

## CREDIT OPINION

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### Contacts

Christopher Yared +1.617.535.7693  
 Associate Analyst  
 christopher.yared@moody's.com

Nicholas Lehman +1.617.535.7694  
 VP-Senior Analyst  
 nicholas.lehman@moody's.com

Thomas Jacobs +1.212.553.0131  
 Senior Vice President  
 thomas.jacobs@moody's.com

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Americas 1-212-553-1653  
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 EMEA 44-20-7772-5454

## Belknap (County of) NH

Update to credit analysis following downgrade to A1

### Summary

Belknap County (A1 negative) has a large tax base with low unemployment that benefits from year-round tourism, but the financial position has significantly weakened due to continued depletion of reserves to balance the county's modest operating budget. While debt levels are average for the state and pension liabilities are manageable, the inability to raise sufficient revenues to cover all costs without relying on fund balance appropriations remains a key credit negative for the county.

On February 27, we downgraded the county's general obligation rating from Aa2 to A1 and assigned a negative outlook.

### Credit strengths

- » Sizeable tax base with year-round tourism
- » Minimal, but growing, debt burden
- » Low fixed costs

### Credit challenges

- » Reliance on fund balance appropriations to balance annual budget
- » Lack of structurally balanced operations and insufficient reserve levels
- » Enterprise risk of nursing home and Gunstock Area Commission
- » Continued deferral of capital expenditures could increase need to raise debt in the future

### Rating outlook

The negative outlook reflects the expectation that the county's financial position will worsen over the near term as the county continues to operate without a structurally balanced budget.

### Factors that could lead to an upgrade

- » Demonstrated willingness to adhere to the county's fund balance policy which recommends maintaining \$3.5 - \$5 million of unassigned fund balance
- » Production of and adherence to structurally balanced budgets for several consecutive years

## Factors that could lead to a downgrade

- » Continued use of reserves to balance the budget
- » An increase in expenditures without a corresponding increase in property tax revenues
- » Lack of willingness to increase revenues

## Key indicators

Exhibit 1

Belknap (County of) NH	2012	2013	2014	2015	2016
<b>Economy/Tax Base</b>					
Total Full Value (\$000)	\$10,023,471	\$9,823,194	\$9,766,035	\$9,984,038	\$10,340,962
Population	60,206	60,216	60,252	60,399	60,399
Full Value Per Capita	\$166,486	\$163,133	\$162,086	\$165,301	\$171,211
Median Family Income (% of USMedian)	102.8%	104.4%	106.0%	109.2%	109.2%
<b>Finances</b>					
Operating Revenue (\$000)	\$25,737	\$25,556	\$25,265	\$26,281	\$24,557
Fund Balance (\$000)	\$3,863	\$3,626	\$3,718	\$4,404	\$3,079
Cash Balance (\$000)	\$4,056	\$3,969	\$3,879	\$5,008	\$3,983
Fund Balance as a % of Revenues	15.0%	14.2%	14.7%	16.8%	12.5%
Cash Balance as a % of Revenues	15.8%	15.5%	15.4%	19.1%	16.2%
<b>Debt/Pensions</b>					
Net Direct Debt (\$000)	\$3,129	\$2,510	\$7,791	\$6,465	\$11,842
3-Year Average of Moody's ANPL (\$000)	\$29,465	\$33,916	\$34,131	\$30,260	\$29,234
Net Direct Debt / Operating Revenues (x)	0.1x	0.1x	0.3x	0.2x	0.5x
Net Direct Debt / Full Value (%)	0.0%	0.0%	0.1%	0.1%	0.1%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.1x	1.3x	1.4x	1.2x	1.2x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	0.3%	0.3%	0.3%	0.3%	0.3%

As of December 31 fiscal year end

Source: Moody's Investors Service and Belknap's audited financial statements

## Profile

One of ten counties in New Hampshire (Aa1 stable), Belknap County is located in the center of the state, bounded on the east by Lake Winnepesaukee. The county seat of Laconia sits approximately 80 miles north of Boston (Aaa stable).

## Detailed credit considerations

### Economy and Tax Base: Large tax base with year-round tourism

The county's sizeable \$10.7 billion tax base will remain stable given modest ongoing redevelopment in Laconia and efforts to add new summer offerings to Gunstock in order to reduce its reliance on the winter season. However, the county is heavily dependent on year-round tourism which suffered in the 2015-2016 winter season due to poor winter weather.

Following a significant drop post-recession, full value remains 4% below its pre-recession high after growing for the past three consecutive years. Full value per capita, however, has consistently outpaced the median for US counties and New Hampshire counties which reflects a very strong resource base for taxes. Given the county has the smallest budget in the state, even while ranking sixth in total population, the potential tax base remains largely unrealized.

The county's population of about 60,399 has remained mostly flat since 2010 and unemployment has continued to fall to its current level of 2.3% as of December 2017. Median family income remains below average for the state (88.2%) but above average

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compared to the rest of the US (109.2%). The largest industry sectors that drive the local economy are retail trade, health services, and accommodation/food services.

In 1959, state legislation created the Gunstock commission to manage and operate the county owned recreational land area which is named the Gunstock ski and summer resort. A memorandum of agreement between the county and commission was signed in October 2010 and included an annual PILOT payment of \$175,000 from the commission to the county and the county's general obligation security pledge on any bonds or notes issued on behalf of the commission. It also required the commission to set rates and fees equal to cover debt service and operations. That agreement expired at the end of 2016, but Gunstock has continued to make its \$175,000 PILOT payment while the renewal process is ongoing.

#### **Financial Operations and Reserves: Continued use of reserves to balance budget drives weakened financial position**

Belknap's financials will remain challenged given the recent 2018 budget decision to continue drawing on reserves to balance the budget. In addition to its property tax and program revenues, the county plans to use \$1 million of available fund balance in combination with excess revenues of \$235,000 and operational savings of \$581,100 in 2018. We believe the operational savings could prove difficult to realize given the small budget. If that were to happen, the county could rely more on its available fund balance than it expects which would put its liquidity levels at historic lows. An available fund balance of \$1 million at the end of 2018 would translate to about 4% of 2016 revenues, which is well below the median for the rating category. While the county has the financial flexibility to increase property taxes instead of drawing on its reserves, it currently lacks the willingness to do so.

The fiscal 2016 audit reflected an operating deficit of \$1.4 million due to planned use of reserves. The deficit reduced the available general fund balance to \$3.1 million or 12.5% of revenues. The Fiscal 2017 unaudited results indicate another year of declines due to further use of reserves for operations. The available reserves are projected to be \$1.7 million or a low 7% of revenues. It is likely that ratio will continue to drop in 2018 barring any significant revenue enhancements or expenditure savings. That significant drop in available general fund balance reduces the county's financial flexibility going forward and puts even more pressure on an already strained and difficult budget process.

The majority of the county's costs are concentrated in the nursing home and corrections departments, while its major revenues come from property taxes, which are relatively stable, and the nursing home.

#### **LIQUIDITY**

As of 2016, the county had general fund cash of \$3.1 million, or 12.5% of revenues, which we expect to drop to about \$1.7 million, or 7% of revenues, when 2017 results are published.

#### **Debt and Pensions: Debt levels remain low and pension liability manageable**

The county will continue to benefit from its low leverage, though recent borrowings have increased overall debt in recent years. Belknap's net direct debt of 0.2% of full value was average for the state but lower than the 0.5% US counties median. Debt service in 2016 represented just 2.4% of expenditures. The county uses tax anticipation notes (TANs) because it receives substantially all of its property taxes in December of each fiscal year. It currently has \$7.6 million of TANs outstanding along with \$8.0 million of bond anticipation notes (BANs) that are expected to be refinanced with bonds in 2018 or 2019. Outside of that refinancing, management expects no future debt issuance in the near term.

#### **DEBT STRUCTURE**

All of the county's debt is fixed rate. The county's debt service payments will decrease until its expected bond issuance in 2018 or 2019 at which time debt service payments will be flat at just under \$500,000 through the maturity of the debt in 2043.

#### **DEBT-RELATED DERIVATIVES**

The county is not party to any derivative agreements.

#### **PENSIONS AND OPEB**

The county participates in the State of New Hampshire Retirement System, a cost sharing, multi-employer, defined benefit pension plan. The county's annual contribution in 2016 was \$1.1 million or 4.1% of general fund expenditures.

The 2016 three-year average Moody's Adjusted Net Pension Liability, under Moody's methodology for adjusting reported pension data, is \$29.2 million, or an average 1.2 times revenues and 0.28% of full value.

The county funds its other post-employment benefit (OPEB) obligation on a pay-as-you-go basis. In 2016, the county contributed \$37,000 toward its OPEB obligation. The unfunded liability is a very small \$2.5 million. The combined debt, pension, and OPEB burden is relatively small compared to other rated counties and provides Belknap with a source of financial flexibility.

Total fixed costs in 2016, including debt service, required pension contributions and retiree healthcare payments, represented \$1.7 million, or 7% of expenditures.

### Management and Governance

County management continues to rely on reserves to balance the annual operating budget, resulting in a material decline in the financial position that could continue over the near term. A lack of willingness to tap the very large tax base with capacity to provide greater operating flexibility is a key credit concern and will be a primary factor in future rating reviews.

New Hampshire Counties have an Institutional Framework score of Aa, which is high compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. New Hampshire counties major revenue sources are property taxes and charges for services that are not subject to any caps. Unpredictable revenue fluctuations tend to be moderate, or between 5-10% annually. Across the sector, fixed and mandated costs are generally less than 25% of expenditures. However, New Hampshire has public sector unions, which can limit the ability to cut expenditures. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

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