S&P Global
Ratings

RatingsDirect®

Summary:

Merrimac, Massachusetts; General Obligation

Primary Credit Analyst:
Thomas J Zemetis, New York + 1 (212) 438 1172; thomas.zemetis@spglobal.com

Secondary Contact:
Anthony Polanco, Boston + 1 (617) 530 8234; anthony.polanco@spglobal.com

Table Of Contents

Summary:

Merrimac, Massachusetts; General Obligation

Credit Profile		
US$8.345 mil GO mun purp loan bnds ser 2019 due 09/15/2044		
Long Term Rating	AA+/Stable	New

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to Merrimac, Mass.' $8.345 million series 2019 general obligation (GO) municipal purpose loan bonds. The outlook is stable.

Merrimac's full faith and credit pledge, payable from taxes levied on all property within the territorial limits of the town, secures the series 2019 bonds. A portion of the bond issue (approximately $1.845 million) is subject to limitations imposed under Proposition 2 1/2 (Chapter 59, Section 21C of Massachusetts General Laws). The remaining portion (approximately $6.5 million) were exempted from the limitations of Proposition 2 1/2 as authorized by the town's voters and passed on Nov. 6, 2018.

Despite limitations imposed by the commonwealth levy limit law on a portion of the series 2019 bonds, and the town's non-exempted debt outstanding, we do not make a rating distinction between the limited-tax GO pledge and Merrimac's general creditworthiness because the local ad valorem tax is not derived from a measurably narrower tax base and there are no limitations on resource fungibility of town resources, supporting our view of the town's overall ability and willingness to pay debt service.

Town officials intend to use a portion of proceeds from the series 2019 bonds to permanently finance various capital improvements, including design and construction of a new police station, the replacement of the town library's roof, and the remodeling of Merrimac's town hall.

Credit Overview

In our view, Merrimac has maintained very strong budgetary flexibility through historically balanced financial operations, with available reserves currently at 18% of general fund expenditures. The town also has a low overall property tax rate with potential capacity to increase revenue to support future operations and capital needs. We believe Merrimac's somewhat rural economic base is anchored by its connection to regional economic centers in the Boston MSA and southeastern New Hampshire, contributing to growth in total assessed value (AV) in the past five years. Also underpinning the rating are strong management conditions, with formal policies and plans that the town adheres to and updates accordingly. Of further benefit is the town's retirement-cost planning that we view as improving compared with that of peers across the commonwealth. Merrimac demonstrated consistent funding of its other postemployment benefits (OPEB) trust fund to manage growth in future liabilities, which could partly offset near-term increases to its debt burden related to extensive capital needs identified by overlapping entities. Therefore, absent a substantial reversal of budgetary performance and flexibility or a deterioration in its wealth and income conditions, we believe Merrimac credit quality will remain stable.

The 'AA+' rating reflects our opinion of Merrimac's general creditworthiness, specifically its:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good 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 in fiscal 2018;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 18% of operating expenditures;
- Very strong liquidity, with total government available cash at 49.8% of total governmental fund expenditures and 17.7x governmental debt service;
- Strong debt and contingent liability position, with debt service carrying charges at 2.8% of expenditures and net direct debt that is 69.0% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value; and
- Very strong institutional framework score.

Very strong economy

We consider Merrimac's economy very strong. The town, with an estimated population of 6,780, encompasses 9 square miles in Essex County in the Boston-Cambridge-Newton MSA, which we consider broad and diverse. The town has a projected per capita effective buying income of 131% of the national level and per capita market value of $121,859. Overall, the town's market value was stable over the past year at $826.2 million in 2019. Essex County's unemployment rate was 3.4% in 2018, which was slightly above the commonwealth's (3.3%), but below the nation's (3.9%) average.

Merrimac is a predominantly rural and small residential community along the New Hampshire border, approximately 40 miles northeast of Boston. I-495 traverses the town, connecting residents to surrounding employment centers in eastern Massachusetts and southern New Hampshire. Reflecting the town's rural character are 900 acres dedicated to various farming operations, but this has been balanced in recent years by a mix of single-family neighborhoods and higher-density multifamily residences and commercial retail developments along its State Route 110 corridor. Due to its largely residential composition, we consider the tax base diverse with the 10 leading taxpayers accounting for roughly 3% of AV.

Although Merrimac's tax base is somewhat limited and modest relative to other communities in the Boston MSA, it has experienced growth in the residential and commercial real estate market due to the affordability of the community. Its total assessed value has risen steadily, increasing by an average of 4.2% annually over the past five years. As a result, Merrimac has consistently generated $200,000 or more in revenue from new growth annually over this same period, although town officials incorporate more modest new growth estimates in the annual budget.

Town officials report that several residential developments are in planning or under construction, including a 96-unit (55-and-older) apartment community, a small office building, and a medical marijuana dispensary. In addition, a private developer is nearing completion of an 87,000 square foot commercial site--with expected occupancy in Fall of 2019–and a second 87,000 square foot commercial site slated for completion in early 2020. Based on the stable composition of its existing tax and employment base, coupled with its embeddedness in the broader regional economy, we believe Merrimac's wealth and income conditions will likely remain stable over the two-year outlook horizon.

Strong management

We view the town's management as strong, with good financial policies and practices under our Financial Management Assessment methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Demonstrating the town's key budgeting practices is management's use of, at least, three years of historical data to build its annual revenue and expenditure assumptions. In preparation of its annual budget, management conducts a line-item review of each department's annual operation request; prioritizes operating expenditures, including future debt service and long-term liability costs; and incorporates changes in contractual obligations. Merrimac also evaluates state and regional economic trends and local tax assessment information to compare its budget growth assumptions for the upcoming budget year. Finance officials conservatively estimate revenue from new sources, and management solicits department input on local fees and charges for services.

During each fiscal year, management monitors the budget regularly, reporting budget-to-actual results to the town's Board of Selectmen monthly. Furthermore, Merrimac adheres to its formal investment policy and reports earnings and holdings at least quarterly to the board. In consultation with state's Department of Local Services, Merrimac recently developed a five-year financial forecast in its budget development process, which features analysis of key revenue and expenditure assumptions and tests budget performance under various conditions. We will continue to monitor how this newly developed forecast guides the town in managing changes related to future operations and debt service.

Merrimac also maintains a strong focus on capital planning, as evidenced by its five-year CIP that identifies various nonrecurring capital expenditures for the general government and utility systems. The town updates its CIP annually and evaluates the potential impact of capital projects on future operations. The plan details pay-as-you-go funding requirements, intergovernmental grants and reimbursements, and debt financing of all capital projects. In addition, management has historically met and sustained reserves in accordance with its formal stabilization fund target. Management maintains an unassigned fund balance in excess of 10% of general fund revenue, which town officials can use to manage financial resources and maintain current service levels in the event of unexpected revenue shortfalls or unpredicted one-time expenditures. Should funds fall below 10%, town officials note that they would undertake necessary steps to restore fund balances to or above the minimum target level.

The town also sustains a formal debt management policy, which stipulates the use of certain debt instruments and reporting requirements. In addition to adhering to state statutes governing debt, the policy formalizes one debt benchmark that annual debt service will be no more than 10% of general fund revenue. Merrimac monitors and sustains debt management practices in accordance with this policy.

Strong budgetary performance

Merrimac's budgetary performance is strong in our opinion. The town had nearly balanced operating results of negative 0.1% of expenditures in the general fund and of 0.2% across all governmental funds in fiscal 2018. Merrimac benefitted from growth in its taxable base that has resulted in modest increases to its revenue base, and we view management's use of conservative revenue projections and intrayear budget monitoring as yielding overall predictable financial operations over the past five fiscal years. Merrimac derives a majority of general fund revenue from stable revenue sources, the largest of which is property tax. Real estate and personal property taxes made up approximately 67% of general fund revenue in fiscal 2018, and the property tax collection rate averaged more than 99% over the past five years. Charges for services accounted for approximately 15% of general fund revenue, while other local receipts accounted for 9%. State and intergovernmental aid comprised about 5% of revenue, and we note that commonwealth funding has been stable recently.

After adjusting for net transfers, the town reported a slight $23,000 operating deficit for fiscal 2018, which town officials attributed to the planned appropriation of available free cash to provide pay-as-you-go funding for one-time items. Merrimac partially offset the use of these funds with conservative revenue forecasting, which resulted in better-than-budgeted revenue collections (nearly $260,000 over budget) from local property and excise-tax receipts. At the same time, Merrimac reported lower-than-budgeted expenditures (approximately $195,000 under budget) due to the return of unexpended departmental appropriations from its general government and public safety departments at fiscal year-end.

Merrimac approved a balanced $16.83 million general fund budget for fiscal 2019. The budget accounted for a $720,000 increase in its capital program to support various one-time expenditures and nearly $432,000 for funding of other special articles. The town also planned for annual increases in education and public safety expenditures, as well as benefit costs. However, during the fiscal year, management identified cost savings across its other governmental departments. On a budgetary basis, management reports that local revenue performance aligned with the budget, and the town realized $290,000 expenditure savings that should generate a positive year-end result.

The adopted fiscal 2020 budget totals $16.5 million, reflecting a 2.1% expenditure decline, as Merrimac reduced its capital expenditures and other one-time budget items. Cost savings in these budget items were partially offset by a budgeted increase in general government, education, and employee benefits. Given Merrimac's recent history of, at least, balanced operations, revenue measures and tight control of expenditures to support increases in general fund operations, and the careful use of reserves for one-time needs, we anticipate budgetary performance will remain strong over our two-year outlook horizon.

Beyond the current fiscal year, one potential source of budgetary pressure for Massachusetts issuers continues to be rising pension and OPEB costs, as the town continues to pay down unfunded liabilities. Merrimac has responded to these future pressures through its planned transfers to its pension and OPEB trusts in its budget, and management does not expect a material change in these costs over the near term. However, we will continue to monitor the budget for potential pressures related to long-term liabilities. Should we see these costs escalate to a point of causing budgetary imbalance, we could modify our view of Merrimac's budgetary performance.

Very strong budgetary flexibility

Merrimac's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 18% of operating expenditures, or $2.7 million. In the two most recent fiscal years, Merrimac has appropriated some free cash or overlay surplus to limit increases provide fund various town special articles and one-time budget items. However, it has consistently reported better-than-budgeted performance that has often regenerated most of the town's appropriation of these funds in recent years.

The town's informal reserve target emphasizes maintaining an unassigned fund balance above 10% of general fund expenditures, a target the town has historically met and sustained. Based on management's expectation that Merrimac will return to positive operating performance in fiscal 2019, and produce at least balanced operations for fiscal 2020, we do not expect Merrimac's overall flexibility to deteriorate.

Very strong liquidity

In our opinion, Merrimac's liquidity is very strong, with total government available cash at 49.8% of total governmental fund expenditures and 17.7x governmental debt service in 2018. In our view, the town has satisfactory access to external liquidity if necessary. Merrimac's record of GO bond anticipation notes (BANs) within the past 20 years supports our view of its strong access to external liquidity. In addition, the town 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.

The town's bank holdings and investments are subject to strict state guidelines, and, where applicable, Merrimac invests cash in high-quality, low-risk assets with original maturities of one year or less, including the Massachusetts Municipal Depository Trust, money markets, and short-term certificates of deposit. For these reasons, the town'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, Merrimac's debt and contingent liability profile is strong. Total governmental fund debt service is 2.8% of total governmental fund expenditures, and net direct debt is 69% of total governmental fund revenue. Overall net debt is low at 2.5% of market value, which is in our view a positive credit factor. After the current bond issuance, Merrimac will have $13.9 million of total direct debt outstanding. At the same time, we adjusted for approximately $2.37 million of self-supported GO debt (by enterprise system revenue) out from our net direct debt calculations. Self-supported GO-related water, sewer, and electric system debt centers on three years of evidence that user charges have provided full coverage to support obligations outstanding. In addition, in our calculation of the town's overall net debt burden, we factor in Merrimac's proportionate share (about 35.1%) of overlapping debt related to the Pentucket Regional School District, which is nearly $8.1 million.

Although Merrimac is unlikely to issue new debt in the next five years, Pentucket Regional School District could issue approximately $42.2 million (currently authorized, but unissued) in additional debt over the medium term to finance the construction of a new regional high school in 2021 and 2022. Based on Merrimac's current proportionate share of the debt burden, the additional $14.8 million in overlapping debt attributable to the town could constrain our view of its debt profile.

Merrimac's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 6.8% of total governmental fund expenditures in 2018. Of that amount, 4.8% represented required contributions to pension obligations, and 2.0% represented OPEB payments. As it has done historically, Merrimac has made its full annual required pension contribution in 2018. Merrimac participates in the Essex Contributory Retirement System, a cost-sharing, multiemployer public employee retirement system. At June 30, 2018, its proportionate share of the reported pension liability of approximately $9.25 million (assuming a discount rate of 7.5%). The town contributed $806,000 to the system for fiscal 2018. In our view, the town's pension and OPEB liabilities will likely increase at a sustainable pace, but we acknowledge town officials have been proactively managing them. Merrimac contributed the full ADC in each of the past six fiscal years, and the pension system funding ratio increased to 55.4% in 2018 from 51% in 2016 (based on Governmental Accounting Standards Board Statement No. 68), even following changes to actuarial assumptions to reflect more conservative mortality and discount rates. The town expects the pension liability to be amortized by June 30, 2035.

The town also provides postemployment health care benefits for retired employees through a town-administered plan. At June 30, 2018, the town's total OPEB liability was $7.75 million, using a discount rate of 5.75%, which we view as conservative relative to the national trend. Merrimac has traditionally funded OPEB through pay-as-you-go financing, but the town established an OPEB trust fund to provide funding for future employee health care costs. At June 30, 2018, the trust's assets totaled $1.39 million, or 37.4% of the total liability ($3.75 million as of June 30, 2018). Based on its formal policies and recent commitment to prefunding these long-term liabilities, we generally expect these factors to support Merrimac's credit stability.

Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

Outlook

The stable outlook reflects our expectation that Merrimac will sustain good financial practices and policies that contribute to generally strong and predictable budgetary performance. It also represents our view that the town maintains sufficient capacity to adjust revenue and expenditures to mitigate downward pressure related to potential increases to its debt burden or growth in operations, which will likely support Merrimac's very strong liquidity and flexibility. The outlook also reflects our view of the town's overall strong underlying wealth and income levels, which will likely ensure credit stability. For these reasons, we do not expect to change the rating within our two-year outlook horizon.

Upside scenario

If Merrimac consistently achieves positive financial performance that supports sustained improvement in its reserves, while also growing and diversifying locally generated revenue base, and exhibiting improved wealth and income levels that are commensurate with those of higher-rated peers, we could raise the rating.

Downside scenario

We could lower the rating if the town were to experience a substantial weakening of budgetary performance, due to significant growth in debt service or operational cost burdens, leading to a material decline of available reserves or constrained liquidity.