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Ratings

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Summary:

Northampton, Massachusetts; General Obligation

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Table Of Contents

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Credit Profile		
US$2.86 mil GO rfdg bnds due 11/15/2028		
Long Term Rating	AAA/Stable	New
Northampton GO (AGM)		
Unenhanced Rating	AAA(SPUR)/Stable	Affirmed
Northampton GO (ASSURED GTY)		
Unenhanced Rating	AAA(SPUR)/Stable	Affirmed
Northampton GO		
Long Term Rating	AAA/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rating Action

S&P Global Ratings assigned its 'AAA' rating to Northampton, Mass.' series 2020 general obligation (GO) municipal-purpose bonds. At the same time, S&P Global Ratings affirmed its 'AAA' rating on the city's GO debt outstanding. The outlook is stable.

Northampton's full-faith-and-credit GO pledge, subject to Proposition 2-1/2 limitations, secures the bonds. Despite commonwealth levy limit laws, we do not make a rating distinction between Northampton's limited-tax bonds and its general creditworthiness, because our analysis of its financial and economic conditions already includes the statutory limitation imposed on its revenue-raising ability. We rate the limited-tax GO debt on par with our view of Northampton's general creditworthiness.

Officials plan to use bond proceeds to refund the city's series 2009 and 2010 GO bonds for present-value savings.

Northampton's GO bonds are eligible to be rated above the sovereign because we believe the city can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings--Methodology And Assumptions" (published Nov. 19, 2013, on RatingsDirect), Northampton has a predominantly locally derived revenue source, with property taxes accounting for 56% of general fund revenues. It also has independent taxing authority and independent treasury management from the federal government.

Credit overview

The rating reflects our view of the city's very strong budgetary flexibility, with reserves averaging more than 23% over the last three fiscal years, supported by consistently positive financial operations and very strong financial management conditions. Although we believe the city's local economy could experience some weakening or slow growth during the economic recovery, we view its access to a broad and diverse metropolitan statistical area (MSA) as a positive, which strengthens our view of Northampton's economy. Furthermore, although we view the city's debt and contingent liability profile as manageable, we believe pension and other postemployment benefit (OPEB) costs will remain a long-term credit pressure, given the size of the liabilities and low funded ratios.

Although the full impact of the COVID-19 pandemic remains to be seen, the stable outlook reflects our view of the city's very strong reserve position, conservative budgeting practices, and strong management conditions, which we believe provide it with adequate cushion to absorb any unanticipated declines in revenues or unexpected stagnation in its economy as a result of the uncertain economic recovery or events related to COVID-19. Our outlook is generally for two years, but we see some risks as a result of the COVID-19 pandemic over the next six to 12 months.

The long-term rating further reflects our opinion of the city's:

- Very strong economy, with access to a broad and diverse MSA;
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 27% of operating expenditures;
- Very strong liquidity, with total government available cash at 46.4% of total governmental fund expenditures and 8.5x governmental debt service, and access to external liquidity we consider strong;
- Very strong debt and contingent liability profile, with debt service carrying charges at 5.4% of expenditures and net direct debt that is 19.7% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 95.4% of debt scheduled to be retired in 10 years, but a large pension and OPEB obligation and the lack of a plan to sufficiently address the obligation; and
- Strong institutional framework score.

Environmental, social, and governance factors

Our rating incorporates our view regarding the health and safety risks posed by the COVID-19 pandemic, particularly with potential future reductions in local and state revenues. Absent the implications of COVID-19, we consider the city's social risks in line with those of the sector. We analyzed the city's environmental and governance risks relative to its economy, management, financial measures, and debt and liability profile, and determined that all are in line with our view of the sector standard.

Stable Outlook

Downside scenario

We could lower the rating if budgetary performance were to weaken, leading to deteriorated reserves and constrained liquidity.

Credit Opinion

Very strong economy

We consider Northampton's economy very strong. The city, with an estimated population of 29,170, is located in Hampshire County in the Springfield, MA MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 113% of the national level and per capita market value of $126,184. Overall, the city's market value grew by 6.8% over the past year, to $3.7 billion in 2020. The county unemployment rate was 2.7% in 2019.

As one of the cities within the "Knowledge Corridor," Northampton is home to Smith College, and is near Amherst College, Mount Holyoke, UMass Amherst, and Hampshire College. In addition to its academic base, the city has a vibrant arts and culture community and strong commercial presence. Numerous theaters and entertainment venues, along with various retailers and restaurants, can be found downtown. The city's diverse tax base includes sectors ranging from manufacturing to health care. Nearly half of Northampton's residents find employment in the education and health services industries, with the trade, transportation, and utilities and leisure and hospitality industries employing the next-largest shares of city residents. Major employers include Smith College, Cooley Dickinson Hospital, the city, and Massachusetts VA Medical Center.

Smith College is currently in the process of redesigning and expanding the Nielsen Library, which consists of a $100 million project expected to drive interest in the college. On the commercial side, some of the city's largest development projects include the construction of five new office space buildings, the addition of a 140,000-square-foot building by L3 KEO (manufacturer of optical devices), and a new headquarters building for Check Writers Payroll Inc. at the site of the former Clark School Campus near the city's downtown areas. On the residential side, in addition to a growing tax base and thriving real estate market over the past few years, various projects are underway that will add to the city's tax base. Most notably is the Village Hill Campus redevelopment project, at the site of a former state hospital, which is now being converted into a new mixed-use project. The development is expected to ultimately consist of 275,000 square feet of retail/office/commercial space and over 300 residential units, coupled with 83 assisted-living units. About 52 of the new apartments are allocated as affordable housing. Management indicates that these and other projects throughout the city have not experienced any major setbacks as a result of the pandemic and continue to move forward.

While the city has seen significant growth in its tax base and local economy over the past 10 years due to new developments, a favorable real estate market, and a diverse and strong regional economy, we believe the adverse effects of COVID-19 could have a negative impact on the local economy, especially as S&P Global Economics forecasts a notable decline in regional and national GDP for much of the remainder of the year (for more information, please see "U.S. Economy Reboots, With Obstacles Ahead," published Sept. 24, 2020). Although officials indicate many of the city's major employers have remain operational throughout the pandemic, we believe countywide unemployment figures (2.7% in 2019) could increase significantly on an annual basis if the current economic disruption is prolonged or if the manufacturing and employment sectors experience further contraction. This could result in a weakening of the city's economic metrics and potentially change our view of its economy.

Very strong management

We view the city's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well-embedded, and likely sustainable.

Overall, in our opinion, Northampton is conservative in its management and budgeting practices. Officials develop revenue and expenditure assumptions using up to 10 years of historical trends in combination with forward-looking, long-term financial planning. Management presents budget-to-actual reports quarterly to the city council, and posts daily expenditures to the city website via its "Open Checkbook." The city maintains a five-year forecast that it updates annually and uses to project expenditure and revenues issues, along with ways to address them. Northampton also has a five-year, rolling capital improvement plan. Both long-term plans are available to the public on the city's website.

Northampton's financial policies include investment management, debt management, and reserve policies. The investment management policy requires annual reporting, and the debt management policy includes thresholds on debt issuance. The reserve policy calls for a stabilization fund balance of 10% of operating expenditures. Northampton complies with all of its policies.

The city has cyber-security protections in place and maintains various backups of its networks and systems, as well as cyber-security insurance.

Adequate budgetary performance

Northampton's budgetary performance is adequate, in our opinion. The city had operating surpluses of 4.2% of expenditures in the general fund and of 3.5% across all governmental funds in fiscal 2019.

We adjusted fiscal 2019 results for recurring transfers and one-time capital expenditures paid for with bond proceeds.

For fiscal 2020, the city estimates to have ended the year with a general fund surplus. According to management, this is primarily the result of savings on expenditures with payroll and employee benefits, as well as operations and maintenance. The city also budgeted conservatively on revenues for the year, and as a result experienced positive budget-to-actual variances in revenues. Officials indicate the city incurred about $866,000 in COVID-19-related expenses for the fiscal year, but expects this to be fully reimbursed by state and federal funds. The city has historically maintained balanced operations, as it has posted a general fund surplus ever year between fiscal years 2017 and 2019.

The fiscal 2021 budget totals $100.2 million, which represents a 0.5% decrease over the previous year. The budget includes a $52,000 fund balance appropriation. We understand that, as a conservative measure, the city has reduced nonessential spending for the year, including OPEB trust contributions and capital. Management has also assumed flat state revenues in the budget and has kept property tax collection rate constant. The city has reduced its local receipt revenue projections for the year. Property taxes account for 56% of general fund revenues, followed by intergovernmental at 14.7%.

While we believe management will continue to make the necessary budgetary adjustments in order to try to maintain balanced operations, we imagine the unprecedented widespread effects of COVID-19 will have an effect on state revenue and many local economies, including Northampton, and could potentially result in weaker budgetary performance for fiscal 2021 and beyond. If management were to maintain balanced financial results during the next two fiscal years, or until we think the threat of stagnating or decreasing revenue as a result of negative economic shocks has subsided, we could revise our view of budgetary performance to strong.

Very strong budgetary flexibility

Northampton's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 27% of operating expenditures, or $27.0 million.

The city has consistently maintained available reserves above 20% over the last three fiscal years. For fiscal 2020, the city estimates to have ended with another increase in available reserves, further bolstering its budgetary flexibility. Additionally, the fiscal 2021 budget only includes a fund balance appropriation of $52,000.

On March 3, 2020, the city approved a $2.5 million general operating override of the levy limit, which, in our view, demonstrates additional revenue-raising flexibility. The city has delayed the implementation of the override by a year and plans to include it in its fiscal 2022 budget. Officials indicate this is part of the city's long-term fiscal stability plan and is aimed primarily at paying for ongoing operations and increasing municipal services for residents. We also understand a portion of the revenues from the override will go toward the city's fiscal stability reserves (within unassigned fund balance). Therefore, we expect the city's budgetary flexibility to remain very strong.

Very strong liquidity

In our opinion, Northampton's liquidity is very strong, with total government available cash at 46.4% of total governmental fund expenditures and 8.5x governmental debt service in 2019. In our view, the city has strong access to external liquidity, if necessary.

Northampton does not invest aggressively and is not exposed to variable-rate or privately placed debt. Current holdings are largely in bank deposits. The city maintains what we view as strong access to external liquidity, having issued GO bonds within the past 20 years. We expect that the city will maintain its current cash balances relative to expenditures and debt service, and that the liquidity profile will remain very strong.

Very strong debt and contingent liability profile

In our view, Northampton's debt and contingent liability profile is very strong. Total governmental fund debt service is 5.4% of total governmental fund expenditures and net direct debt is 20.6% of total governmental fund revenue. Overall net debt is low, at 0.7% of market value, and approximately 95.4% of the direct debt is scheduled to be repaid within 10 years, which are in our view positive credit factors.

Including this issue, Northampton will have approximately $40.2 million in total direct debt. Management is forecasting the city to issue approximately $12.5 million in general fund debt and $15 million in water and sewer enterprise debt over the next several years. As both enterprise funds have recently been fully self-supporting, in our view, we expect that water and sewer user charges will likely support the entirety of the upcoming issuances, particularly given the current amortization schedule. We do not expect these plans to have a material effect on the city's debt profile.

Pension and other postemployment benefits

- We view pension and OPEB liabilities as a source of credit pressure for Northampton, given that costs represent a notable portion of the budget, and we expect they will increase.
- Because the city's pension actuarially determined contribution (ADC) is built from what we view as weak assumptions and methodologies, we believe it increases the risk of unexpected contribution escalations. However, we expect higher contributions will likely remain affordable in the short term, given the city's conservative

budgeting assumptions and very strong reserve levels.

- Although OPEB liabilities are funded on a pay-as-you-go basis, which, given claims volatility as well as medical cost and demographic trends is likely to lead to escalating costs, the city has legal flexibility to alter OPEB benefits, which we view as a potential means of mitigating escalating costs.

Northampton participates in the following plans as of June 30, 2019:

- Northampton Contributory Retirement System (NCRS): 69.6% funded, with a net pension liability of $53.4 million.
- A defined-benefit health care plan that provides both explicit subsidies: 0.82% funded, with an OPEB liability of about $167.8 million.

Northampton's combined required pension and actual OPEB contributions totaled 9.0% of total governmental fund expenditures in 2019. Of that amount, 4.8% represented required contributions to pension obligations and 4.2% represented OPEB payments. The city made 100% of its annual required pension contribution in 2019.

NCRS is currently on track for full funding by 2035, five years ahead of the commonwealth-mandated deadline of 2040. However, we view the plan's payroll growth assumption of 4% as optimistic, and we believe it could lead to increases in retirement contributions if the target is not consistently achieved. We believe its discount rate of 7.38% is above-average and introduces market volatility risk, which could lead to a higher unfunded pension liability and costs.

For OPEB, management maintains a trust fund with a current balance of $1.4 million as of fiscal 2019, which represents a funded ratio of less than 1%. The city had initially planned to contribute about $350,000 to the fund in fiscal 2021. However, in efforts to cut costs for the year, the city has elected to delay this contribution and plans to instead make it in fiscal 2022.

While the city is managing its retirement costs and expects to continue to do so, we expect these costs will continue to increase and could potentially pressure the budget going forward, given the low funded ratios and large unfunded liabilities, especially in relation to the city's OPEB plan.

Strong institutional framework

The institutional framework score for Massachusetts 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