

RatingsDirect®

Summary:

Saugus, Massachusetts; General Obligation

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Credit Profile

US\$14.925 mil GO mun purp loan of 2020 bnds due 10/01/2050

<i>Long Term Rating</i>	AA+/Stable	New
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Saugus GO mun purp loan bnds

<i>Long Term Rating</i>	AA+/Stable	Affirmed
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Rating Action

S&P Global Ratings assigned its 'AA+' rating and stable outlook to the Town of Saugus, Mass.' \$15 million series 2020 general obligation (GO) municipal-purpose loan bonds and affirmed its 'AA+' rating, with a stable outlook, on the town's existing GO debt.

The bonds are payable from the town's full faith and credit pledge, subject to Proposition 2 1/2 limitations. We rate the limited-tax GO debt based on the application of our criteria "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness," published Nov. 20, 2019. We rate the obligation at the same level as our view of the town's general creditworthiness, as expressed in our rating on Saugus' unlimited-tax GO bonds.

Proceeds from the series 2020 bonds will refinance approximately \$1.5 million of bond anticipation notes (BANs) permanently and provide new money to support school construction projects and other capital projects within the town.

Credit overview

The rating reflects our opinion of Saugus' strong and growing property tax base that benefits from the Boston metropolitan statistical area (MSA), which has supported continued positive budgetary performance and led to improved reserves. These strengths are offset partially by the elevated pressures associated with pension and other postemployment benefit (OPEB) carrying costs. The town received voter approval to exclude the additional debt for school projects from Proposition 2 1/2 limitations, and future infrastructure obligations will be paid for by user rates.

The stable outlook reflects S&P Global Ratings' opinion that Saugus will likely maintain strong reserves, supported by strong management and budgetary performance, along with the town's participation in the broad and diverse Boston MSA. Our outlook is generally for two years, but we see significant downside risks due to the COVID-19 pandemic and recent recession over the next 12 months.

The rating also reflects our opinion of Saugus':

- Very strong economy, with access to a broad and diverse MSA;
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;

- Adequate budgetary performance, with operating surpluses in the general fund in fiscal 2019 and expected surplus, on a budgetary basis, in fiscal 2020;
- Strong budgetary flexibility, with the available fund balance in fiscal 2019 at 14.2% of operating expenditures;
- Very strong liquidity, with total government available cash at 13.4% of total governmental-fund expenditures and 2.2x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability profile, with debt service carrying charges at 5.8% of expenditures and net direct debt that is 143.8% of total governmental fund revenue, and OPEB obligation and the lack of a plan to sufficiently address the obligation; and
- Strong institutional framework score.

Environmental, social, and governance factors

We consider environmental risks in line with the sector standard, although the town is susceptible to flooding due to its location near the Rumney Marsh Reservation. We also analyzed the town's governance and social factors, including the health and safety risks posed by the COVID-19 pandemic, and believe them to be in line with the sector.

Stable Outlook

Downside scenario

We could lower the rating if budgetary performance deteriorates beyond current levels leading to falling reserves, caused by pressures such as rising pension and OPEB costs. In addition, if the economic trends deteriorates the rating could also come under pressure.

Upside scenario

While currently unlikely during our outlook period, if management continues addressing its long-term liabilities and prevents pension and OPEB costs from escalating, coupled with strengthening economic indicators, we could raise the rating.

Credit Opinion

Very strong economy

The town, with an estimated population of 26,628, is 10 miles north of Boston, centered in Essex County. Saugus has a projected per capita effective buying income at 120.4% of the national level and per capita market value of \$180,382. Overall, market value grew by 4.4% to \$4.7 billion in fiscal 2019, and an estimated 7.0% to \$5.0 billion in fiscal 2020. County unemployment was 3.0% in 2019. The onset of the pandemic resulted in an increase in unemployment, peaking at a high of 19.9% in June, and falling to 12.4% as of August 2020. Management noted that employment in the town remains solid, with the primary employers consisting of big box retailers, restaurants, and other service providers that continue to operate.

Saugus is primarily residential, with residential properties accounting for an average of 81% of assessed value over the past three fiscal years. The town is continuing redevelopment efforts with the U.S. Route 1 corridor, with expanded residential and mixed-use development. Saugus rezoned this area several years ago for new development types,

including multiple mixed-use sites, with efforts to continue to diversify and expand the share of commercial properties in the town's business highway sustainable development zoning district as well as expand multi-family residential developments.

Included in these efforts are the town's expectation of enhancing community offerings through renovation and redevelopment of closed school buildings. While the focus is on commercial development in the district, management noted that housing sales continue to see solid growth, despite the pandemic.

Due to residential base stability, ongoing commercial and residential development, and easy access to Boston and the surrounding MSA, we expect Saugus' economy will likely remain very strong throughout the outlook period.

Strong management

We continue to view the town's financial management as strong, with good financial policies and practices under our FMA methodology, indicating that financial practices exist in most areas but that governance officials might not formalize or regularly monitor all of them.

Strengths include management's:

- Strong revenue and expenditure assumptions when budgeting;
- Strong intrayear budgetary monitoring; and
- Long-term financial plan.

The town manager works with the finance committee under Saugus' charter to prepare the town budget annually, and it reviews budget-to-actual results in conjunction with the board of selectmen. The finance committee has the ability to make recommendations at town meetings based on town manager suggestions. While it is not a rolling plan, Saugus annually updates its five-year capital improvement plan that identifies funding sources for specified projects. The town continues to mirror the commonwealth guidelines for its investment policy, with quarterly reports to the board. Finance committee members regularly review the budget compared with actual performance.

The adopted debt management policy targets debt service below 10% of the annual operating budget. Saugus adopted emergency reserve policies, including maintaining unreserved fund balance at 3%-5% of operating expenditures and 5% of the operating budget for stabilization reserves. Management currently adheres to both reserve policies.

Adequate budgetary performance

The town recorded operating surpluses of 0.7% of expenditures in the general fund and 1.1% across all governmental funds in fiscal 2019. The town has achieved balanced operating results in each of the past six fiscal years. Management attributes this to positive revenue growth and conservative budgeting. In fiscal 2019, revenue exceeded budgeted expectations, which management attributes to better-than-expected investment income and meals tax collections during the fiscal year. Despite steady operating performance over several years, in our assessment, we take into account potential downside risks stemming from the COVID-19 pandemic and related recessionary pressures (For more information see "The U.S. Economy Reboots, With Obstacles Ahead," published Sept. 24, 2020, on RatingsDirect). We believe, however, that general fund performance will remain in line with the budget, in large part due to the town's proactive budget monitoring and generally conservative budgeting practices over several years.

Property taxes remain the town's primary source of revenue, accounting for approximately 70% of general fund revenue. Saugus' fiscal 2020 preliminary figure show continued positive performance, with an estimated \$3.4 million budgetary surplus. Because of the pandemic, the town's revenue figures were approximately \$1.9 million below budgeted from a delay in property tax collections and associated interest income related to delayed payments and lower overall performance of key economically sensitive revenues, such as local meals and hotel occupancy tax collections. Property tax collections were slightly lower for fiscal 2020 compared with fiscal 2019 (98.11% compared with 99.28% for fiscal 2019) due to an emergency order Saugus enacted to extend the due date for the May 1, quarterly payment to June 1; however, collections remained solid, with the majority distributed through escrows. The town received a \$2.4 million allocation of Coronavirus Aid Relief and Economic Security (CARES) Act funding and to date has spent approximately \$500,000. Saugus expects to spend the remaining funding by the end of the year for eligible related costs, including HVAC improvements in the town's buildings and schools. Despite the reductions in the fiscal year, we expect local tax sources will continue to generate the majority of operating revenue.

With respect to expenses, public safety and education remain the town's primary expenditures, averaging 14.0% and 39.9%, respectively. Based on the pandemic-related impact on the town's economy, Saugus communicated to its divisions to reduce spending and established a pandemic fund for receipt of the aforementioned CARES Act funding and other related support. The efforts to curb expenses included lower spending in key areas, and other measures, which will help provide a budgetary savings in fiscal 2020.

With stable operating performance in the past several years and limited identified capital needs, we expect management will likely maintain adequate budgetary performance throughout the outlook period. However, we expect future performance to remain pressured with residual effects of the pandemic through the recovery. Pension costs will also likely remain a budgetary pressure due to aggressive pension plan funding. Saugus actively manages these liabilities and adjusts when needed.

Saugus funds the actuarially determined contributions and prefunds OPEB. In line with other Massachusetts municipalities, we believe these liabilities could strain operations, particularly if economic or business conditions weaken and management does not meet actuary assumptions or revises them, or if we find them inadequate at current levels. Management continues to budget to make all required payments to amortize the unfunded liability by 2029.

The town's fiscal 2021 budget initially estimated a use of reserves to balance; however, management noted that revenue figures as of the second quarter are trending toward normal levels and may reduce the amount of fund balance estimated for fiscal 2021 and allow for the replenishment of reserves. Management continued its conservative budgeting practices, estimating a potential 25% reduction in local aid, 10% in local estimated receipts and maintained appropriations, in line with fiscal 2020 levels. Based on the recent stabilizing trends, including the commonwealth holding local aid stable for the year, we would expect that the need to draw on the fund balance for budgetary balance is diminishing.

Strong budgetary flexibility

Saugus' budgetary flexibility remains strong, in our view, with the fiscal 2019 available fund balance stabilizing at \$13.6 million or 14.2% of expenditures. This continues a five-year trend of strong budgetary flexibility for the town.

Although the fiscal 2021 budget anticipates a draw on the fund balance, with the operating surplus in fiscal 2019 and

surplus budgeted for fiscal 2020, we expect management will likely maintain available reserves in line with previous years. If operating performance continues to improve, budgetary flexibility could transition to very strong in the next few fiscal years.

Very strong liquidity

In our opinion, Saugus' liquidity is very strong, with total government available cash at 13.4% of total governmental fund expenditures and 2.3x governmental debt service in fiscal 2019. In our view, the town has strong access to external liquidity if necessary.

Saugus has demonstrated strong access to external liquidity by issuing GO debt and BANs during the past 20 years. In accordance with commonwealth law, the town does not have any variable-rate or direct-purchase debt. Management confirmed it does not have any contingent liquidity risks from financial instruments with payment provisions that change on the occurrence of certain events. Management invests most cash in money market funds and certificates of deposit maturing in less than one year. Therefore, we expect liquidity will remain very strong during the outlook period.

Very weak debt and contingent liability profile

In our view, Saugus' debt and contingent liability profile remains very weak. For fiscal 2019, total governmental fund debt service is over 5% of total governmental fund expenditures, and net direct debt is 143.8% of total governmental-fund revenue. With the issuance of the series 2020 bonds, the town's overall net debt remains in line with that of peers at 3.3% of market value, which remains, in our view, a positive credit factor.

Total net direct debt is \$164 million, including the new money from this issuance. Management noted limited additional GO debt plans in the next two-to-three years, but continues to monitor and prioritize its capital equipment and improvement needs, both in the general fund as well as the town's water, sewer, and stormwater management plans. We expect any prospective debt for water, sewer, and stormwater purposes will remain self-supporting from user system charges.

Pension and other post-employment benefits

- We view pension and OPEB liabilities as a source of credit pressure for Saugus, based on rising liability levels and our expectation that costs will increase.
- Because the town's pension actuarially determined contribution (ADC) is built from what we view as weak assumptions, we believe it increases the risk of unexpected contribution escalations. However, we anticipate higher contributions will likely remain affordable given the strength of the town's budgetary performance.
- Although, the town established a trust fund for OPEB liabilities, fund balances in the trust have not reached levels that we would deem substantial to offset the large liabilities. We believe that, given the size of the liability and respective funded ratio, the OPEB cost will increase and potentially challenge the budget over time.

Saugus participates in the following plans as of January 1, 2019:

- Saugus Contributory Retirement System (SCRS): 74.95% funded with a net pension liability of \$34.6 million.
- Massachusetts Teachers Retirement System (MRTS): 54% funded, with the town's share of the net pension liability of \$63.9 million, however the commonwealth remains required to make 100% of the ADC.

- A defined-benefit health care plan that provides lifetime healthcare, dental, and life insurance for eligible retirees and their spouses: 0.48% funded with an OPEB liability of about \$182.7 million. Management noted the plan liability improved to \$146.7 million as of June 30, 2020.

The town's combined required pension and actual OPEB contributions totaled 12.5% of total governmental fund expenditures in 2019. Of that amount, 6.5% represented required contributions to pension obligations, and 6% represented OPEB payments. As a credit mitigant to the rising retirement costs, the town implemented, at the start of fiscal 2021, a requirement for retirees over age of 65 who are Medicare eligible to enroll in a Medicare supplement plan. Management expects this requirement will help reduce the overall OPEB liability in the future.

In our view, a discount rate of 7.25% for SCRS is aggressive as it is above our 6% guideline. In our view this will lead to contribution escalation given current market performance. The town funds 100% of pension ADCs, with contributions above both static funding and minimal funding progress. The plans' 30 year, closed, and level 4.25% of payroll amortization defers costs and will result in slow funding progress.

For more on our view of the state's pension plans and recent reforms, see "Pension Spotlight: Massachusetts," published Oct. 14, 2020, on RatingsDirect.

Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 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
- 2019 Update Of Institutional Framework For U.S. Local Governments

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