S&P Global
Ratings

55 Water Street, 38th Floor
New York, NY 10041-0003
tel 212-438-2000
reference no.: 1605194

February 12, 2020

Town of Sullivan's Island
2056 Middle Street
PO Box 427
Sullivan's Island, SC 29482
Attention: Mr. Andy Benke, Town Administrator

Re: ***US$18,230,000 Town Of Sullivan's Island Public Facilities Corporation, South Carolina, Installment Purchase Revenue Bonds, (Town Of Sullivan's Island), Series 2020, dated: Date of delivery, due: December 01, 2046***

Dear Mr. Benke:

Pursuant to your request for an S&P Global Ratings rating on the above-referenced obligations, S&P Global Ratings has assigned a rating of "AA" . S&P Global Ratings views the outlook for this rating as stable. A copy of the rationale supporting the rating is enclosed.

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Please send hard copies to:
S&P Global Ratings
Public Finance Department
55 Water Street
New York, NY 10041-0003

The rating is subject to the Terms and Conditions, if any, attached to the Engagement Letter applicable to the rating. In the absence of such Engagement Letter and Terms and Conditions, the rating is subject to the attached Terms and Conditions. The applicable Terms and Conditions are incorporated herein by reference.

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cc: ***Mr. Andy Benke***
Mr. David Cheatwood

S&P Global Ratings

S&P Global Ratings
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Summary:

Sullivan's Island, South Carolina Sullivan's Island Public Facilities Corp.; Appropriations; General Obligation

Primary Credit Analyst:
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Summary:

Sullivan's Island, South Carolina Sullivan's Island Public Facilities Corp.; Appropriations; General Obligation

Credit Profile		
US$18.23 mil installment purch rev bnds (Town of Sullivan's Island) ser 2020 due 12/01/2046		
Long Term Rating	AA/Stable	New Rating

Rationale

S&P Global Ratings assigned its 'AA' rating to Sullivan's Island Public Facilities Corp., S.C.'s series 2020 installment-purchase revenue bonds (IPRBs), supported by the Town of Sullivan's Island, based on the application of its criteria "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" (published Nov. 20, 2019, on RatingsDirect). The outlook is stable.

Security and bond proceeds

The series 2020 IPRBs are an obligation of Sullivan's Island Public Facilities Corp., issued on parity with the series 2018 IPRBs and payable by semiannual installments of the town as dictated under a trust agreement to be dated Aug. 1, 2018, and a supplemental trust agreement dated March 1, 2020. The trust estate primarily consists of amounts paid to the corporation under the agreement, which obligates Sullivan's Island to make installment payments in an amount equal to annual debt service on the bonds from any lawfully available source of funds. Under the agreement's terms, on each payment, an undivided interest in the facilities equal to that percentage of the purchase price--the sum of all installment base payments--represented by such a payment will transfer to Sullivan's Island from the corporation.

Additional security is provided by an agreement in which the corporation has assigned all of its rights in the facilities agreement to the trustee. Pursuant to the facilities agreement, the town is required to include the installment payments in its budget and there is no abatement of the installment payments. The contract constitutes a triple-net lease with no right to set off or counterclaim. In addition, the town has agreed to provide for the necessary insurance, taxes, and maintenance on the facilities.

The intended payment source on the series 2020 IPRBs, as well as on the series 2018 IPRBs that were previously issued primarily to fund improvements to the town's wastewater treatment plant, consists of general obligation (GO) proceeds to be issued annually by Sullivan's Island. Specifically, management intends to make semiannual lease payments on its IPRBs through the annual issuance of GO debt, which management estimates will add 11.3 mills to the debt service tax rate in fiscal 2020. Although this is a plan of finance, the town also could use any legally available sources for the payment of debt service, including general fund reserves. The town's current debt capacity based on the state-imposed 8% of assessed value (AV) limit is about $6.7 million, with about $3.4 million currently outstanding against this limit, and aggregate annual debt service on the series 2018 and 2020 IPRBs through maturity is about $2.3

million. The town projects debt service capacity to continue growing and expects to have approximately $4.7 million of capacity in fiscal 2021 as previously issued GO debt is repaid.

We rate the bonds one notch off of the implied GO issuer credit rating to reflect annual appropriation risk. Furthermore, we note that while annual lease payments on the series 2018 and 2020 IPRBs are significant relative to operating revenues, we do not believe the obligation introduces a moderate level of contingent liquidity risk given current capacity under the 8% AV limit, extremely strong property valuation, limited future debt plans, and current reserve levels.

Officials intend to use series 2020 bond proceeds to fund various town improvements, including improvements to the town's wastewater treatment plant project and stormwater improvements. The bonds have been structured to produce level annual debt service over a 26-year repayment term.

Credit profile

The rating reflects our view of the town's very affluent tax base that sits at the entrance to Charleston Harbor and is a suburb of Charleston. The rating also reflects our view of the town's strong financial performance. As a coastal community, we believe Sullivan's Island is somewhat susceptible to severe weather events, although, we note the town's very strong reserves and resiliency planning help mitigate this risk. In our view, the town's debt and continent liability position constrains near-term upward potential given Sullivan's Island's elevated debt service carrying costs and very weak debt and contingent liability profile.

Credit factors supporting our opinion include Sullivan's Island's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good 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 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 96% of operating expenditures;
- Very strong liquidity, with total government available cash at 1.5x total governmental fund expenditures and 8.0x governmental debt service, and access to external liquidity we consider strong, but an exposure to a non-remote contingent liability risk;
- Very weak debt and contingent liability profile, with debt service carrying charges at 19.1% of expenditures and net direct debt that is 274.4% of total governmental fund revenue, as well as high overall net debt at greater than 10% of market value; and
- Strong institutional framework score.

Very strong economy

We consider Sullivan's Island's economy very strong. The town, with an estimated population of 1,893, is located in Charleston County in the Charleston-North Charleston MSA, which we consider to be broad and diverse. The town has a projected per capita effective buying income of 273% of the national level, which we view as extremely high and a positive credit factor and per capita market value of $885,494. Overall, the town's market value grew by 5.0% in 2018 to $1.7 billion in 2019. The county unemployment rate was 2.8% in 2018.

The affluent town consists primarily of residential properties as demonstrated by the number of individuals included among its 10-largest property taxpayers. There are very few short-term rentals and no hotels, motels, bed and breakfast establishments, or other transient lodging. Sullivan's Island was affected by Hurricane Hugo in 1989, but rebuilding efforts swiftly ensued and AV quickly rebounded, demonstrating the town's resiliency. Although the island is susceptible to hurricanes and other natural disasters, we believe its desirable location on the Atlantic and access to Charleston will likely keep market values extremely strong. In addition, management indicates that extensive resiliency planning occurs both in private developments as well as in the town's management, mitigating the impacts of severe weather-related events.

The island is home to Fort Moultrie, which, until its closure, served as the base of command for the defense of Charleston from 1776 to 1947. Today, the fort is part of the National Park System and attracts visitors year-round. Sullivan's Island's beachfront lands, which have accreted over the years, are owned by the town and held in a perpetual easement by the Lowcountry Open Land Trust, protecting the natural environment along the Atlantic Ocean.

Strong management

We view the town's management as strong, with good financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Factors in our assessment include the following:

- The town uses, in our opinion, conservative revenue and expenditure assumptions when crafting the budget, and revenues and expenditures are derived using historical trends, outside sources, and forward-looking rate increases;
- Sullivan's Island has the ability to amend the budget as needed with budget-to-actual reports provided monthly to town council;
- The town adopts a five-year capital improvement plan, specifically for its water and sewer department, that is updated annually with the budget, identifying projects, costs, and funding sources;
- Sullivan's Island follows state investment management guidelines, with holdings reported to the council quarterly; and
- The town upholds a policy to maintain an emergency reserve fund of 20%-30% of total audited cash disbursement for all combined funds, and allocates at least 20% of the prior year's surplus to a capital improvement reserve.

Sullivan's Island lacks a formal long-term financial plan and debt management policies.

Management indicates it is on the front lines in terms of resiliency planning given its location on the coast. In recent years, the town has experienced higher tides and some flooding, in addition to storm-related events. As a result, resiliency planning is heavily involved both in new home construction and in general infrastructure construction. Nevertheless, management indicates the town has fared better than other coastal communities given that its shores are not losing sand but are in fact maintaining its shorelines.

Strong budgetary performance

Sullivan's Island's budgetary performance is strong in our opinion. The town had operating surpluses of 1.7% of expenditures in the general fund and of 12.4% across all governmental funds in fiscal 2019.

Our calculations are adjusted to account for recurring transfers into the general fund, as well as capital outlay funded through bond proceeds.

Based on year-end results for fiscal 2019, the town posted a sizable operating surplus due to strong revenue growth and conservative budgeting. Property tax revenues have grown by about 12% annually over the past four fiscal years, while local option sales tax revenues grew by a strong average annual rate of 8%. Management maintained relatively level general fund expenditures in fiscal 2019.

The budget for fiscal 2020 is balanced and includes a slight increase to the operating millage rate to 35.8 mills from 35.0 mills. Through the first six months of the fiscal year, management indicates revenues and expenses are largely on track relative to budget. Given past historical results, increasing debt service payments, and the relative size of the general fund compared to its total governmental funds, we believe there could be some fluctuations in future budgetary performance, but Sullivan's Island should post at least adequate, if not better, budgetary performance over the next two years given that more than half of general fund revenues are derived from property taxes.

The town's general fund revenues are composed of property taxes, equal to slightly more than half of general fund revenues, followed by licenses, which account for about 22% of revenues.

Very strong budgetary flexibility

Sullivan's Island's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 96% of operating expenditures, or $7.1 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. The available fund balance includes $5.5 million (74.3% of expenditures) in the general fund and $1.6 million (21% of expenditures) of committed reserves.

The $1.6 million consists of funds classified as committed, but could be made available for operations through council action. Although, we note that a portion of these committed funds might be used for capital projects. As a result, we believe the fund balance could decline relative to annual operating expenditures over the next two years. There are no plans to spend down the town's unassigned fund balance, which totals nearly $5.5 million. As a result, and with at least balanced operating results expected for fiscal 2020, we believe Sullivan's Island's budgetary flexibility will remain very strong.

Very strong liquidity

In our opinion, Sullivan's Island's liquidity is very strong, with total government available cash at 1.5x total governmental fund expenditures and 8.0x governmental debt service in 2019. In our view, the town has strong access to external liquidity if necessary. Weakening Sullivan's Island's liquidity position, in our assessment, is the town's exposure to a nonremote contingent liability that could come due within 12 months.

This strong access to external liquidity is in part demonstrated by the town's access to the market in the past two decades. Sullivan's Island has issued primarily GO- and revenue-backed bonds over the past 20 years. The series 2014 bonds, which were issued to construct a new town hall, are privately placed and do not have any permissive events of default that could immediately accelerate debt outstanding. The town has historically had what we consider very strong cash balances and we do not believe its liquidity position will materially worsen over the next two years. Currently, all of Sullivan's Island's investments comply with state statutes and the town's internal investment policy. At year-end fiscal 2019, the majority of the town's cash was stored in demand deposits, state government pools, or investment instruments with maturities of less than one year.

Payment of the 2020 bonds is expected from the annual issuance of GO bonds under its 8% debt capacity on an annual basis. Although Sullivan's Island has covenanted to maintain annual GO debt capacity to cover debt service payments, we believe this covenant exposes it to an annual liability for the life of the IPRBs. Given the intended payment source is property taxes, council's ability to sufficiently maintain capacity is key as the aggregated average annual debt service is nearly $2.5 million, which is more than 36% of 2019 general fund revenues. At this time, however, the town has sufficient capacity to meet this annual liability, in addition to ample reserves.

Very weak debt and contingent liability profile

In our view, Sullivan's Island's debt and contingent liability profile is very weak. Total governmental fund debt service is 19.1% of total governmental fund expenditures, and net direct debt is 274.4% of total governmental fund revenue. Negatively affecting our view of the town's debt profile is its high overall net debt of 10.3% of market value.

We expect debt service costs to increase to nearly $2.5 million annually by 2025 through maturity. Town council plans to increase its debt service levy by 11 mills to help service the debt. As a result, net direct debt-to-total governmental revenues could moderate over time, but we expect debt ratios to remain what we consider very weak as carrying charges will remain elevated. Management, however, has no plans to issue additional debt for the foreseeable future and minor capital projects will be funded with pay-as-you-go capital.

Pension and other postemployment benefits

Sullivan's Island's pension contributions totaled 6.2% of total governmental fund expenditures in 2019. The town continues to meet its contractually required annual contributions for the plans.

We expect Sullivan's Island will continue to absorb pension and other postemployment benefits (OPEB) costs into its overall budget; however, if these costs rise to levels that we believe account for an outsized portion of the budget compared with those of peers, our view of the town's debt and long-term liability profile could weaken.

- We do not view pension and OPEB liabilities as an immediate source of credit pressure for Sullivan's Island, despite lower funding levels and our expectation that costs will likely increase in the long term.
- Because the town's pension actuarially determined contribution is built from what we view as weak assumptions and methodologies, we believe it increases the risk of unexpected contribution escalations. However, we anticipate higher contributions will likely remain affordable given the strength of the town's revenue base.

Sullivan's Island participates in the following cost-sharing, multiple-employer pension plans funded as follows:

- South Carolina Retirement System (SCRS): 54.7% funded, with a net pension liability of $2.4 million.
- Police Officers' Retirement System (PORS): 61.7% funded, with a net pension liability of $2.8 million.

In addition, the town provides health care benefits to eligible employees through the state's health plan. Sullivan's Island acts as a pass-through for the retirees' premium payments and retirees can opt in or out of the plan. Employees have to be in the state's health insurance system for at least five years before retiring in order to qualify for postretirement eligibility. In addition, given the town is simply a pass-through for the retiree's premium payments to the state, the town does not have a liability related to the plan.

The town's combined required pension contributions totaled 6.2% of total governmental fund expenditures in 2019. Although the town funds 100% of its actuarially determined contribution, payments fell short of both static funding and minimum funding progress. The plans' amortization methods, especially the level 3% of payroll amortization, defer costs and will result in slow funding progress. In our view, a discount rate of 7.25% for both plans could lead to contribution volatility. For more information on the pension reform, see "South Carolina's Proposed Pension Reform Provides Path To Improve Funding, But Challenges Remain," published March 14, 2017.

Strong institutional framework

The institutional framework score for South Carolina municipalities is strong.

Outlook

Our stable outlook reflects our view that management will maintain what we consider very strong reserves, in excess of its policy, and that liquidity will remain very strong despite increasing debt service. Sullivan's Island's very strong economy and desirable location in the Charleston MSA provide additional stability to the rating. As a result, we do not expect to change the rating within the two-year outlook period.

Upside scenario

If the town is able to demonstrate its ability to maintain reserves in excess of 75% of annual operating expenditures in addition to debt levels moderating, all else being equal, we might consider a higher rating.

Downside scenario

Should AV or income levels significantly decline due to deteriorating economic factors, or a natural disaster, we could lower the rating on the town's general creditworthiness. Our view of Sullivan's Island's general creditworthiness could also be affected, potentially by multiple notches, if the town's contingent liquidity risk materially increases due to a decline in the taxable base or a reduction of capacity under the 8% AV limit.

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
- 2019 Update Of Institutional Framework For U.S. Local Governments

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