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Summary:

Northampton, Massachusetts; General Obligation

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Credit Profile		
US$7.775 mil GO mun purp loan bnds ser 2021 due 06/15/2031		
Long Term Rating	AAA/Stable	New
Northampton GO		
Long Term Rating	AAA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' rating to Northampton, Mass.' series 2021 general obligation (GO) municipal-purpose bonds, totaling about $7.8 million. 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 the bond proceeds to fund various capital improvement projects.

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 26% over the past three fiscal years, supported by consistently positive financial operations and very strong financial management conditions. Although we believe the city's local economy could potentially experience some slow growth during the economic recovery, we view its access to a broad and diverse metropolitan statistical area (MSA) as a positive credit factor, 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 benefits (OPEB) costs will remain a long-term credit pressure, given the size of the liabilities and low funded ratios. Nevertheless, 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.

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;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2020;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2020 of 27% of operating expenditures;
- Very strong liquidity, with total government available cash at 47.7% of total governmental fund expenditures and 9.3x governmental debt service, and access to external liquidity that we consider strong;
- Very strong debt and contingent liability profile, with debt service carrying charges at 5.2% of expenditures and net direct debt that is 22.9% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of market value and rapid amortization, with 96.1% 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 (ESG) factors

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. The city also maintains various cyber-security protections and plans in place.

Stable Outlook

Downside scenario

We could lower the rating if budgetary performance weakens, leading to reduced 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 in Hampshire County in the Springfield MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 114% of the national level and per capita market value of $127,999. Overall, the city's market value grew by 1.4% over the past year to $3.7 billion in 2021.

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 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 recently completed a redesign and expansion of the Nielsen Library, which consists of a $100 million project to drive further 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 more than 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 we believe the city's economy will remain stable, especially as we expect the economic recovery will continue to accelerate, we believe the lingering effects of the pandemic including elevated state and regional unemployment rates, could potentially lead to slower-than-anticipated economic growth (For more information, see "State, Local Government, School District, And Charter School Sector Views Revised Back To Stable," published March 24, 2021, and "Economic Outlook U.S. Q2 2021: Let The Good Times Roll," published March 24, 2021, on RatingsDirect). Although officials indicate the city's major employers remain operational throughout the pandemic and tax collections are very strong, we believe countywide unemployment figures (5.4% as of March 2021) could remain elevated if the current economic recovery weakens or is hampered by the ongoing pandemic. As a result, this could lead to 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 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.

Strong budgetary performance

Northampton's budgetary performance is strong, in our opinion. The city had operating surpluses of 2.5% of expenditures in the general fund and 1.9% across all governmental funds in fiscal 2020. General fund operating results were stable, at 4.2% in 2019 and 2.1% in 2018.

We adjusted fiscal 2020 results for recurring transfers and one-time capital expenditures paid for with bond proceeds.

According to management, the fiscal 2020 positive results were primarily due to savings in expenditures. This included savings across different departments and areas of the budget including public safety, schools, general government, as well as health and human services. The city also realized some higher-than-budgeted revenues such as hotels and meals taxes, motor vehicle excise taxes, and charges for services.

The fiscal 2021 budget totals $100.2 million, which represents a 0.5% decrease over the previous year. As a conservative measure, we understand the city reduced non-essential spending for the year including OPEB trust contributions and capital. Management has also assumed flat state revenues in the budget and it has kept property tax collection rates constant. As a result, the city's revenue projections are exceeding the budget, including ambulance revenues and motor vehicle excise taxes, and other revenue items such as state aid are on target. The city is also realizing savings because departments are underspending their budget, according to officials. Therefore, the city projects to end the year with positive financial operations. Property taxes account for 56% of general fund revenues, followed by intergovernmental at 14%.

The fiscal 2022 proposed budget totals $105.9 million, which represents a 5.7% increase over the previous year and no appropriation of fund balance. The city plans to implement a $2.5 million operating override, which was voted for in 2020 but was delayed in implementation due to the pandemic. In addition, we understand most of the increase in the budget will go toward capital, public works, and general hiring of additional staff. The city also believes it budgeted conservatively on revenues. It expects to receive about $22 million in American Rescue Plan funds over the next two years, which management did not include in its fiscal 2022 budget.

While the ongoing pandemic and its lingering effects on the economy, such as the elevated unemployment rate, could lead to budgetary weakness, we believe management will continue budgeting conservatively and making the necessary adjustments in order to maintain balanced operations. In addition, we believe the city's strong tax collection rate, predominantly property tax revenue base, and additional federal funding for the city and state, should allow it to maintain a stable budgetary environment. Therefore, we believe the city's budgetary performance should remain strong.

Very strong budgetary flexibility

Northampton's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2020 of 27% of operating expenditures, or $29.8 million.

The city has consistently maintained available reserves above 20% over the past three fiscal years. For fiscal 2021, the city projects to end the year with another increase in fund balance. It also does not plan to appropriate any fund balance in its fiscal 2022 budget.

On March 3, 2020, the city approved a $2.5 million general operating override of the levy limit, which, in our view, demonstrated a willingness to raise revenues to meet expenditures. The city delayed the implementation of the override by a year and it 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 will remain very strong.

Very strong liquidity

In our opinion, Northampton's liquidity is very strong, with total government available cash at 47.7% of total governmental fund expenditures and 9.3x governmental debt service in 2020. 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 5.2% of total governmental fund expenditures, and net direct debt is 22.9% of total governmental fund revenue. Overall net debt is low at 0.8% of market value, and approximately 96.1% 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. The city expects to issue about $12.6 million in additional debt for various capital projects, as part of its capital improvement plan.

Pension and OPEB:

- 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, 2020:

- Northampton Contributory Retirement System (NCRS): 73.6% funded, with a net pension liability of $48 million.
- A defined-benefit health care plan that provides both explicit subsidies: 1.78% funded, with an OPEB liability of

about $128 million.

Northampton's combined required pension and actual OPEB contributions totaled 8.8% of total governmental fund expenditures in 2020. Of that amount, 4.9% represented required contributions to pension obligations and 3.9% represented OPEB payments. The city made 100% of its annual required pension contribution in 2020.

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 $2.3 million as of fiscal 2020, which represents a funded ratio of about 1.78%. 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 level funded this contribution at the fiscal 2020 level of $300,000. The city plans to add at least $350,000 in the trust in fiscal 2022 and increase that amount by $50,000 minimum every year. We also understand the city plans to make additional appropriations to the trust when possible every year.

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, 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
- 2020 Update Of Institutional Framework For U.S. Local Governments

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