

RatingsDirect®

Summary:

Methuen, Massachusetts; General Obligation; Non-School State Programs; Note

Primary Credit Analyst:

Victor M Medeiros, Boston (1) 617-530-8305; victor.medeiros@standardandpoors.com

Secondary Contact:

Timothy W Little, New York (212) 438-7999; timothy.little@standardandpoors.com

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Credit Profile

US\$15.0 mil GO st qual mun purp loan bnds ser 2015 due 09/01/2043

Long Term Rating AA/Stable New

Underlying Rating for Credit Program AA-/Stable New

US\$5.415 mil GO BANs dtd 08/07/2015 due 08/05/2016

Short Term Rating SP-1+ New

Methuen GO State Qualified Sch Prj Loan CH 70B Bonds due 09/01/2034

Long Term Rating AA/Stable Affirmed

Underlying Rating for Credit Program AA-/Stable Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA' long-term rating and 'AA-' underlying rating to Methuen, Mass.' series 2015 general obligation (GO) state qualified school project bonds. We also assigned our 'SP-1+' short-term rating to the city's bond anticipation notes (BANs). The outlook on all the ratings is stable.

A pledge of the city's full faith and credit, subject to Proposition 2-1/2 secures the bonds. Officials will use the bond proceeds for a high school revitalization project. The city authorized \$99.1 million for the project. Of that amount, 68.84% is eligible for reimbursement from the Massachusetts School Building Authority (MSBA). Proceeds from this sale will redeem \$15 million of outstanding BANs and extend the maturity of \$5 million in BANs for another year. It is anticipated that proceeds from the MSBA will redeem the outstanding BANs.

The 'SP-1+' short-term rating reflects our view that the city maintains a very strong capacity to pay principal and interest when the notes come due. Methuen has a low market risk profile because of its strong legal authority to issue long-term debt to take out the notes. In addition, it is a frequent issuer that regularly provides disclosure to market participants.

The 'AA' long-term rating reflects the city's eligibility under the commonwealth's Chapter 44A Qualified Bond Act. Under the Act, the state treasurer pays debt service directly to the paying agent and withholds the amount of the payment from the borrower's monthly state aid appropriation. Approval by the Municipal Finance Oversight Board (formerly the State Emergency Finance Board), which oversees and monitors the program, is required.

The 'AA-' underlying rating reflects our assessment of the following factors, including its:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Adequate management, with "standard" financial policies and practices under our Financial Management Assessment (FMA) methodology;

- Strong budgetary performance, with balanced operating results in the general fund and at the total governmental fund level;
- Weak budgetary flexibility, with an available fund balance in fiscal 2014 of 2.1% of operating expenditures;
- Very strong liquidity, with total government available cash of 9.2% of total governmental fund expenditures and 1.9x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges of 4.9% of expenditures and net direct debt that is 33.0% of total governmental fund revenue, and low overall net debt at less than 3% of market value, but a large pension and other postemployment benefit (OPEB) liability and the lack of a plan to sufficiently address the obligation; and
- Strong institutional framework score.

Strong economy

We consider Methuen's economy strong. The city, with an estimated population of 48,880, is located in Essex County in the Boston-Cambridge-Newton, MA-NH MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 107.0% of the national level and per capita market value of \$94,701. Overall, the city's market value was stable over the past year at \$4.6 billion in 2016. The county unemployment rate was 6.0% in 2014.

Residential properties account for about 84% of total assessed valuation (AV), with commercial and industrial properties accounting for 13%. Methuen's AV has been stable the past three fiscal years, with recent increases suggesting values and associated economic activity are picking up.

Adequate management

We view the city's management as adequate, with "standard" financial policies and practices under our FMA methodology, indicating the finance department maintains adequate policies in some but not all key areas.

Highlights include management's use of 10-year historical trend analysis when determining its budget, monthly monitoring of budget-to-actuals by the city council, and formal investment policy. The city does not do any long-term financial or capital planning, nor does it maintain formal reserve or debt management policies.

Strong budgetary performance

Methuen's budgetary performance is strong in our opinion. The city had balanced operating results of negative 0.1% in the general fund and negative 0.2% across all governmental funds in fiscal 2014. General fund operating results of the city have been stable over the last three years, with a result of 0.3% in 2013 and a result of negative 0.1% in 2012.

For analytical consistency, we have adjusted out any capital spent by bond proceeds across all governmental funds.

Property taxes are the city's leading revenue source, accounting for 48% of general fund revenues, followed by intergovernmental aid (44%). Property tax collections have historically averaged about 97% on a current basis. The city anticipates ending fiscal 2015 with balanced operating results. Motor vehicle excise taxes outperformed the budget by \$550,000, which, along with \$400,000 in savings from a change to ambulance billing and other expenditure savings, offset the city's sizable snow and ice deficit. The fiscal 2016 budget is balanced, and management anticipates performance will remain in line with years past.

Based on our macroeconomic forecasts (see the article titled, "U.S. State And Local Government Credit Conditions

Forecast," published July 22, 2015, on RatingsDirect), credit conditions in the Northeast remain stable, which supports our view that the city's budgetary performance will remain in line with current levels.

Weak budgetary flexibility

Methuen's budgetary flexibility is weak, in our view, with an available fund balance in fiscal 2014 of 2.1% of operating expenditures, or \$3.1 million.

It is anticipated the city will close 2015 with reserves in line with current balances. However, we believe this is an area of weakness as the city maintains much flexibility. We acknowledge that if reserves decline to very weak levels (less than 1% of expenditures) with no projections for improvement, it could weaken the rating. The city maintains some unused levy capacity, affording it some additional flexibility, but the level is not substantial enough to warrant a positive adjustment to this factor.

Very strong liquidity

In our opinion, Methuen's liquidity is very strong, with total government available cash of 9.2% of total governmental fund expenditures and 1.9x governmental debt service in 2014. In our view, the city has strong access to external liquidity if necessary.

The city has demonstrated strong market access by issuing GO bonds within the past several years. Therefore, we believe liquidity will remain very strong since there is no significant deterioration of cash balances planned or expected. Furthermore, we note the city does not have any contingent liquidity risk from financial instruments with payment provisions that change on the occurrence of certain events. In addition, management is not aggressive in its use of investments.

Adequate debt and contingent liability profile

In our view, Methuen's debt and contingent liability profile is adequate. Total governmental fund debt service is 4.9% of total governmental fund expenditures, and net direct debt is 33.0% of total governmental fund revenue. Overall net debt is low at 1.2% of market value, which is in our view a positive credit factor.

Following this bond issue, the city will have roughly \$75 million of total direct debt of which roughly \$5 million will be outstanding BANs. Further, roughly \$20.3 million is self-supporting enterprise debt paid by user charges of the water and sewer system.

In our opinion, a credit weakness is Methuen's large pension and OPEB liability, without a plan in place that we think will sufficiently address the obligation. Methuen's combined pension and OPEB contributions totaled 8.5% of total governmental fund expenditures in 2015. Of that amount, 5.9% represented contributions to pension obligations and 2.6% represented OPEB payments. The city made its full pension annual required contribution (ARC) in 2015.

Methuen administers its own contributory defined-benefit retirement system. The city contributed its full ARC in 2015. As of its Jan. 1, 2014 valuation, the system was about 47% funded. The city also provides OPEBs in the form of health insurance. As of its Dec. 31, 2013 valuation, the OPEB plan had an unfunded liability of \$144 million. We expect that given the magnitude of the pension and OPEB liability, coupled with significant underfunding, that costs will increase in the short term and could further pressure the budget. However, the city has taken steps to improve funding levels by increasing pension contributions previously underfunded with pension holidays and early retirement programs.

Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

Outlook

The stable outlook reflects Standard & Poor's expectation that Methuen will continue to adjust its budget to maintain structural balance while improving its weak reserves. The underlying wealth and income levels provide rating stability, along with its very strong debt profile.

While we expect the city to maintain stable operations, should performance deteriorate and reserves decline, particularly below 1% of expenditures, we could lower the rating. Conversely, although upward rating movement is somewhat limited by the city's weak budgetary flexibility, improvement of reserves could lead to a higher rating. Accordingly, we do not anticipate changing the rating within the two-year outlook horizon.

Related Criteria And Research

Related Criteria

- USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- USPF Criteria: Financial Management Assessment, June 27, 2006
- USPF Criteria: Debt Statement Analysis, Aug. 22, 2006
- USPF Criteria: State Credit Enhancement Programs, Nov. 13, 2008
- USPF Criteria: Limited-Tax GO Debt, Jan. 10, 2002
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- U.S. State And Local Government Credit Conditions Forecast, April 2, 2015
- Institutional Framework Overview: Massachusetts Local Governments

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