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Conor Baldwin
Chief Financial Officer

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Deputy CFO

MEMORANDUM

TO: Eileen M. Donoghue, City Manager EMD

FROM: Conor Baldwin, Chief Financial Officer

CC: Allison Chambers, Deputy CFO

DATE: October 1, 2020

SUBJECT: INFORMATIONAL - Refunding Bonds – Budgetary Savings

The City received competitive bids from bond underwriters on Thursday, September 10, 2020, for a $59,945,000 29-year general obligation state qualified bond issue. Citigroup Global Markets Inc. was the winning bidder on the Bonds with an average net interest rate of 1.898%. The City received a total of 5 bids on the Bonds. Both the level of competition and the low interest rate are testament to the city's credit worthiness and vindication of the financial policies adopted by the City Council.

As part of the sale, the city also refinanced bonds currently outstanding, which were originally issued on September 15, 2010. The refinancing will generate total net savings of $824,019 through the remaining life of the bonds refunded. Bond proceeds will be used to fund various municipal capital projects, including $5.3 million in school building improvements and equipment purchases for the school department, as well as $16 million to finance a component of the local share of the Lowell High School project. Other purposes financed from the bond proceeds include the replacement of the field turf at Cawley Stadium, the Concord River Greenway project, and the Hamilton Canal Innovation District garage construction. Infrastructure projects like traffic signalization, paving for roads and sidewalks, bridge repairs, and various accessibility improvements, city-wide, comprised the remaining amounts of the bonds.

Prior to the sale, S&P Global Ratings, a municipal bond credit rating agency, affirmed the City's 'AA-' underlying bond rating. The rating agency cited the City's very strong management with strong financial policies and practices, very strong liquidity, and strong institutional framework as positive credit factors. Furthermore, S&P Global Ratings assigned the 'AA' enhanced rating to the Bonds as debt service is secured by the State Qualified Bond Act local state aid intercept program. A copy of the credit report from S&P is enclosed for your reference.

During these difficult budgetary times, these savings are critical and will provide some much needed flexibility. Please let me know if you have any questions.

S&P Global
Ratings

RatingsDirect®

Summary:

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

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Summary:

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

Credit Profile		
US$60.675 mil GO st qual mun purp loan ser 2020 due 09/01/2050		
Long Term Rating	AA/Stable	New
Underlying Rating for Credit Program	AA-/Stable	New
Lowell GO st qual mun purp loan ser 2020 due 09/01/2050		
Long Term Rating	AA/Stable	Rating Assigned
Underlying Rating for Credit Program	AA-/Stable	Rating Assigned

Rating Action

S&P Global Ratings assigned its 'AA' long-term rating and 'AA-' underlying rating to Lowell, Mass.' series 2020 state qualified municipal purpose general obligation (GO) bonds. At the same time, we affirmed our 'AA' long-term rating and 'AA-' underlying rating on the city's existing GO debt as well as our 'SP-1+' short- term rating on the city's existing bond anticipation notes (BANs). The outlook, where applicable, is stable.

The city's full-faith-and-credit pledge, subject to limitations of Proposition 2 1/2, secures the bonds and BANs outstanding. We rate the limited-tax GO debt on par with our view of the city's general creditworthiness, given that we factor Lowell's revenue-raising flexibility and ability to pay debt service into our view of its general creditworthiness. In addition, this issue, along with certain other long-term issues are enhanced by the Massachusetts Qualified Bond Program. We base the 'AA' long-term rating on the bonds' eligibility under the Commonwealth's Chapter 44A Qualified Bond Act. The Massachusetts' Municipal Finance Oversight Board has authorized the city to issue bonds or notes as commonwealth-qualified bonds. Under the Qualified Bond Act, the state treasurer pays debt service directly to the paying agent and withholds the amount of the payment from the borrower's annual state aid appropriation, which it receives on a monthly basis. The program is rated on par with Massachusetts' GO debt, and will move in tandem with the GO rating.

The short-term rating reflects our view of Lowell's very strong capacity to pay principal and interest when the BANs come due. The city maintains a low market-risk profile with strong legal authority to issue long-term debt to take out the BANs, and it is a frequent debt issuer that regularly provides ongoing disclosure to market participants.

We understand proceeds from this issue will be used to finance various city capital projects as well as refund the city's existing BANs and series 2010 GO municipal purpose loans in the amount of $7.485 million.

Credit overview

The city serves as a gateway city and remains the economic hub of its respective metropolitan statistical area (MSA). Lowell's economy centers on education and health services but also benefits from manufacturing, trade, and professional services employment; providing stability to the area. Historically very strong liquidity, strong budgetary performance and adequate reserves have supported the rating, with rising pension and OBEB contributions remaining a concern; similar to other Massachusetts localities. While the scope of economic and financial challenges posed by the COVID-19 pandemic remains unknown, we believe a prolonged disruption could weaken the city's local economy and affect revenues received from the state. (For more information, see "The U.S. Faces a Longer and Slower Climb from the Bottom" published June 25, 2020, on RatingsDirect). However, due to its strong management conditions and historically conservative budgeting practices, we expect management will make the necessary budgetary adjustments to maintain balanced operations. Although we think retirement liabilities and costs could pressure the budget over the long term, we do not believe they pose an immediate budgetary pressure. We do not expect to change the rating within the outlook period.

In our opinion, the rating reflects the city's:

- Adequate 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 a slight operating surplus in the general fund and break-even operating results at the total governmental fund level in fiscal 2019;
- Adequate budgetary flexibility, with an available fund balance in fiscal 2019 of 5.9% of operating expenditures;
- Very strong liquidity, with total government available cash at 14.8% of total governmental fund expenditures and 7.0x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges at 2.1% of expenditures and net direct debt that is 45.0% 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 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 indirect risks posed by the COVID-19 pandemic. Absent the implications of COVID-19, we consider the city's social risks in line with those of the sector. We view the city's governance risks as being generally in line with those of peers, although pension funding discipline and assumption choices will likely lead to elevated costs for the county. In addition, given Lowell's location along the Merrimack River, flooding has occurred in certain sections of the city. However, we do not believe these infrequent occurrences pose an abnormal near-term risk for the community. We view environmental risks as being generally in line with the sector standard.

Stable Outlook

Upward scenario

Although unlikely in the near term, we could raise the rating if the city's economic metrics and reserve levels improved and stabilized, more in-line with higher rated peers coupled with an improved funded ratio for its large pension and OPEB liabilities.

Downward scenario

Conversely, we could lower the rating if the city draws on its fund balance without replenishing funds used in a timely manner, and if rising fixed costs associated with debt, pension, and OPEB costs lead to sustained budgetary imbalance.

Credit Opinion

Adequate economy

We consider Lowell's economy adequate. The city, with an estimated population of 112,151, is located in Middlesex County in the Boston-Cambridge-Newton, Ma.-N.H. MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 77.9% of the national level and per capita market value of $80,635. The county unemployment rate was 2.3% in 2019.

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 in 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. The city's economic development success translates to over $150 million in private investment in the past 15 years stemming from the city's economic development incentive program and over $4.6 million in investment in 46 downtown retail establishments through the city's partnership with the Lowell Development and Financial Corporation.

Management has reported that none of the projects, which are in various stages of planning or construction have been postponed or cancelled as a result of the COVID-19 pandemic. In fact, several of the larger projects may be completed earlier than scheduled as a result of decreased traffic and additional available laborers. However, we believe new economic growth is likely to be pressured should the recession persist. S&P Global Economics currently forecasts a recessionary period lasting six-to-12 months.

Although we currently view these as positive developments in the local economy and expect them to contribute to improving economic metrics over time, we do not expect to change our assessment of Lowell's economic strength over the near term.

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. They 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 excludes the commonwealth-mandated Chapter 17 special-stabilization fund, to remain at 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.

In addition, in September 2018, the city developed and adopted an OPEB policy to address the financial challenge. The policy goals will be achieved by building a dedicated appropriation into the budget, beginning in fiscal year 2020 and dedicating 10% of the annual certified free cash total to the OPEB trust. When the city fully funds its pension liability in approximately fiscal year 2036, the surplus available funding will be redirected toward OPEB in its entirety.

Lastly, the city maintains a Computer Use Policy, which was adopted in 2018. The policy is intended to ensure that the technology resources made available to employees are utilized in an appropriate and responsible manner.

Adequate budgetary performance

Lowell's budgetary performance is adequate in our opinion. The city had slight surplus operating results in the general fund of 1.3% of expenditures, and balanced results across all governmental funds of 0.5% in fiscal 2019.

Strong management and historically conservative budgeting practices have allowed the city to maintain stable financial operations. While we believe the city will likely face near-term fiscal pressures and revenue reductions related to the COVID-19 pandemic, we also believe it will take the necessary and substantive steps to maintain structural balance over the near term.

Budgetary performance metrics include adjustments for recurring transfers. After adjustments, the city closed with a $4.8 million surplus, primarily attributed to unexpended appropriations and snow removal savings; bringing available reserves to $22.0 million or 5.9% of expenditures. Free cash increased to a high of $7.46 million, but is expected to be reduced for fiscal 2020 to historical levels. Property taxes account for 35% of general fund revenues with intergovernmental revenue (mostly education aid) accounting for 58%.

Despite concerns for revenue reductions as a result of the pandemic, management estimates fiscal 2020 to close with positive results of roughly $2.7 million, as certain revenues are trending above budget such as building permits and local option excise tax for marijuana, while expenditures are below budget, directly related to expenditure controls. Free cash is expected to decrease, falling to historical levels while the stabilization fund is expected to remain flat, as it was not needed to close the fiscal year. Undesignated general fund balance is estimated at $19.0 million; just slightly higher than the previous year. The city made its first contribution to the OPEB Trust in the amount of $250,000.

Although the state has recently committed to level fund for Unrestricted General Government Aid (UGGA) and Chapter 70 education aid, the city has been working off a one-month contingency budget, the full budget will be presented to council in September. In doing so, this has allowed them to better prepare and adopt a more realistic fiscal 2021 budget. Potential revenue reductions in local taxes remain a concern; however, the city hopes to remedy any imbalances through ongoing cost control measures, early retirements or lastly, the use of reserves. We understand further reductions have been made for permits, penalties and interest, motor vehicle excise tax, hotel tax and recreation costs in the fiscal 2021 budget; ensuring continued conservative budgeting practices. In addition, the city's stabilization fund totals $11.8 million coupled with an unused levy capacity of $20.57 million; which could be used to offset any significant revenue shortfalls. The city has utilized the special legislation to amortize COVID-19 expenses, which to date are estimated at $644,000, over three years. Furthermore, federal aid, if received, could aid in maintaining budgetary balance.

Officials introduced a performance-management initiative known as LowellStat in 2010 that tracks financial, personnel, and operational data. This initiative, now in its 11th 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. Furthermore, the city received a state grant for a feasibility study to address weather-related issues. The study is expected to be completed in the coming month. Once received the city will determine how to proceed in addressing future concerns. Although the effects from COVID-19 remain unknown, we believe the city will continue to work toward maintaining fiscal stability. Over the near term, we believe the city's budgetary performance score will likely shift between strong and adequate as it manages through the recessionary effects caused by the pandemic coupled with rising pension costs amid below-average funded levels. We believe careful cost controls and monitoring will be important to ensure budgetary operations remain balanced.

Adequate budgetary flexibility

Lowell's budgetary flexibility is adequate, in our view, with an available fund balance in fiscal 2019 of 5.9% of operating expenditures, or $22.0 million.

Following the surplus for fiscal 2019 and the projection for positive results in fiscal 2020, and despite the effects of COVID-19, we believe the city's available fund balance reserves will remain adequate. We believe that in the wake of the COVID-19 pandemic, city management, guided by several formal fiscal policies, including the formal reserve policy that requires maintaining reserves at 5%-10% of general fund operating revenues, will take the necessary steps to maintain adequate reserves, at least, over the near term.

In addition, management maintains about $20.6 million in unused levy capacity it could use to accommodate budgetary growth. Currently, this capacity represents about 5.0% 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 14.8% of total governmental fund expenditures and 7.0x governmental debt service in 2019. 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. It does not have any variable-rate or direct-purchase debt, nor hold any aggressive investments. With positive projections for fiscal 2020 and already very strong liquidity position, we do not expect the city's liquidity position to weaken. Furthermore, management does not plan to issue any TANs (tax anticipation notes) or RANs (revenue anticipation notes) to offset any potential liquidity concerns.

Adequate debt and contingent liability profile

In our view, Lowell's debt and contingent liability profile is adequate. Total governmental fund debt service is 2.1% of total governmental fund expenditures, and net direct debt is 45.0% of total governmental fund revenue. Overall net debt is low at 2.3% of market value, which is in our view a positive credit factor.

Lowell has about $318 million of total direct debt, $121 million of which is self-supporting enterprise debt. The city currently expects to issue roughly $100.0 million of additional GO debt over the next four years to finance a portion of the new high school as well as for water and sewer projects and other city capital needs. The Lowell High School project (a new high school), the largest high school project in Massachusetts's history has an expected completion date set for the fall of 2026. The project, now in the final design stage, has construction slated to begin in the fall of 2020. The city and commonwealth will share the cost of the high school; with the city paying 20% of the cost. Lowell's portion should be about $70 million (net of reimbursement of approximately 80% from the Massachusetts School Building Authority), which it will fund with non-excluded GO bonds. The city plans to tap its unused levy capacity to pay bond debt service.

Following a recent BAN issuance, principal amortization is now less than 65% in 10 years; and as per our criteria, is no longer seen as a positive credit factor. We believe that the city's debt and liability score could further weaken depending on how and when they issue the debt for the high school.

In our opinion, a credit weakness is Lowell's large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation. Lowell's combined required pension and actual OPEB contributions totaled 10.7% of total governmental fund expenditures in 2019. Of that amount, 6.3% represented required contributions to pension obligations, and 4.4% represented OPEB payments. The city made its full annual required pension contribution in 2019. The funded ratio of the largest pension plan is 55.4%.

In our opinion, a credit weakness is Lowell's large pension and OPEB obligation, without a plan in place that we think will sufficiently address it. We believe the low pension funded ratio, permissive assumptions, and large OPEB liability, collectively, result in a liability profile that will likely pressure the operating budget, particularly if assumptions are not met.

While the use of an actuarially determined contribution (ADC) is a positive, we believe some of the assumptions used to build the pension ADC reflect what we view as slightly weak assumptions and methodologies, which we believe increases the risk of unexpected contribution escalations.

Although the city began prefunding its OPEB liability, annual costs are paid on a pay-as-you-go basis, which, due to claims volatility and medical-cost and demographic trends, is likely to lead to escalating costs.

As of June 30, 2019, the city participated in the following plans:

- Lowell Contributory Retirement System, using a 7.65% discount rate, as of Dec. 31, 2018. The city's unfunded liability was about $296.3 million with a funded ratio of 55.4%.

In our opinion, a credit weakness is Lowell's large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation. Lowell's combined required pension and actual OPEB contributions totaled 10.7% of total governmental fund expenditures in 2019. Of that amount, 6.3% represented required contributions to pension obligations, and 4.4% represented OPEB payments. The city made its full annual required pension contribution in 2019. The funded ratio of the largest pension plan is 55.4%.

We generally view higher discount rates negatively because they include increased market volatility within contributions. Higher discount rates correspond to riskier investments that could lead to weaker funded ratios and increasing contributions for the city, potentially stressing its budgetary balance. The city is amortizing its unfunded liability with the intention to be fully funded in 2036. We view the plan's amortization method of an increasing dollar amount at 4% as a negative credit factor since the unfunded liability will increase in the near term, as costs are deferred into the future. While we view the city's commitment to funding its ADC and paying down its unfunded liability as positive steps to address its long-term liability, we believe underlying plan assumptions and amortization methods leave Lowell exposed to increasing and potentially volatile contributions.

Lowell also provides OPEBs to retirees. It has set up an OPEB trust to prefund the liability, which we view positively. The OPEB trust had a balance of $9.3 million as of fiscal 2019. As of the most recent actuarial valuation on June 30, 2019, the OPEB unfunded liability was $697.5 million. While the practice of prefunding the OPEB liability is positive, Lowell's large and growing pension and OPEB liabilities could pressure the budget. In September 2018, the city developed and adopted an OPEB policy to address the financial challenge; a credit strength in our opinion.

Strong institutional framework

The institutional framework score is strong.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 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

Ratings Detail (As Of August 20, 2020)

Ratings Detail (As Of August 20, 2020) (cont.)		
Lowell GO		
Long Term Rating	AA/Stable	Affirmed
Unenhanced Rating	NR(SPUR)	
Underlying Rating for Credit Program	AA-/Stable	Affirmed
Lowell GO mun purp loan bonds ser 2018 due 03/01/2038		
Long Term Rating	AA-/Stable	Affirmed
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 BANs dtd 06/19/2020 due 09/25/2020		
Short Term Rating	SP-1+	Affirmed
Lowell NONSCHSTPR		
Long Term Rating	AA/Stable	Affirmed
Underlying Rating for Credit Program	AA-/Stable	Affirmed

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.