towns may issue bonds for purchases to be paid back through the life of the fund with the 2% tax revenues. Certain requirements must be met before this occurs. The town has bought land to preserve it and limit redevelopment on open space. It has also adopted FEMA guidelines for zoning, flood maps, and building standards to ensure new construction conforms to best practices. We believe these extensive measures will help Southampton to protect its tax base and remain resilient amid the anticipation of rising sea levels and the higher frequency of adverse weather-related events.

Strong budgetary performance

Southampton's budgetary performance is very strong, in our opinion. The town had operating surpluses of 1.5% of expenditures in the general fund and 11.7% across all governmental funds in fiscal 2018.

Fiscal 2018 closed with another surplus of $746,728 as a result of ongoing conservative budgeting practices that resulted in under-expenditures. The town has adopted a debt reduction policy in which the town board can allocate up to 75% of the difference between the adopted budget's fund balance projects versus the actual fund balance for that year. Since 2017, the town has moved a portion of its surplus to a debt service fund to help pay down debt service. As a result, we do not anticipate multimillion-dollar surpluses that had been the case prior to 2017, but note the reduced debt burden and debt service costs. That said, we believe the town will maintain its strong performance.

The 2019 townwide budget is $193.8 million. The $43.3 million budget for the town's general fund continues the trend of reducing the tax rate for general fund operations. The budget includes a fund balance appropriation of $598,581. Although closing out fiscal 2019, management is estimating break-even results in its general fund. Additionally, the town retired a considerable portion of its CPF debt during the year--roughly $23 million.

The town's 2020 budget is $176.8 million across all funds. The general fund's budget is $50.6 million and includes another reduction in that funds tax rate and $600,000 in appropriated fund balance, which we expect will be replenished throughout the fiscal year. Increases in the general fund are primarily a result of higher salaries, benefits, and other expenses. On the revenue side, the town is experiencing a high level of mortgage tax revenue so far for 2020. With conservative budgeting practices and several formal fiscal policies, we do not expect budgetary performance to weaken in the near term.

As of March 17, 2020, the town has declared a state of emergency in response to the COVID-19 pandemic. It has canceled special programs and reduced staffing in city buildings. Drop boxes have been set up to receive various documents--including tax payments. While it may be too early to establish the full economic effects of the virus, the town may experience lower-than-budgeted beach ticket revenues, as well as other tourism-derived revenues. Nevertheless, we anticipate that through the town's strong management and financial policies, as well as its dependence on property tax revenue, it will maintain a strong performance over the outlook period.

Very strong budgetary flexibility

Southampton's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 41% of operating expenditures, or $16.1 million. We expect the available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

Flexibility is supported by a formal policy to maintain a fund balance in the general fund at the end of each fiscal year equal to no less than 17% of the total respective ensuing year's operating budget. Fund balance levels continue to improve, rising to $16.7 million in fiscal 2019. We note that since the town's 2017 policy designating 75% of general fund surpluses to pay down existing debt, we do not anticipate the its fund balance will materially grow. However, we expect the very strong level of fund balance to remain.

While not considered available, we note the town maintains a CPF to preserve open space and farmland as part of the five East End towns of Long Island. The fund is financed by a 2% tax on most real estate sales. For fiscal 2018, the restricted balance was $96.03 million. A portion of the fund will likely be drawn on in the near term for water projects.

Very strong liquidity

In our opinion, Southampton's liquidity is very strong, with total government available cash at 28.3% of total governmental fund expenditures and 2.4x governmental debt service in 2018. In our view, the town has strong access to external liquidity if necessary.

We believe the town's strong access to external liquidity is supported by its regular debt issuances, including GO bonds. Management has confirmed it has no contingent liquidity risks from financial instruments with payment provisions that change on the occurrence of certain events. Though the state allows for what we view as permissive investments, we believe the town does not currently have aggressive ones with the majority of its investments in FDIC-insured accounts. The town has consistently had very strong liquidity and we do not anticipate a change to these ratios.

Strong debt and contingent liability profile

In our view, Southampton's debt and contingent liability profile is strong. Total governmental fund debt service is 12.0% of total governmental fund expenditures, and net direct debt is 63.1% of total governmental fund revenue. Overall net debt is low at 0.8% of market value, and approximately 83.7% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

The town has limited future capital needs, with capital projects funded through annual cash contributions and GO bond issuances. Future debt issuances, although not yet planned for, are anticipated to continue in similar amounts that have been issued in the past.

Pension and other postemployment benefits

- We do not view pension and other postemployment benefit (OPEB) liabilities as an immediate source of credit pressure for Southampton, given our opinion of current strong plan funding status and limited escalating cost trajectory risk.
- However, significant OPEB liabilities that are funded on a pay-as-you-go basis, which, given claims volatility as well as medical cost and demographic trends, are likely to lead to escalating costs and could create budgetary pressure.

Southampton participates in the following plans as of Dec. 31, 2018,

- Employee Retirement System (ERS): 98.24% funded, with a proportional share of the net pension liability equal to $3.03 million.
- Police and Fire Retirement System (PFRSS): 96.93% funded, with a proportional share of the net pension liability equal to $4.08 million.
- A defined-benefit health care plan that provides retiree health care for employees and their dependents: 0% funded with an OPEB liability of $259 million.

PFRS' and ERS' discount rate of 7% could lead to some contribution volatility. However, the plan's high funded status largely mitigates the risks of Southampton's costs increasing significantly. Southampton's combined required pension and actual OPEB contributions totaled 8.7% of total governmental fund expenditures in 2018. Of that amount, 4.7%

represented required contributions to pension obligations, and 4.0% represented OPEB payments. The town made 100% of its annual required pension contribution in 2018. It also provides OPEBs on a pay-as-you-go basis. State law does not allow for the prefunding of this liability.

Strong institutional framework

The institutional framework score for New York municipalities is strong.