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Ratings

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Summary:

Smithfield, Rhode Island; General Obligation

Primary Credit Analyst:
Thomas J Zemetis, Centennial 303.721.4278; thomas.zemetis@spglobal.com

Secondary Contact:
Timothy W Little, New York (212) 438-7999; timothy.little@spglobal.com

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Credit Profile		
US$6.4 mil GO bnds ser 2016 dtd 08/30/2016 due 08/01/2036		
Long Term Rating	AA/Stable	New
Smithfield GO bnds		
Long Term Rating	AA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA' rating and stable outlook to Smithfield, R.I.'s series 2016A general obligation (GO) bonds. At the same time, S&P Global Ratings affirmed its 'AA' rating long-term rating on the town's outstanding GO debt. The outlook is stable.

A pledge of the town's full faith and credit GO pledge secures the bonds. We understand officials intend to use series 2016A bond proceeds to finance the renovation and expansion of the town's police station.

The long-term rating reflects our opinion of the following factors for Smithfield, specifically its:

- 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 methodology;
- Adequate budgetary performance, with slight operating deficits in the general fund and at the total governmental fund level in fiscal 2015;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2015 of 16% of operating expenditures;
- Very strong liquidity, with total government available cash at 34.4% of total governmental fund expenditures and 10.6x governmental debt service, and access to external liquidity that we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges at 3.2% of expenditures and net direct debt that is 35.8% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value, but a large pension and other postemployment benefit (OPEB) obligation and the lack of comprehensive plans to sufficiently address all long-term obligations; and
- Strong institutional framework score.

Very strong economy

We consider Smithfield's economy very strong. The town, with an estimated population of 21,521, encompasses 26.7 square miles, approximately 11 miles northwest of Providence and 62 miles southwest of Boston. It is located in Providence County in the Providence-Warwick MSA, which we consider to be broad and diverse. The town has a projected per capita effective buying income of 115% of the national level and per capita market value of $119,647. Overall, the town's market value grew by 2% over the past year to $2.6 billion in 2015. The county unemployment rate was 6.4% in 2015.

Smithfield is a primarily residential community with a sizable local commercial and industrial base. Residential properties constitute approximately 63.1% of the town's assessed value (AV), followed by commercial and industrial property, which account for 25% of taxable property. Following a roughly 7% decline in net AV in 2012, due largely to a full revaluation of all real property, Smithfield's AV's increased by 2.6%, totaling $2.6 billion in 2015. The town expects AV to increase to $2.75 billion in 2017 following a statistical revaluation completed in December 2015. Town officials report an uptick in real estate investment, and a proposed 124-unit mixed-use development and 42-unit affordable housing development are pending approval from the planning board. At the same time, 130 condominium units and 65 single-family homes are at various stages of approval or construction. Furthermore, Interstate Highway 295, U.S. Route 44, and state routes 7 and 116 traverse Smithfield, connecting residents with employment centers in the surrounding metropolitan areas.

In addition, a number of large private employers are in Smithfield. Notably, financial institutions Fidelity Investments (3,900 employees) and Citizens Bank of Rhode Island (400), as well as pharmaceutical companies FGX International (385) and Alexion (300) occupy professional office campuses along the routes 7 and 116 corridor. Over the past five years, two of the town's leading private employers, Fidelity and FGX International, have expanded their facilities and added new employees. Furthermore, Alexion has indicated plans to undergo a $120 million expansion of its office and lab spaces, which would create 100 new jobs over the next five to seven years. According to management, the presence of the town's leading employers continues to attract additional business, including retail, restaurant, and hotel developments. Little taxpayer concentration exists with the 10 leading taxpayers representing 12.95% of total AV.

Smithfield is also home to a higher education institution, Bryant University (656 employees), which currently educates approximately 3,600 undergraduate and graduate students. According to management, the university continues to expand and offers continuing education and corporate outreach programs to various private-sector organizations. The university is home to the Center for International Business and Economic Development, which provides business consulting, professional training, research, and support.

Furthermore, in September 2015, Smithfield adopted the Economic Growth Overlay District, which management expects will promote diverse, high-density development on 714 acres along the routes 7 and 116 corridor.

Strong management

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

Demonstrating Smithfield's key budgeting practices is management's use of two years of historical data to forecast its annual revenue and expenditure assumptions. In preparation of its annual budget, the town conducts a detailed review of departmental requests and historical spending. In addition, the town 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 to address variances and propose budget amendments when necessary. In addition, the town submits a quarterly budget-to-actuals report to the state Department of Municipal Finance, the Auditor General's Office, and the Department of Education. Furthermore, the town maintains an investment policy and an OPEB investment policy, and management reports earnings and holdings to the town council monthly.

Management highlights include its focus on financial and capital planning, evidenced by Smithfield's six-year capital improvement plan (CIP) and five-year long-term budget forecast. The CIP is updated every two years, as required by the town charter. It also outlines departmental and total capital project costs and identifies internal or external financing sources. The long-term financial forecast is updated annually, in accordance with state laws, and it evaluates conditions affecting future municipal revenue and expenditure trends.

Smithfield formalized and approved a reserve policy in its town charter, which calls for a minimum unassigned fund balance of 5% of the subsequent year's general fund budgeted expenditures. In November 2014, the town charter was amended to annually increase fund balance by 0.6% until the fund balance policy minimum reaches 8% in fiscal 2020. Historically, the town has met and sustained reserves in accordance with its stated fund balance policy. Currently, Smithfield does not have a formal debt management policy.

Adequate budgetary performance

Smithfield's budgetary performance is adequate in our opinion. The town had slight operating deficits of negative 1.4% of expenditures in the combined general fund and school unrestricted fund, and negative 0.7% across all governmental funds in fiscal 2015.

For analytical consistency, we adjusted for recurring net transfers to the general fund from enterprise and nonmajor governmental funds. In addition, we accounted for the town's $784,976 deferral of pension contributions to its fire pension plan, which could overstate budgetary performance in fiscal 2015.

For fiscal 2015, the town's general fund budget, which includes the school department's budget, had an operating deficit of $938,000, or 1.4% of expenditures. The town reported a general fund surplus of about $72,410, which management attributes to higher intergovernmental revenue sources and better-than-budgeted license, fee, and permit revenues. At the same time, the school unrestricted fund realized a negative operating result, totaling $225,134. Management attributes the deficit in the school unrestricted fund to the planned use of restricted fund balance to finance capital improvement projects and to cover other revenue shortfalls.

However, we understand that the town's deferral of pension expenditures could inflate budgetary result ratios in fiscal 2015. The town did contributed 100% of its actuarially determined contribution to the three state-administered Municipal Employees Retirement System (MERS) plans, as well as the Employees' Retirement System of Rhode Island (ERSRI) for teachers. Smithfield's locally administered pension plans--the fire pension plan and police pension plan--have historically been underfunded at 70% and 24%, respectively.

Although management implemented a funding improvement plan with state oversight to address the police pension plan, which increases contributions at or above the level of the actuarially determined contribution (ADC) for 2015 and onward, the fire pension plan's contributions are tied to employee compensation. For fiscal 2015, we note the town contributed 110% of its ADC to the police pension plan. However, it funded only $551,629, or 41.3% of its ADC, to the fire pension plan. We understand Smithfield's funding for the fire pension will increase to 45.7% of ADC in fiscal 2016 and 47.8% of ADC in fiscal 2017. At the same time, we continue to recognize that pension and OPEB costs continue to increase, and that these costs could constrain budgetary performance over the next few fiscal years due to each plan's funded status and unfunded liability.

For fiscal 2016, Smithfield's $67.03 million combined general and school department operating budget is a 3.46% expenditure increase from the previous year. The budget includes a 2.47% tax levy increase, coupled with $1.595 million in capital improvement projects. In addition, the town did not appropriate any use of reserves to balance the operating budget. At fiscal year ended June 30, 2016, Smithfield projected a slight operating surplus of $70,000 in its general fund and $10,000 surplus in its unrestricted school fund.

The town approved a balanced fiscal 2017 budget, totaling approximately $69.04 million, or an increase of 3% from the fiscal 2016 budget. The budget includes a 2.58% tax rate decrease, and an overall tax levy increase of 1.78%, due to a statistical revaluation in 2015. Management indicates the rise in budgetary expenditures is due primarily to a $1.54 million increase in education funding. Furthermore, management did appropriate $600,000 in fund balance for capital expenditures, but it does not expect to use the appropriation of assigned reserves. All collective bargaining contracts are scheduled to end in fiscal year ending June 30, 2017. The town reached three-year contract agreements with both its police and fire departments through fiscal 2019.

We expect Smithfield's overall revenue base to remain strong and stable. Local property taxes generate about 83.5% of Smithfield's general fund revenue, and state aid contributes about 13.8%. Strong tax collections, approximately 97.8% in 2015, provide, what we view as, good financial stability; the limited dependence on state aid insulates the town from significant revenue variances.

Very strong budgetary flexibility

Smithfield's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2015 of 16% of operating expenditures, or $10.9 million. Over the past three years, the total available fund balance remained at a consistent level, totaling 16% of expenditures in 2014 and 17% in 2013.

In addition to calculating assigned and unassigned reserves, we also consider re-appropriated unexpended balance, which is committed fund balance that is re-appropriated annually to the subsequent year's expenditures. Smithfield realized an increase in this reserve, from $3.94 million in fiscal 2013 to $4.34 million in fiscal 2015. The town planned to use $495,000 in reserves during fiscal 2014, due mainly to the school department's use of fund balance to finance one-time capital expenditures. However, due to positive general fund performance, Smithfield's unassigned fund balance increased slightly in fiscal 2015.

For fiscal 2016, the town appropriated $600,000 in reserves toward capital expenditures. However, due to what we consider management's conservative budgeting practices and better-than-budgeted performance, the town reported a slight positive operating result, coupled with a slight operating surplus in the unrestricted school fund. In addition, management approved a balanced budget in fiscal 2017, with no appropriation of reserves.

Smithfield also sustains a reserve policy in its town charter, which calls for a minimum unassigned fund balance of 5% of the subsequent year's general fund budgeted expenditures. In November 2014, the town charter was amended to annually increase fund balance by 0.6% until the fund balance policy minimum reaches 8% in fiscal 2020, which the town has met and sustained in each of the previous two fiscal years. Due to very strong overall fund balances over the past three fiscal years and positive expected operating results in fiscal 2016, in conjunction with management instituting and adhering to a formal fund balance policy, we believe the town's reserves will remain at least strong over our two-year outlook period.

Very strong liquidity

In our opinion, Smithfield's liquidity is very strong, with total government available cash at 34.4% of total governmental fund expenditures and 10.6x governmental debt service in 2015. In our view, the town has strong access to external liquidity if necessary.

Our opinion of the town's strong access to external liquidity is based on its issuance of debt as recently as 2011, and we have no reason to believe Smithfield's access has diminished. In addition, it does not currently have any variable rate or direct-purchase debt. Management also confirmed it does not currently have any 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 somewhat permissive investments, we believe the town does not currently have aggressive investments. The town invests its cash in low-risk assets, including U.S. securities and highly-rated money market funds. Smithfield consistently had strong liquidity and we do not anticipate a change to these ratios.

Adequate debt and contingent liability profile

In our view, Smithfield's debt and contingent liability profile is adequate. Total governmental fund debt service is 3.2% of total governmental fund expenditures, and net direct debt is 35.8% of total governmental fund revenue. Overall net debt is low at 0.9% of market value, which is in our view a positive credit factor.

Including this issue, Smithfield has approximately $31.6 million of total direct debt. Furthermore, we have adjusted out roughly $7.3 million of enterprise-related GO debt from our net direct debt calculations. The GO-related water and sewer debt centers on three years of evidence that user charges have provided full coverage to support obligations outstanding. According to management, the town may seek voter approval for approximately $5.5 million in additional debt over the next two years to finance a new fire station and to fund improvements to existing stations.

In our opinion, a credit weakness is Smithfield's large pension and OPEB obligation, without a comprehensive plan in place that we think will sufficiently address and fund fully all of the town's long-term obligations. Smithfield's combined required pension and actual OPEB contributions totaled 11.8% of total governmental fund expenditures in 2015. Of that amount, 9.7% represented required contributions to pension obligations, and 2% represented OPEB payments. The town made a combined 91% of its annual required pension contribution in 2015.

Smithfield's employees contributes to six defined-benefit pension funds, three of which are part of the state's Municipal Employees' Retirement System (MERS), and two of which are administered by a private insurer on behalf of the town. The town also makes required contributions to the state-administered plan through the Employees' Retirement System of Rhode Island (ERSRI) for teachers. The town is required to make payments equal to 100% of the ADC for state-administered funds, but its payments for the locally administered funds–the firefighters fund and police pension fund–have historically been below required levels.

According to Governmental Accounting Standards Board Statement No. 68 standards, which the town implemented for financial statements ended June 30, 2015, employers with benefits administered through a single-employer plan are to identify their net pension liability for the recognition of pension-related activity incurred prior to July 1, 2014. The town's net pension liability for all plans was approximately $57.7 million as of June 30, 2015, the most recent actuarial valuation. The town's largest pension plan is the ERSRI. Smithfield's proportionate share of the net pension liability ERSRI was $22.97 million and its plan fiduciary net position as a percentage of the total pension liability is 96.2%.

As of the most recent actuarial valuation, June 30, 2015 , the unfunded liability for the:

- Police pension fund was $18.81 million and 24% funded;
- Fire pension fund was $8.69 million and 70% funded;
- MERS general employees' plan was $1.22 million and 92% funded;
- MERS police pension plan was overfunded by $199,454, or 102% funded; and
- MERS fire pension plan was overfunded by $29,463, or 104% funded.

Management has taken a number of steps to improve the funded ratios of Smithfield's pension plans, including adoption and implementation of a funding improvement plan that will continue to fund the locally administered police pension at 100% or more of ADC, beginning in fiscal 2015. According to the adopted plan, the town expects to fund 60% of the plan by fiscal 2026 and 100% of the plan in fiscal 2031. Furthermore, management reported it closed the defined-benefit plan to police department employees in July 1999.

In addition, the town made efforts to address funding of the fire pension plan by increasing both employee and employer contributions through the collective bargaining process. Beginning in fiscal 2017, the town's contribution will increase by 1% annually, while employee contributions will increase from 1% to 10% of their annual compensation. Smithfield also conducts studies every three years to align its assumptions with pension funding standards and trends. In July 2011, all fire department employees joined the state-administered plan. In our view, closing the plan mitigates the risk of significant increases in future liabilities. Despite improved planning efforts, the town expects to contribute only 45.7% and 47.8% of its ADC to the fire pension plan in fiscals 2016 and 2017, which could contribute to downward budgetary pressure if annual costs continue to rise.

Smithfield also provides OPEB to its retirees in the form of health care benefits, in accordance with contractual obligations of the town and school department. In fiscal 2015, the town contributed $1.41 million, or 61.3% of its annual required contribution, which is a decrease from fiscal 2013 (118%) and fiscal 2014 (100.1%). As of June 30, 2015, the unfunded OPEB liability was $26.45 million. According to management, the town plans to continue funding OPEB on a pay-as-you-go basis, and contributes a minimum of $100,000 per year to an OPEB trust. The town has also negotiated with its police and fire unions to extend required service time for benefit eligibility and institute annual employee contributions to the OPEB trust.

Strong institutional framework

The institutional framework score for Rhode Island municipalities is strong.

Outlook

The stable outlook reflects S&P Global Ratings' opinion of Smithfield's strong wealth and income levels, coupled with its stable economy, which benefits from access to the broad and diverse Providence-Warwick MSA. The rating also reflects our opinion that Smithfield will likely maintain, at least, adequate budgetary performance, which we believe will sustain its very strong budgetary reserves and liquidity. Further supporting the rating are the town's strong management policies and practices, including its long-term capital and financial planning, which will likely ensure the town's long-term credit stability. For these reasons, we are unlikely to change the rating during our two-year outlook period.

Upside scenario

All else being equal, we could raise the rating if the town were to demonstrate consistent annual funding of all of its pension contributions and make progress in moderating the plans' unfunded liabilities, coupled with the town strengthening and sustaining positive annual budgetary performance.

Downside scenario

We could lower the rating if the town were to experience a sustained or substantial weakening of budgetary performance, leading to a deterioration of reserves and constrained liquidity. We could also lower the rating if the town's long-term liabilities continue to rise, particularly pension and OPEB costs, leading to downward budgetary pressure.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.