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Ratings

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Summary:

Marlborough, Massachusetts; General Obligation; Note

Primary Credit Analyst:
Thomas J Zemetis, New York + 1 (303) 371 4278; thomas.zemetis@spglobal.com

Secondary Contact:
Steven E Waldeck, Boston (1) 617-530-8128; steven.waldeck@spglobal.com

Table Of Contents

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Credit Profile		
US$21.2 mil GO BANS ser 2018 dtd 06/14/2018 due 06/14/2019		
Short Term Rating	SP-1+	New
US$16.03 mil GO mun purp loan of 2018 bnds ser 2018 due 06/01/2038		
Long Term Rating	AA+/Stable	New
Marlborough GO		
Long Term Rating	AA+/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to Marlborough, Mass.' series 2018 general obligation (GO) municipal purpose loan. At the same time, we affirmed our 'AA+' long-term rating and underlying rating (SPUR) on the city's outstanding GO debt. The outlook is stable.

At the same time, we assigned our 'SP-1+' short-term rating to the city's series 2018 GO bond anticipation notes (BANs) and affirmed our 'SP-1+' rating on the BANs outstanding that mature June 15, 2018.

The short-term rating on the notes reflects our criteria for evaluating and rating BANs. In our view, Marlborough maintains a very strong capacity to pay principal and interest when the notes come due. We view the city's market risk profile as low because it has strong legal authority to issue long-term debt to take out the notes and is a frequent debt issuer that regularly provides ongoing disclosure to market participants. We understand officials intend to use proceeds from the notes to temporarily finance various citywide capital improvements.

The ICR reflects the application of our criteria, titled "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" (published Jan. 22, 2018, on RatingsDirect).

The city's full-faith-and-credit pledge, subject to limitations of Proposition 2-1/2, secures the series 2018 GO bonds and notes. Despite limitations imposed by the commonwealth levy limit law, we did not make a rating distinction between the limited-tax GO pledge and Marlborough's general creditworthiness because the tax limitation imposed on the city's ability to raise revenue is already embedded in our analysis of its financial and economic conditions.

We understand that the proceeds from the bonds will be used to permanently finance outstanding BANs used to fund various capital improvement projects.

The rating reflects our opinion of the following factors for Marlborough, specifically its:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (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 2017;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 23% of operating expenditures, and the flexibility to raise additional revenues despite statewide tax caps;
- Very strong liquidity, with total government available cash at 21.2% of total governmental fund expenditures and 7.2x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability position, with debt service carrying charges at 3.0% of expenditures and net direct debt that is 44.3% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value, but a large pension and other postemployment benefit (OPEB) obligation; and
- Strong institutional framework score.

Very strong economy

We consider Marlborough's economy very strong. The city, with an estimated population of 41,635, is in Middlesex County, approximately 25 miles west of Boston. It is in the Boston-Cambridge-Newton MSA, which we consider broad and diverse. The city has a projected per capita effective buying income of 136% of the national level and per capita market value of $129,474. Overall, market value grew by 8.1% over the past year to $5.4 billion in 2018. Middlesex County's unemployment rate was 3.2% in 2017, which is below the state's (3.7%) and the nation's (4.4%) averages.

Marlborough is a predominantly residential community that also features a diverse industrial and commercial base. Interstates 290 and 495, as well as U.S. Route 20 traverse the city, which connects residents to Boston, Worcester, and other regional employment centers. In addition, due to its central location and highway access, Marlborough has experienced considerable residential and commercial growth. Over the past five years, its assessed value (AV) increased by 23.4% to approximately $5.4 billion in fiscal 2018.

Due partly to the city's efforts to attract commercial development and form mixed-use overlay districts, several large corporate employers have relocated there since 2011, which has contributed to its broadening employment and property tax base. Notably, the city's leading employers, including Raytheon (2,000 employees), TJX Cos. Inc. (1,900), Boston Scientific (1,600), and Quest Diagnostics (1,300), anchor the community and have supported additional residential development and expansion of smaller business in the area. According to city officials, several new apartment complexes--with approximately 875 units--were recently completed, and the construction of a 165-unit apartment and townhouse condominium development is underway. In addition, officials report that the city has instituted policies which they expect will promote business expansion and construction of new housing. We consider the tax base to be very diverse, with the 10 leading taxpayers accounting for 12% of AVs.

Based on our expectation that the city will likely attract a healthy mix of commercial and residential development, with the city maintaining access to regional employment centers, we are unlikely to modify our view of Marlborough's very strong economic profile over the next two years.

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. Our revision of the city's FMA score reflects the development and consistent implementation of comprehensive long-term planning, particularly its rolling five-year capital improvement plan (CIP).

In preparation of its annual budget, management employs conservative budgeting practices, which includes the use of four-to-five years of historical data to forecast its revenue and expenditure assumptions. In addition, the city estimates its local tax receipts and intergovernmental revenue by reviewing economic and demographic growth trends in coordination with the assessor's office. Management determines its annual budget appropriations by assessing fixed costs, such as debt service and contractual obligations from collective bargaining to determine its baseline. The remainder of budgeted appropriations are then identified and prioritized based on municipal department and community needs.

Throughout each fiscal year, the city also monitors its budget-to-actual performance internally, and management delivers a report to the city council monthly to address budget variances. According to management, the city council may not increase any supplementary appropriations without the recommendation of the mayor.

Marlborough maintains a five-year CIP, which it updates on an annual basis. The plan identifies capital needs and various funding sources, as well as debt service amortization. In addition, it maintains a five-year long-term financial plan to forecast future revenue and expenditures trends. The city adopted an investment policy which complies with commonwealth guidelines for fund investments and investment reporting is done quarterly. It has adopted debt policies to limit debt service to 5% of expenditures, requiring tax-supported debt to amortize at least 65% over the first ten years or retirement, as well as forbidding enterprise debt from exceeding 25% of total operating expenditures. Marlborough has a formal reserve policy, with a requirement to maintain reserves at minimum of 15% of annual expenditures and it has historically met this target and sustained its reserves at those levels.

Strong budgetary performance

Marlborough's budgetary performance is strong, in our opinion. The city had operating surpluses of 3.7% of expenditures in the general fund and 3.8% across all governmental funds in fiscal 2017. For analytical consistency, we adjusted fiscal 2017 operating results to reflect recurring transfers and account for one-time capital expenditures paid with bond and grant proceeds.

We believe management's use of conservative revenue projections and intrayear budget monitoring have yielded historically positive financial operations. In addition, Marlborough derives a majority of its general fund revenue from stable and predictable revenue sources, the largest of which is property tax. Real estate and personal property taxes made up 62.1% of general fund revenue, and its property tax collection rate has averaged 100% over the past five years. State intergovernmental aid accounted for 29.6% of revenue, and we note commonwealth funding has been stable recently.

Net of operating adjustments, the city reported a $5.5 million operating surplus for fiscal 2017, which management attributes to better-than-budgeted revenue from real estate and motor vehicle tax receipts and departmental revenue (totaling $3.55 million). In addition, the city reported the turnback of unexpended departmental appropriations, as well as health insurance and pension cost savings.

Marlborough approved a balanced $133.5 million general fund budget for fiscal 2018, which reflects a 4.3% increase over the prior fiscal year. Although the city used about $1.6 million to address higher costs related to snow and ice removal, thanks to management's conservative local revenue projections and implementation of various cost-saving measures to control expenditures during the year, the city expects to realize an operating surplus at fiscal year-end. Furthermore, Marlborough's adopted fiscal 2019 budget totals $139.5 million. Given its history of balanced operations and no plans to draw on reserves, we anticipate budgetary performance will likely remain strong during our outlook horizon.

However, beyond the current fiscal year, one potential source of budgetary pressure includes elevated pension and OPEB costs and the pay-down of unfunded liabilities. While we believe Marlborough has made recent efforts to plan for and absorb increases in its budget and does not generally expect a material change in these costs within the two-year outlook period, we will continue to monitor how the city incorporates changes in its assumptions related to long-term liabilities. Should we see these costs escalate to a point of causing structural imbalance, we could modify our view of the city's budgetary performance.

Very strong budgetary flexibility

Marlborough's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 23% of operating expenditures, or $34.9 million. In addition, the city has the flexibility to raise additional revenues despite statewide tax caps, which we view as a positive credit factor.

Due to strong and positive budgetary performance over the past two fiscal years, Marlborough improved its reserve position to approximately $34.9 million from $25.5 million in fiscal 2015. Based on management's expectation that the city will maintain positive operating performance in fiscal 2018, and at least balanced operations for fiscal 2019, we do not expect its very strong overall flexibility position to deteriorate over the next two years.

Furthermore, the city's formal reserve policy stipulates that it maintain a minimum unassigned fund balance of 15% of general fund expenditures, a target it has historically met and sustained. Over the past five fiscal years, Marlborough has an unused levy capacity greater than $21 million. For fiscal 2018, it expects roughly $33.6 million of unused levy capacity; the current amount represents 21.4% of budgeted expenditures. We view unused levy capacity as additional operating flexibility because the city can raise the levy up to that amount without an operating override. In the past, Marlborough has shown a willingness to use that excess taxing capacity when needed. Therefore, we expect the city's flexibility to remain very strong over the next two years.

Very strong liquidity

In our opinion, Marlborough's liquidity is very strong, with total government available cash at 21.2% of total governmental fund expenditures and 7.2x governmental debt service in 2017. In our view, the city has strong access to external liquidity if necessary.

Marlborough is a frequent market participant that has issued debt frequently over the past 20 years, including GO bonds and short-term BANs. The city has no variable-rate or direct-purchase debt, and management has confirmed it has no contingent liquidity risks from financial instruments with payment provisions that change on the occurrence of certain events. City investments are subject to state guidelines, and Marlborough invests its cash in low-risk assets with original maturities of three months or less, including the Massachusetts Municipal Depository Trust, money markets, and short-term certificates of deposit. For these reasons, the city's available cash position remains strong and stable, and we expect its liquidity profile to remain very strong over the next two years.

Strong debt and contingent liability profile

In our view, Marlborough's debt and contingent liability profile is strong. Total governmental fund debt service is 3.0% of total governmental fund expenditures, and net direct debt is 56.4% of total governmental fund revenue. Overall net debt is low at 2% of market value, which is, in our view, a positive credit factor.

After these issuances, Marlborough will have $171.6 million of total direct debt outstanding, of which $21.2 million are short-term notes. In addition, its proportionate share of overlapping debt is $13.9 million related to Assabet Valley Regional Vocational School District. As outlined in its capital project plan, the city could issue about $20 million in additional debt over the next two years and approximately $53 million to finance various capital projects. Given its low overall net debt, however, we do not expect our assessment of its debt profile to weaken.

In our opinion, a credit weakness is Marlborough's large pension and OPEB obligations. Marlborough's combined required pension and actual OPEB contributions totaled 7.8% of total governmental fund expenditures in 2017. Of that amount, 4.8% represented required contributions to pension obligations, and 2.9% represented OPEB payments. The city made its full annual required pension contribution in each of the last three fiscal years, including an actuarially determined contribution of $8.1 million for fiscal 2017. The funded ratio of the largest pension plan is 76.5%, which is an improvement from 67% in the prior year.

The city participates in the Marlborough Contributory Retirement System, a cost-sharing, multiple-employer, defined-benefit pension plan. Using updated reporting standards in accordance with Governmental Accounting Standards Board Statement Nos. 67 and 68, its proportionate share of the net pension liability was about $47.3 million as of Dec. 31, 2015. This is based on a more conservative assumed discount rate of 7.5%, which was lowered from 7.75%. The current funding schedule completely funds the plan by fiscal 2025. While we believe the city is making strides to address its long-term pension liabilities using a condensed amortization schedule, we believe contributions are likely to rise over the next few fiscal years, which could place downward pressure on its finances if assumptions or adverse market conditions were to expose the plan to additional risk.

Furthermore, Marlborough provides OPEBs to its retirees in the form of health and life insurance benefits. Its unfunded OPEB liability, as of June 30, 2017, was $113.1 million. In 2017, the city contributed $5.3 million, or 63.1%, of its annual required contribution to the OPEB liability. Marlborough contributed $5 million in free cash (which was previously committed in its stabilization fund) to establish an OPEB trust fund in fiscal 2015, and management expects to use this fund to reduce the city's unfunded liability. To fund this obligation, the city has elected to contribute a base amount of $100,000 and, at least, 10% of free cash to its OPEB trust. In fiscal 2017, it contributed $1.5 million to the trust, which as of June 30, 2017, had a net position of nearly $7.8 million. The city plans to contribute similar amounts to the OPEB trust for fiscal years 2017 and 2018.

Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

Outlook

The stable outlook reflects our view of Marlborough's overall very strong economy, which benefits from its participation in the broad and diverse Boston-Cambridge-Newton MSA. It also reflects our expectation that the city's very strong financial practices and policies, which contribute to generally stable and predictable budgetary performance, which will likely support its very strong budgetary flexibility and liquidity. At the same time, we expect that the city will maintain, at least, an adequate debt and contingent liability profile, supported by low overall net debt as a percentage of market value. While ongoing economic expansion could support a stable overall debt profile, we believe the city's substantial pension and OPEB liabilities will likely remain a continuing limitation beyond the outlook period. Therefore, we do not anticipate changing the rating in the next two years.

Upside scenario

All other rating factors remaining equal or improving, should the city exhibit sustained economic growth that supports improved wealth and income metrics commensurate with higher rated peers, coupled with consistent implementation of its strategy to reduce its pension and OPEB liabilities, we could raise the rating.

Downside scenario

We could lower the rating if there was significant downward pressure on the city's budgetary performance, leading to deterioration of its flexibility or weakened liquidity.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- Local Government Pension And Other Postemployment Benefits Analysis: A Closer Look, Nov.8, 2017

Ratings Detail (As Of June 1, 2018)		
Marlborough		
Long Term Rating	AA+/Stable	Affirmed
Marlborough		
Short Term Rating	SP-1+	Affirmed
Marlborough GO		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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