MOODY'S INVESTORS SERVICE

Rating Action: Moody's assigns Aa2 to Sullivan's Island, SC's IPRBs

06 Feb 2020

New York, February 06, 2020 -- Moody's Investors Service has assigned a Aa2 to the Town of Sullivan's Island, South Carolina's $18.2 million Installment Purchase Revenue Bonds, Series 2020. Moody's maintains a Aa1 issuer rating on the town and affirms a Aa2 rating on the town's outstanding installment purchase revenue bonds (IPRBs). Following the sale, the town will have approximately $37.6 million of IPRBs outstanding.

RATINGS RATIONALE

The Aa2 rating on the installment purchase revenue bonds is one notch below the town's GOULT-implied issuer rating to reflect the risk of non-appropriation, which is somewhat mitigated by a long-term leasehold interest in the town's two most essential assets (the town hall and fire station).

RATING OUTLOOK

Moody's does not typically assign outlooks to local governments with this amount of debt outstanding.

FACTORS THAT COULD LEAD TO AN UPGRADE

- Upgrade of the town's issuer rating

FACTORS THAT COULD LEAD TO A DOWNGRADE

- Downgrade of the town's issuer rating

LEGAL SECURITY

The Series 2020 IPRBs are secured by the town's appropriation pledge along with a leasehold interest in the town hall and fire station. The Series 2020 IPRBs are secured on a parity basis with the town's outstanding Series 2018 IPRBs.

USE OF PROCEEDS

The bonds will be used to fund various capital projects including wastewater treatment and stormwater improvements, and commercial district and fire station improvements, among several others.

PROFILE

Sullivan's Island is a barrier island north of Charleston Harbor. The town is home to approximately 2,000 residents and provides standard municipal services such as public works, safety, water and sewer utilities and a variety of other general government services.

METHODOLOGY

The principal methodology used in these ratings was Lease, Appropriation, Moral Obligation and Comparable Debt of US State and Local Governments published in July 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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CREDIT OPINION
7 February 2020

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Sullivan's Island (Town of) SC

Update to analysis

Summary

The Town of Sullivan's Island, South Carolina (Issuer Rating Aa1) is an affluent, coastal community just outside the rapidly growing Charleston (Aaa stable) metropolitan area. The town's high-end housing stock and ocean front location attract a growing number of high income residents and have yielded steady tax base growth. The town's financial position is healthy, characterized by balanced operations and strong reserves – a key mitigant to the island's exposure to climate change generally and hurricane damage more specifically. The town's debt burden is above average when compared to similarly rated cities, and its pension burden is modest.

On February 6th, 2020, we assigned a Aa2 rating to the town's $18.2 million Installment Purchase Revenue Bonds, Series 2020.

Credit strengths

» Affluent and growing tax base

» Balanced financial operations and very healthy liquidity

Credit challenges

» Exposure to climate change and costs from recurring storm damage

» Above average debt burden and related fixed costs

Rating outlook

Moody's does not typically assign outlooks to local governments with this amount of debt outstanding.

Factors that could lead to an upgrade

» Reduction in debt burden and associated fixed costs

» Significant tax base growth

Factors that could lead to a downgrade

» Significant draws on financial reserves and/or trend of imbalanced operations

» Increases in debt and/or pension burden

Key indicators

Exhibit 1

Sullivan's Island	2015	2016	2017	2018	2019
Economy/Tax Base					
Total Full Value ($000)	$1,420,678	$1,479,295	$1,511,791	$1,596,591	$1,676,242
Population	2,067	2,049	2,050	2,050	2,050
Full Value Per Capita	$687,314	$721,959	$737,459	$831,125	$872,588
Median Family Income (% of US Median)	196.7%	204.4%	190.0%	190.0%	190.0%
Finances					
Operating Revenue ($000)	$8,294	$5,857	$6,248	$6,316	$7,085
Fund Balance ($000)	$7,169	$7,062	$6,598	$7,249	$7,086
Cash Balance ($000)	$10,253	$8,204	$6,739	$7,507	$7,497
Fund Balance as a % of Revenues	86.4%	120.6%	105.6%	114.8%	100.0%
Cash Balance as a % of Revenues	123.6%	140.1%	107.8%	118.9%	105.8%
Debt/Pensions					
Net Direct Debt ($000)	$5,029	$4,693	$3,614	$3,106	$22,195
3-Year Average of Moody's ANPL ($000)	$7,660	$7,964	$8,896	$10,135	$11,103
Net Direct Debt / Full Value (%)	0.4%	0.3%	0.2%	0.2%	1.3%
Net Direct Debt / Operating Revenues (x)	0.6x	0.8x	0.6x	0.5x	3.1x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	0.5%	0.5%	0.6%	0.6%	0.7%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	0.9x	1.4x	1.4x	1.6x	1.6x

Sources: audited financial statements, Moody's Investors Service, US Census Bureau

Profile

Sullivan's Island is a barrier island north of Charleston Harbor. The town is home to approximately 2,000 residents and provides standard municipal services such as public works, safety, water and sewer utilities and a variety of other general governmental services.

Detailed credit considerations

Tax base and economy: affluent coastal tax base near Charleston

Sullivan's Island's tax base benefits from its high-end housing stock, ocean front location and proximity to Charleston; however, its location also exposes the town to short term shocks stemming from hurricanes and longer-term risks associated with climate change. The town's tax base is fully valued at just $1.7 billion, well below the $5.4 billion median for Aa1 rated cities. While small compared to its peers, the town's full value per capita ($872,000) and median home value ($1.2 million) are among the highest of all Moody's-rated cities. The tax base is also trending positively, growing at a compound annual rate of 4.6% over the last five years.

The town's population is estimated at 2,050 and grew approximately 14% since 2010. Material future growth is unlikely given limited land for new development. The town's median family income is equal to approximately 190% of the national median – higher than the median for other Aa1 rated cities (around 146%).

Given its geographic location, the town its highly exposed to longer-term sea level rises associated with climate change as well as recurring costs associated with hurricanes and tropical storms. The town's very healthy financial position (discussed in the following sections) help mitigate the short term risks.

Finances and reserves: balanced operations and very strong reserves

The town's financial position will likely remain strong due to its healthy tax base and balanced operations. The town's available fund balance ended fiscal 2019 at $7.1 million (100% of annual operating revenue), up from $4.5 million (83.4%) in fiscal 2014. Town officials budgeted for balanced operations in fiscal 2020 and do not anticipate drawing down reserves for any one time needs. The town's reserves are significantly higher than the median for Aa1 rated cities (around 44%), which is a key mitigant to its exposure to environmental risks.

The healthy financial performance is driven by solid growth in property taxes, which account for approximately half of fiscal 2019 revenues. The positive trend is due to a combination of tax base growth and annual millage increases. Business licenses are the town's next largest source of operating revenue, accounting for around 22% of total income. These revenues, generated by a tax on gross business income, are more susceptible to economic volatility but have gradually increased in recent years.

LIQUIDITY

The town ended fiscal 2019 with a cash balance of $7.5 million, an amount equal to 106% of annual revenues. The national median cash balance for Aa1 rated cities is around 46% of annual revenue.

Debt and pensions: above average debt burden and heightened fixed costs

The town's debt burden will be heightened following its upcoming issuance, but begin to moderate given no additional borrowing plans. Following issuance of the Series 2020 IPRBs the town will have approximately $41.2 million of direct debt, an amount equal to 2.5% of full value and 5.9 times operating revenue. The town's debt burden is much higher than the national median for Aa1 rated cities (around 0.9% of full value and 0.6 times operating revenue).

Moody's three-year average adjusted net pension liability (ANPL) for the town is moderate at 0.7% of full value and 1.6 times operating revenue. The town's pension burden is favorable compared to the national median for Aa1 rated cities (around 1.7% of full value and 1.6 times operating revenue).

The town's fixed costs are currently high and slated to grow following the Series 2020 issuance. Pro-forma total fixed costs, which include annual debt service and retirement contributions, will exceed 30% of annual revenues.

DEBT STRUCTURE

The town's debt is fixed rate and amortizes over the long term. Approximately $37.6 million of outstanding debt is comprised of two parity series of installment purchase revenue bonds (IPRBs) that are subject to annual appropriation. Under the trust agreement and supplemental trust agreement, the town has assigned its right, title and interest in the its town hall and sole fire station – two essential assets – that mitigate the risk of non-appropriation. The town will make annual base payments in the amount equal to debt service the IPRBs. Base payments are due every May 16th and November 15th, 15 days prior to the payment dates on the bonds. Upon each payment, an undivided interest in the pledged facilities equal to that payment's share of the facilities acquisition price will be transferred to the town. The facilities agreement stipulates that the acquisition price is equal to the sum of all base payments. In the event of non-appropriation the town will surrender its undivided interest in the fire station and town hall.

The town intends to make annual base payments on the IPRBs by issuing short-term GO debt under its 8% debt limit. Doing such allows the town to access an unlimited property tax in order to service its debt.

DEBT-RELATED DERIVATIVES

The town is not party to any derivatives.

PENSIONS AND OPEB

Town employees participate in the South Carolina Retirement System (SCRS) and the South Carolina Police Officers Retirement System (PORS), two cost-sharing, multiple employer defined benefit pension plans. Moody's aforementioned ANPL uses the city's liabilities and fair market value of assets reported under GASB68 and adjusts the liability based on a market-based discount rate. The cost-sharing plans' current discount rate is 7.25%, the market based discount rate Moody's used to value liabilities was 4.14% as of the measurement date of the plan as reported in the town's financial statements.

Contributions to the cost sharing plans are paid by the town and employees alike, and contribution rates are set by the state pension board as a share of annual payroll. The town's contribution totaled $423,000 in fiscal 2019, an amount equal to 4.8% of annual revenue. In 2019, plan wide contributions to SCRS and PORS were 90% and 100%, respectively, of the amount needed to tread water – that is the amount needed to forestall growth in unfunded liabilities based on the plan's own assumptions.

The town does not provide post-retirement healthcare benefits (OPEBs).

Management and governance: strong institutional framework and prudent management

The town has a demonstrated history of maintaining balanced operations, increasing property tax rates when needed, and holding very strong reserves in order to mitigate short-term operating shocks associated with storms. Management's policy is to maintain emergency reserves equal to at least 20% to 30% of total expenditures and at least 20% of the prior year's surplus is allocated to the capital improvement reserve. The town has routinely exceeded its minimum reserve policies.

South Carolina cities have an Institutional Framework score of "Aa", which is strong. The sector's main revenue source is property taxes. South Carolina cities' ability to raise property tax revenue is subject to Act 388, an annual cap, which sets a maximum operating millage increase based on CPI increase and population growth. However, the cap can be overridden by a two-third vote of the governing body under specific conditions allowing for moderate revenue-raising ability. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Fixed costs are driven mainly by debt service and pension costs. Across the sector, fixed and mandated costs are generally less than 25% of expenditures. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 2

Sullivan's Island

Rating Factors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$1,676,242	Aa
Full Value Per Capita	$872,588	Aaa
Median Family Income (% of US Median)	190.0%	Aaa
Finances (30%)		
Fund Balance as a % of Revenues	100.0%	Aaa
5-Year Dollar Change in Fund Balance as % of Revenues	36.9%	Aaa
Cash Balance as a % of Revenues	105.8%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	-14.8%	Ba
Notching Factors:[2]		
Other Analyst Adjustment to Finances Factor: Reserves well in excess of Aaa threshhold		Up
Management (20%)		
Institutional Framework	Aa	Aa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	1.0x	A
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	2.5%	A
Net Direct Debt / Operating Revenues (x)	5.9x	Ba
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	0.7%	Aaa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	1.6x	A
	Scorecard-Indicated Outcome	Aa1
	Assigned Rating	Aa1

[1] Economy measures are based on data from the most recent year available. [2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology. [3] Standardized adjustments are outlined in the GO Methodology Scorecards Input publication.
Sources: US Census Bureau, Moody's Investors Service

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