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Ratings

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Summary:

Rhode Island Health & Educational Building Corp. Smithfield; General Obligation

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Credit Profile		
US$35.3 mil General Obligation (Smithfield) (Public School Bonds) ser 2021 H dtd 09/30/2021 due 05/15/2042		
Long Term Rating	AA/Stable	New
Smithfield GO bnds		
Long Term Rating	AA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA' long-term rating to the Rhode Island Health & Educational Building Corp.'s (RIHEBC) approximately $35.300 million series 2021H public schools revenue bonds, issued for Smithfield, R.I., and affirmed its 'AA' rating on the town's general obligation (GO) debt outstanding. The outlook is stable.

The town's full faith credit pledge, including a pledge to levy ad valorem taxes without limitation as to rate or amount on all real property within its borders, secures the bonds. The 2021H bonds will finance improvements and renovations to school facilities.

Credit overview

Smithfield is a primarily residential town about 15 miles northwest of Providence. The town's financial performance has generally hovered around break-even on a GAAP basis. We believe its performance is slightly inflated due to actual contributions falling below its full pension actuarially determined contributions (ADCs), which is related to collective bargaining agreement requirements. We generally believe pension and other postemployment benefits (OPEBs) present a long-term credit risk for the town due to optimistic assumptions and poor funding discipline. However, management has begun revising assumptions and funding plans, and officials hope to work toward fully funding ADCs in the future. Currently, Smithfield maintains strong available reserves and our view of its financial management practices remains good, which we believe provides rating stability. We do not anticipate changing the rating within the outlook period.

The long-term rating reflects our view of the following factors for the town:

- Adequate economy, with access to a broad and diverse metropolitan statistical area (MSA), but a high county unemployment rate exceeding 10%;
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with operating results that we expect could improve in the near term relative to fiscal 2020, which closed with operating deficits in the general fund and at the total governmental fund level in fiscal 2020;

- Strong budgetary flexibility, with an available fund balance in fiscal 2020 of 11.3% of operating expenditures;
- Very strong liquidity, with total government available cash at 17.7% of total governmental fund expenditures and 6.6x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability profile, with debt service carrying charges at 2.7% of expenditures and net direct debt that is 64.2% of total governmental fund revenue, and a large pension and OPEB obligation and the lack of a plan to sufficiently address it, but low overall net debt at less than 3% of market value; and
- Strong institutional framework score.

Environmental, social, and governance factors

We believe Smithfield's governance risks are slightly elevated compared to peers based on the town's pension assumptions and funding discipline. We view the county-level elevated average unemployment rate of 10.2% in 2020, caused by the pandemic and government-related shutdowns, as a social risk that could potentially hinder management's ability to raise revenue if prolonged. However, we do not expect this to be a long-term trend and it has not yet had a material impact on the town's financial position as the economy continues to recover and vaccination rates increase, therefore lowering unemployment. We also view environmental risks as average for the sector.

Stable Outlook

Downside scenario

We could lower the rating if the town were to experience a material weakening of available reserves, particularly if rising retirement or debt service costs limit its ability to develop a plan to restore reserves to current levels.

Upside scenario

We could raise the rating if the town were to develop a credible plan to address its retirement liabilities and demonstrate over multiple years that it is able to adhere to the plan, coupled with sustaining strong budgetary performance, along with continued growth in wealth and income metrics.

Credit Opinion

Adequate economy

We consider Smithfield's economy adequate, revised from strong, reflecting the high county unemployment rate in 2020. The county unemployment rate was 10.2% in 2020, which we consider high and a negative credit factor. The town, with a population of 21,673, is in Providence County in the Providence-Warwick MSA, which we consider to be broad and diverse. It has a projected per capita effective buying income of 109.8% of the national level and per capita market value of $141,291. Overall, market value was stable over the past year at $3.1 billion in 2022.

Smithfield is a primarily residential community, although it has a sizable commercial and industrial base. Residential properties constitute approximately 67% of the town's total assessed value (AV). Smithfield's AV increased by 9% from 2019 to 2020, following a statistical revaluation. It has increased 1.1% since then. Residential growth reflects rising home prices as well as new condominium developments. Officials reported that the local economy appeared to do well during the pandemic and expect continued redevelopment, which we believe is likely to lead to stability in the underlying tax base and wealth metrics.

County unemployment rates magnified national trends, peaking during the COVID-19 pandemic to a high of 18.4% before falling to 6.0% by June 2021. Overall, with the resumption of economic activity, we anticipate that local employment will continue to stabilize. (For more information on S&P Global Economics' view, see "Economic Outlook U.S. Q3 2021: Sun, Sun, Sun, Here It Comes," published June 24, 2021, on RatingsDirect.) Falling county unemployment rates for 2021 could improve our view of Smithfield's economic position.

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. Highlights include:

- Officials use both trend analysis and zero-based budgeting when developing the annual budget. Assumptions incorporate two years of revenue and expenditure data. In addition, management reviews projected tax revenues, internal transfers, health care cost trends, and personnel expenditures.
- The town also performs internal monitoring of its budget-to-actual performance, and the finance director reports to the town monthly. From now on, a newly created budget review board will review monthly budget-to-actual updates.
- It uses its annually updated five-year long-term financial projection as a tool to guide decision-making.
- Its six-year capital improvement plan (CIP), which identifies projects and funding sources, is updated biannually. The town plans to produce a 20-year capital plan annually from now on.
- Furthermore, it maintains pension and OPEB investment policies, and management reports earnings and holdings to the town council monthly.
- Smithfield formalized and approved a reserve policy in its town charter, which calls for a maximum unassigned fund balance of 8% of the subsequent year's general fund budgeted expenditures, which the town targets. The town also recently created a school capital reserve.
- Smithfield has a formal debt management policy that outlines approved debt types and sets limitations on debt as a percentage of the tax base and debt service as a percentage of general fund revenues. It also requires integration with the CIP.

In November 2020, voters approved a town charter amendment to create a budget and financial review board, eliminating the financial town meeting. It also called for the creation of the school capital reserve and 20-year CIP. We spoke with the town about cybersecurity and considered officials conversant in the relevant risks and proactive in their approach to identifying and protecting assets. The town is not prone to extreme weather events, although it can be vulnerable to tropical storms and hurricanes. It is currently undertaking a number of projects to manage stormwater runoff and reduce the effects of natural disasters. We note the town was not severely affected by the recent Hurricane Henri.

Adequate budgetary performance

Smithfield's budgetary performance is adequate, in our opinion. The town had operating deficits of 2.3% of expenditures in the general fund and 6.5% across all governmental funds in fiscal 2020. Our assessment accounts for the fact that we expect budgetary results could improve from 2020 results in the near term.

Our view of adequate performance combines our view of the town's recent and projected financial results, along with our expectation that it will not fully fund its fire pension trust fund contribution, leading to an adjusted deficit result in both operations and total governmental performance. For analytical consistency, we adjusted for recurring net transfers, pension contributions below the required contribution, and the expenditure of bond proceeds in our calculation of general fund and total governmental fund performance. We also combined the town's general and school unrestricted funds, consistent with our view of municipalities across the state.

Smithfield works to incorporate capital investment into the annual budget, to limit bond issuances. We believe this has led to some volatility in performance, but believe the underlying operational budget is balanced. However, in fiscal 2020, we viewed the town as having an operating deficit related to both planned use of fund balance and due to its $1.5 million adjustment for underfunding the fire pension trust annual contribution. This underfunding adjustment increased from $897,000 in fiscal 2019 related to the town's changes to more conservative actuarial assumptions. Management is working through its 2021 audit process, but we expect operating performance to remain approximately consistent with recent years. Officials estimate the town achieved a budgetary basis surplus of approximately $700,000, indicating a increase in GAAP-basis fund balance of around $100,000. We also expect total governmental funds performance to be approximately balanced. This result reflects cost savings realized in school expenditures related to the pandemic, as well as federal funding that offset losses in state aid and other revenue line items.

Its fiscal 2022 operating budget totals $78.8 million, an approximately $2.3 million increase from 2021. The town increased its property tax rate by $0.32 for residential and $0.35 for commercial. With growth in the property tax base, this represents a levy increase of 2.26% net of motor vehicle taxes. Property taxes generally account for nearly 80% of audited operating revenue and intergovernmental aid (including school aid but not state on-behalf payments) is about 15%. We expect this revenue mix to remain relatively consistent. The town anticipates receiving approximately $2.4 million in state aid related to increases in education aid and the continued phase-out of motor vehicle taxes. The budget does not include American Rescue Plan funds, although Smithfield is slated to receive approximately $6.4 million over multiple fiscal years, with a $1.1 million initial tranche.

Strong budgetary flexibility

Smithfield's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2020 of 11.3% of operating expenditures, or $8.9 million.

In addition to the town's assigned and unassigned reserves, we also consider re-appropriated unexpended balance available. This is committed fund balance that is re-appropriated annually to the subsequent year's expenditures. The town generally appropriates reserves into its budget, but due to better-than-budget performance, has maintained relatively stable reserve levels, which we expect will continue. Smithfield's non-spendable fund balance includes $1.0 million related to a property the town intends to sell in fiscal 2021. The sale could increase fund balance we consider available and provide proceeds for capital projects.

Very strong liquidity

In our opinion, Smithfield's liquidity is very strong, with total government available cash at 17.7% of total governmental fund expenditures and 6.6x governmental debt service in 2020. In our view, the town has strong access to external liquidity if necessary.

The town has issued GO debt periodically over the past ten years, supporting our view of its strong access to external liquidity. It has one privately placed debt obligation that the current issue will refund. It does not present a potential liquidity pressure as there are no payment provisions that change on the occurrence of certain events. Though the state allows for what we view as somewhat permissive investments, we believe the town does not currently have aggressive ones. It invests its cash in low-risk assets, including U.S. securities and highly-rated money market funds. Smithfield consistently had very strong cash balances and we do not anticipate a change in our view of its overall liquidity profile.

Weak debt and contingent liability profile

In our view, Smithfield's debt and contingent liability profile is weak. Total governmental fund debt service is 2.7% of total governmental fund expenditures, and net direct debt is 64.2% of total governmental fund revenue. Overall net debt is low at 1.7% of market value, which is, in our view, a positive credit factor. In our opinion, a credit weakness is Smithfield's large pension and OPEB obligation, without a plan in place that we think will sufficiently address it.

Following this issuance, the town will have approximately $59 million in total direct debt. Of this, approximately $5 million is self-supporting enterprise debt, along with an additional $3 million in revenue-supported bond anticipation notes. The town expects to receive 50% state reimbursement for the debt service on the new bonds. It anticipates issuing approximately $4.5 million in the next two years for a fire station project, although we do not believe this will materially weaken the town's debt profile given amortization of existing debt.

Pension and other postemployment benefits:

- We believe a credit weakness is Smithfield's large pension and OPEB obligation, without a plan in place that we think will sufficiently address it.
- Additionally, we anticipate costs are likely to grow, given low funded ratios, optimistic assumptions, and poor funding discipline within the town's largest pension plans. We view the fiscal 2020 adoption of more conservative assumptions favorably, although we recognize they resulted in larger reported liabilities.
- The town also offers OPEBs to eligible retirees. It established a trust to begin prefunding the liability; the trust is about 7.9% funded, with an OPEB liability of about $50.2 million.

As of June 30, 2020, the town participated in the following defined-benefit plans:

- Employees' Retirement System of Rhode Island (ERSRI): 54.3% funded, $34 million proportionate share of the net pension liability (NPL);
- Fire Pension Trust Fund: 60.9% funded, $16.7 million NPL;
- Police Pension Trust Fund: 40.9% funded, $15.1 million NPL;
- Municipal Employees' Retirement System (MERS) Police Employees Plan: 91.6% funded, $1.6 million NPL;
- MERS Fire Employees Plan: 102.5% funded, $46,000 net pension asset;
- MERS General Employees COLA Plan: 85.9% funded, $2.7 million NPL; and

- MERS General Employees Plan: 85.4% funded, $2.2 million NPL.

Smithfield's combined required pension and actual OPEB contributions totaled 11.5% of total governmental fund expenditures in 2020. Of that amount, 9.9% represented required contributions to pension obligations, and 1.6% represented OPEB payments. The town made 81% of its required pension contribution in 2020. The funded ratio of the largest pension plan is 54.3%. The town typically makes its full annual required contribution to each plan except for the Fire Pension Trust Fund, which it underfunded by about $1.5 million or 18% of the total combined required contribution. It is required to make payments equal to 100% of the ADC for the state-administered plans (ERSRI and MERS), but its contributions for the locally administered Fire pension trust funds have historically been below required levels. However, it contributed more than the required contribution to the locally administered Police plan in each year from 2015 to 2019, although changes in actuarial assumptions led it to unintentionally underfund the ADC in 2020.

ERSRI and the two locally administered plans combined account for about 91% of its NPL of $71 million. ERSRI met our static funding metric, but did not meet our minimum funding progress metric. The Fire Pension Trust Fund did not meet our static or minimum funding progress metrics. We note that the town contributes to the Fire Trust Fund on a contractual basis, and it has underfunded relative to the required contribution in each of the past six years. However, we understand that management hopes to revisit the funding agreement in its next round of collective bargaining in fiscal 2023. The town expects to continue meeting or exceeding the required contribution to the Police Pension Trust Fund from now on.

Given the low-funded ratios, particularly in the locally administered plans where funding discipline historically lagged the required contribution, we believe costs are likely to escalate. We view the local fire and police plans' investment rate of return of 7.5% as elevated relative to our 6.0% guideline, and believe the plans are likely to have contribution volatility. We further note that the local fire plan has a crossover date, indicating assets are expected to be insufficient to meet obligations, although the date is not until 2074. We expect pension costs will grow, particularly if assumptions are not met. Smithfield recently adopted an amendment to the town charter, with a goal to achieve 30% OPEB funding within ten years. The town expects to contribute $250,000 more than the pay-as-you-go amount (and budgeted $275,000 for fiscal 2022). The town has made changes to OPEB for future retirees, such as cutting benefits for some new joiners, increasing retiree co-shares and contributions, and reducing time retirees can stay on health plans. As it is not making the required OPEB contributions we expect the OPEB liability and costs will continue to grow over the next several years.

Strong institutional framework

The institutional framework score for Rhode Island municipalities is strong.

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
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020