Office of the City Manager
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Conor Baldwin
Chief Financial Officer

Heather Varney
Deputy CFO

MEMORANDUM

TO: Kevin J. Murphy, City Manager KJM

FROM: Conor Baldwin, Chief Financial Officer CB

CC: Rodney Conley, City Treasurer/ Collector

DATE: March 12, 2018

SUBJECT: Municipal Bond/ Note Sale

I am pleased to report that our office received extremely competitive bids from bond and note underwriters on Wednesday, March 12, 2018 for a $20.2 million, 20-year general obligation state qualified bond issue and a $700,839 88-day Bond Anticipation Note issue. Janney Montgomery Scott LLC was the winning bidder on the Bonds with an average net interest rate of 2.88%. Century Bank was the winning bidder on the Notes with a net interest cost of 1.55%. The City received a total of 5 bids on the Bonds and 2 bids on the Notes. Bond proceeds will be used to fund various critical municipal capital projects.

Those investments include several projects approved as part of the City Council's 2018 Capital Plan, as well as projects already approved, but recently completed. A list of the projects and approximate amounts included in the bond sale are included below, however, the list is not exhaustive.

- $8.6 million for Phase II of the Wastewater Utility's capital improvement plan, including sewer separation work and improvements to the Wastewater plant;
- $2.3 million for the city's and UML's share of the TIGER bridge repair project to finance design services;
- $1.3 million for city-wide paving and work on sidewalks/ curbs;
- $1.0 million for architectural/ engineering services in connection with the new garage in the Hamilton Canal Innovation District;
- $755,000 for the city's match to a grant to purchase fire apparatus and for heavy equipment/ vehicles for the snow fleet;
- $711,000 for building improvements to schools in the district;
- $700,000 for LED Streetlight conversion
- $550,000 for improvements to LeLacheur baseball stadium, including new lights and playing field;
- $563,000 for improvements to the South Common, including new lighting around the playing field;
- $350,000 for improvements to the Andover Street concrete roadway;
- $110,000 for improvements to the Pollard Memorial Library;

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Due to the size of the bond and the good credit rating of the city, a premium of nearly $2 million was received as part of the sale. On March 6th, the City Council unanimously voted to allow the finance department to take advantage of a newly available provision of Massachusetts General Law Chapter 44, §20, which allows municipalities to immediately apply premiums during a bond sale. After subtracting issuance costs, the net premium was applied to the capital projects and the amount of debt the city needed to issue was reduced by what the premium totals. By employing this financial strategy, the city was able to save approximately $600,000 in interest cost over the life of the bond.

Prior to the sale S&P Global Ratings, a municipal bond credit rating agency, affirmed the city's 'AA-' underlying bond rating with a 'stable' outlook. The rating agency cited the City's very strong financial management with strong financial policies and practices, strong budgetary performance, very strong liquidity, and strong institutional framework as positive credit factors.
The stable outlook on the underlying rating reflects S&P Global Ratings' opinion of Lowell's very strong liquidity and management. S&P remarked that the city's participation in the broad and diverse Boston MSA enhances rating stability and they expect the debt and contingent liability profile to remain at least adequate despite additional debt plans. Although they again expressed concern that the funded ratios of the pension and OPEB plans could pressure finances in the long term, they do not expect to change the rating downwards within the next two years due to our very strong assessment of management and management's ability to maintain at least adequate budgetary flexibility. However, all else being equal, they said they could raise the rating if management were to make progress in addressing Lowell's unfunded liabilities while building available reserves coupled with improved economic indicators.

S&P Global
Ratings

RatingsDirect®

Summary:

Lowell, Massachusetts; General Obligation; Non-School State Programs

Primary Credit Analyst:
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Table Of Contents

Summary:

Lowell, Massachusetts; General Obligation; Non-School State Programs

Credit Profile		
US$22.76 mil GO mun purp loan bonds ser 2018 due 03/01/2038		
Long Term Rating	AA-/Stable	New
Lowell GO		
Long Term Rating	AA-/Stable	Affirmed
Underlying Rating for Credit Program	AA-/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA-' long-term rating and stable outlook to Lowell, Mass.' series 2018 commonwealth-qualified general obligation (GO) bonds and affirmed its 'AA-' long-term rating and underlying rating (SPUR), with a stable outlook, on the city's existing GO debt.

The program rating reflects the bonds' eligibility under the commonwealth's Chapter 44A Qualified Bond Act, which we rate on par with the underlying rating of 'AA-' with a stable outlook. Massachusetts' Municipal Finance Oversight Board has authorized the city to issue bonds or notes, including this issuance, as commonwealth-qualified bonds.

The bonds are a full-faith-and-credit-GO ad valorem pledge of Lowell, subject to Proposition 2 1/2 limitations. We rate the limited-tax GO debt on par with our view of Lowell's general creditworthiness. The Massachusetts Qualified Bond Act provides additional bond security.

We understand officials intend to use series 2018 bond proceeds to fund various capital projects and permanently finance a portion of bond anticipation notes (BANs) outstanding.

The rating reflects our opinion of the city's:

- Adequate economy, with market value per capita of $68,746 and projected per capita effective buying income at 82.7% of the national level, that benefits from 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 an operating surplus in the general fund and a slight operating surplus at the total-governmental-fund level in fiscal 2017;
- Adequate budgetary flexibility, with an available fund balance in fiscal 2017 of 5.4% of operating expenditures;
- Very strong liquidity, with total government available cash at 16.3% of total-governmental-fund expenditures and 6.9x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt-and-contingent-liability position, with debt service carrying charges at 2.4% of expenditures and net

direct debt that is 21.2% of total-governmental-fund revenue, as well as low overall net debt at less than 3% of market value, but significant medium-term debt plans and a large pension and other-postemployment-benefit (OPEB) obligation and the lack of a plan to sufficiently address the obligation; and

- Strong institutional framework score.

Adequate economy

We consider Lowell's economy adequate. The city, with an estimated population of 111,486, is in Middlesex County in the Boston-Cambridge-Newton MSA, which we consider broad and diverse. The city has a projected per capita effective buying income of 82.7% of the national level and per capita market value of $68,746. Overall, market value has grown by 8.1% over the past year to $7.7 billion in fiscal 2018. The county unemployment rate was 3% in 2016.

Lowell's economy centers on education and health services but also benefits from manufacturing, trade, and professional services employment. Leading employers include Lowell General Hospital, U-Mass Lowell, and Kronos. Officials are looking to rebrand the city as an education hub by leveraging the presence of U-Mass Lowell and Middlesex Community College and making them part of the effort to revitalize the downtown area.

Lowell benefits from various developments, including the continued development of Ayer City Industrial Park--a 108-acre underused site a mile south of Lowell's central business district--and Hamilton Canal District, a 15-acre mixed-use area known for its now-defunct mill buildings, which is being converted into market-rate lofts and office space. Other developments include the Boott Mills redevelopment into a mixed-use residential and commercial space and the ongoing construction of a $175 million judicial center in the Hamilton Canal District that serves Middlesex Courts, as well as other development in the downtown area. Lowell is also undertaking various infrastructure projects to support many of these projects, including the expansion of Thorndike Street, which provides direct access to the downtown area from the Lowell Connector Highway.

The city's commercial sector continues to expand with new retail businesses moving into the city and several existing businesses expanding. Kronos, a cloud-based workforce-management software company, recently relocated and opened its new headquarters at the newly renovated Crosspoint site, bringing more than 1,600 jobs with 500 new jobs planned over the next five years.

Although we view these as positive developments in the local economy and we expect them to contribute to improving economic metrics over time, we do not expect to change our assessment of Lowell's economic strength within our two-year outlook period.

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.

Officials are conservative with revenue and expenditure assumptions, and they consider historical trends when developing the budget. Officials have the flexibility to amend the budget as needed, and management monitors performance regularly and makes monthly reports on budget-to-actual results to the city council. Management performs formal financial forecasting and maintains a five-year capital improvement plan it updates annually.

Management also maintains a formal reserve policy that requires reserves, including free cash and stabilization funds but excluding the commonwealth-mandated Chapter 17 special-stabilization fund, to remain 5%-10% of general operating revenue. Lowell also follows an internal investment policy and reports on investment holdings and earnings annually. Finally, the city maintains a debt policy that caps debt at 1.5% of total assessed value and debt service at 10% of general fund revenue.

Strong budgetary performance

Lowell's budgetary performance is strong, in our opinion. The city had surplus operating results in the general fund of 1.5% of expenditures and slight surplus results across all governmental funds of 1% of expenditures in fiscal 2017.

Fiscal 2017 results include adjustments for recurring transfers and one-time capital expenditures. Management attributes fiscal 2017 positive results to higher-than-budgeted revenue. In particular, local receipts came in more than $2 million overbudget, supported by a council-approved revised fee schedule fully implemented in fiscal 2017. The city also realized approximately $3 million in cost savings during the fiscal year across the budget, including public-safety, energy, and public-works expenditures.

The fiscal 2018 budget totals $385 million and does not include an appropriation from reserves. Officials indicate fiscal 2018 budget-to-actual results are tracking favorably with revenue currently exceeding the budget and expenditures remaining on target. The city currently expects to end fiscal 2018 with another general fund surplus. Property taxes account for 35% of general fund revenue and intergovernmental revenue accounts for 58%, which is made up of mostly education aid. State aid has increased modestly over the past three years by an average of 6.4% annually.

We note city officials introduced a performance-management initiative known as LowellStat in 2010 that tracks financial, personnel, and operational data. This initiative, now in its eighth year, has resulted in demonstrated cost savings and efficiency gains. We believe the level of detail, planning, and foreshadowing involved in this initiative will translate into stable operating performance. While we expect Lowell to maintain strong budgetary performance, rising future pension and OPEB costs could become a budgetary pressure due to below-average funding ratios and large long-term liabilities.

Adequate budgetary flexibility

Lowell's budgetary flexibility is adequate, in our view, with an available fund balance in fiscal 2017 of 5.4% of operating expenditures, or $19.7 million.

Management attributes increased reserves in fiscal 2017 to positive operations. We believe budget flexibility will likely remain unchanged over the next few fiscal years. We understand that officials do not currently plan to spend down reserves and that management currently adheres to policy levels that require maintaining reserves at 5%-10% of general fund operating revenue.

In addition, while not sufficient to warrant a higher budgetary-flexibility assessment, we note management maintains about $18.2 million in unused levy capacity it could use to accommodate budgetary growth. Currently, unused levy capacity represents about 4.7% of the budget. Lowell has been actively working to build unused levy capacity in anticipation of the new high school's construction.

Very strong liquidity

In our opinion, Lowell's liquidity is very strong, with total government available cash at 16.3% of total-governmental-fund expenditures and 6.9x governmental debt service in fiscal 2017. In our view, the city has strong access to external liquidity if necessary.

Lowell is a regular market participant that has issued bonds frequently over the past several years, including GO bonds and BANs. Lowell does not have any variable-rate or direct-purchase debt. We expect liquidity will likely remain very strong.

Adequate debt-and-contingent-liability profile

In our view, Lowell's debt-and-contingent-liability profile is adequate. Total-governmental-fund debt service is 2.4% of total-governmental-fund expenditures, and net direct debt is 21.2% of total-governmental-fund revenue. Overall net debt is low at 1.2% of market value, which is, in our view, a positive credit factor. Negatively affecting our view of the city's debt profile is its significant medium-term debt plans.

Lowell has about $247 million of total direct debt, $166 million of which is self-supporting enterprise debt. The city currently expects to issue about $34 million in new debt over the next two years to three years. It is also undergoing a feasibility study for the construction of a new high school. The city and commonwealth will split paying for the high school, which will be one of the largest high school projects in commonwealth history. Lowell's portion should be about $130 million, which it will fund with nonexcluded GO bonds. The city will tap its unused levy capacity to pay bond debt service.

In our opinion, Lowell's large pension and OPEB obligation, without a plan in place we think will sufficiently address the obligation, is a credit weakness. Lowell's combined required pension and actual OPEB contribution totaled 9.9% of total-governmental-fund expenditures in fiscal 2017. Of that amount, 5.5% represented required contributions to pension obligations and 4.3% represented OPEB payments. The city made its full annual required pension contribution in fiscal 2017. The funded ratio of the largest pension plan is 52.6%.

Lowell contributes to the Lowell Contributory Retirement System. Using updated reporting standards in accordance with Governmental Accounting Standards Board Statement Nos. 67 and 68, the city's proportionate share of the net pension liability was about $273.2 million with 53% funded at Dec. 31, 2016, based on an assumed rate of return of 7.75%. We believe this below-average funding ratio is likely due to numerous years of underfunding, aggressive assumptions, and weak market performance. Due to the funded ratio, we believe contributions will likely continue to rise over the next few fiscal years. While the city is currently managing these costs, we believe it has a limited ability to control future pension-liability growth. The city regularly funds the actuarially determined full contribution, and it expects to pay down the liability by fiscal 2036.

Lowell also provides OPEB to retirees. It has set up an OPEB trust to prefund the liability, which we view positively. The OPEB trust had a balance of $8.3 million as of fiscal 2017. As of the most recent actuarial valuation on July 1, 2016, the OPEB unfunded liability was $598 million. While the practice of prefunding the OPEB liability is positive, Lowell's large and growing pension and OPEB liabilities could pressure the budget.

Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

Outlook

The stable outlook reflects S&P Global Ratings' opinion of Lowell's very strong liquidity and management. We believe the city's participation in the broad and diverse Boston MSA enhances rating stability. Furthermore, we expect the debt-and-contingent-liability profile will likely remain, at least, adequate despite additional debt plans. Although we believe funded ratios of the pension and OPEB plans could pressure finances, we do not expect to change the rating within the next two years due to our very strong assessment of management and management's ability to maintain, at least, adequate budgetary flexibility.

Upside scenario

Beyond our two-year outlook period, with all else being equal, we could raise the rating if management were to make progress in addressing unfunded liabilities while building available reserves, coupled with improved economic indicators.

Downside scenario

We could lower the rating if budgetary performance were to become imbalanced, leading to draws on reserves.

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
- 2017 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of March 6, 2018)		
Lowell GO st qual mun purp loan bnds ser 2015 due 09/01/2035		
Long Term Rating	AA-/Stable	Affirmed
Underlying Rating for Credit Program	AA-/Stable	Affirmed
Lowell GO st qual rfdg bnds		
Long Term Rating	AA-/Stable	Affirmed
Underlying Rating for Credit Program	AA-/Stable	Affirmed
Lowell GO (AGM)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Lowell NONSCHSTPR		
Long Term Rating	AA-/Stable	Affirmed
Underlying Rating for Credit Program	AA-/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 the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.