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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: September 20, 2021

SUBJECT: INFORMATIONAL - Refunding Bonds – Budgetary Savings

The City received competitive bids from bond underwriters on Wednesday, September 15, 2021, for a $39,265,000, 30-year general obligation state qualified bond issue. Bank of America Securities was the winning bidder on the Bonds with an average net interest rate of 2.028%. The City received a total of 8 bids on the Bonds. Bond proceeds will be used to fund various municipal capital projects and will refinance bonds of the City originally issued September 15, 2011. The low interest rate and strong credit rating are a reflection of the city's strong financial management.

The refunding bonds will generate total net savings of $412,002 to the budget, through the remaining life of the bonds refunded. 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. Additionally, the finance department was able to use the excess premium received in connection with the sale to reduce the par amount of the various purposes, thereby saving approximately $2.6 million in avoided future debt service costs to the city's budget.

Bond proceeds will be used to fund several ongoing capital projects such as the Lord Overpass construction, city-wide paving, park improvements, as well as $21.2 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 include approximately $7.3 million in sewer improvements, $1.9 million in design and engineering services for water system improvements, both of which are self-supported by user fees in the water and sewer enterprise funds.

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 budgetary performance 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.

Please let me know if you have any questions.

S&P Global
Ratings

RatingsDirect®

Summary:

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

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Summary:

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

Credit Profile		
US$38.905 mil GO st qual mun purp loan of 2021 bnds due 09/01/2051		
Long Term Rating	AA/Stable	New
Underlying Rating for Credit Program	AA-/Stable	New
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

Rating Action

S&P Global Ratings assigned its 'AA' long-term rating and 'AA-' underlying rating to Lowell, Mass.' series 2021 state qualified municipal-purpose general obligation (GO) bonds. At the same time, we affirmed our 'AA-' underlying rating on the city's existing GO debt. 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. 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 our '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.

We understand proceeds from this issue will refund various bonds anticipation notes outstanding as well as provide new money towards the city's high school construction. A portion of the proceeds will also refund the city's 2011 GO bonds for interest savings.

Credit overview

Lowell serves as a gateway city and remains the economic hub of its respective metropolitan statistical area (MSA). Its 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 other postemployment benefit (OPEB) contributions remaining a long-term challenge like for other Massachusetts localities.

Due to its strong management conditions and historically conservative budgeting practices, we expect management will continue to make the necessary budgetary adjustments to maintain balanced operations. At the onset of the pandemic, Lowell was conservative in its budgetary estimates for fiscal 2021. As a result, the city is projecting a sizable general fund surplus which will substantially improve reserve levels, but it has not established any plans or policies on how it plan to use it. Although we think retirement liabilities and costs could pressure the budget over the long term, we do not believe they pose an immediate credit risk, particularly with good management practices and budgetary framework, and with the prospect of improving reserves.

Key rating factors include 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;
- Strong budgetary performance, with balanced operating results in the general fund but break-even operating results at the total governmental fund level in fiscal 2020;
- Adequate budgetary flexibility, with an available fund balance in fiscal 2020 of 5.7% of operating expenditures;
- Very strong liquidity, with total government available cash at 18.6% of total governmental fund expenditures and 5.7x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability profile, with debt service carrying charges at 3.3% of expenditures and net direct debt that is 56.0% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value, but a large pension and OPEB obligation and the lack of a plan to sufficiently address it; and
- Strong institutional framework score.

Environmental, social, and governance factors

We view Lowell'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 city, which could influence governance factors over time. In addition, given its location along the Merrimack River, flooding has occurred in certain sections, slightly elevating the city's environmental risks. However, we do not believe these infrequent occurrences pose an abnormal near-term credit risk for the community. The city remains very active in resiliency planning and continually invests in infrastructure improvements to mitigate climate-related concerns. We view social risks as being generally in line with the sector standard.

Stable Outlook

Upward scenario

Over time, we could raise the rating if Lowell's economy continues to grow and diversify, and if reserve levels improve and the city is able to sustain them at very high levels, which, in our view, will help it manage growing debt, pension, and OPEB costs.

Downward scenario

Conversely, we could lower the rating if the city draws on its fund balance to weak levels without a plan to replenish. A weaker reserve position limits its ability to maintain structural alignment over economic cycles and elevates the credit risks posed by rising fixed costs related to debt, pension, and OPEBs.

Credit Opinion

Adequate economy

The city, with a population of 112,711, is in Middlesex County in the Boston-Cambridge-Newton MSA, which we consider to be broad and diverse. It has a projected per capita effective buying income of 77.6% of the national level and per capita market value of $83,875. Overall, market value grew by 4.5% over the past year to $9.5 billion in 2021.

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 (a cloud-based workforce management software company). 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.

Management reports no effects from the pandemic on its economic development projects, which are in various stages of planning or construction. The city's commercial sector continues to realize growth with new retail businesses moving in and several existing businesses expanding. Kronos relocated and opened its new headquarters at the newly renovated Crosspoint site, bringing more than 1,600 jobs with 500 more planned over the few years. The city's economic development success translates to over $150 million in private investment in the past 15 years stemming from its economic development incentive program through its partnership with the Lowell Development and Financial Corp.

Lowell benefits from various developments, including the continued development of Ayer City Industrial Park, a 108-acre underused site a mile south of the 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 recent construction of a judicial center in the Hamilton Canal District that serves Middlesex Courts, as well as other development in the downtown area.

The county unemployment rate was 7.3% in 2020, increasing because of the stay-at-home orders during the pandemic. Unemployment remains above its average, but we note it has come down over the past few months as the economic recovery has taken hold. Strengthening of the macroeconomic environment is likely to also support continued growth in the tax base. For more information on S&P Global Ratings' economic view, see "Economic Outlook U.S. Q3 2021: Sun, Sun, Sun, Here It Comes," published June 24, 2021, on RatingsDirect.

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. It 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 OPEBs 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 used in an appropriate and responsible manner.

Strong budgetary performance

The city had balanced operating results in the general fund of 0.2% of expenditures, but a break-even result across all governmental funds in fiscal 2020. General fund operating results have been stable, at 1.3% in 2019 and negative 0.9% in 2018. Despite early concerns for revenue reductions because of the pandemic, management estimates fiscal 2021 to close with very strong operating results. The city currently estimates a general fund surplus upward of $46 million, or roughly 8% of general fund expenditures. The robust operating result stemmed from the support of stimulus funds, which the city used in certain situations to support the budget.

Strong management and historically conservative budgeting practices have allowed the city to maintain stable financial operations. While we believe it will likely continue to face near-term financial pressures related to the pandemic, we also believe it will take the necessary and substantive steps to maintain structural balance over the near term as it did in fiscal 2021.

The 2022 budget totals $464.1 million, with increases spread through several departments. As noted, throughout the pandemic, Lowell has done well implementing several cost-saving initiatives and managing discretionary spending and staffing levels. Currently, budgetary results for fiscal 2022 are in line with estimates, and with level funding of state aid, we believe maintenance of strong budgetary performance is likely. Moreover, the city is benefiting from upward of $76 million in direct American Rescue Plan (ARP) funds, and the school district is also benefiting from Elementary and Secondary School Emergency Relief (ESSER) stimulus funds, which we believe will support steady operating performance across all its major departments. Notably, pensions, OPEBs, and other fixed costs, while currently manageable, could pose future budgetary pressure and is a risk we continually monitor.

Adequate budgetary flexibility

Lowell's budgetary flexibility is adequate, in our view, with an available fund balance in fiscal 2020 of 5.7% of operating expenditures, or $23.2 million. The city is projecting to substantially increase this balance, so our assessment will likely improve once it demonstrates its ability to sustain these balances at the stronger level.

Prior to the pandemic, guiding management was a formal reserve policy requiring reserves between 5%-10% of general fund operating revenues. The policy requires steps to replenish reserves if they fall below policy targets.

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

Lowell's liquidity is very strong, with total government available cash at 18.6% of total governmental fund expenditures and 5.7x governmental debt service in 2020. 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 does it hold any aggressive investments.

Adequate debt and contingent liability profile

In our view, Lowell's debt and contingent liability profile is adequate. Total governmental fund debt service is 3.3% of total governmental fund expenditures, and net direct debt is 56.0% of total governmental fund revenue. Overall net debt is low at 2.8% of market value, which is, in our view, a positive credit factor.

Lowell has about $333 million of total direct debt. A portion of the city's direct debt is self-supporting enterprise debt. The city currently expects to issue 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 has an expected completion date set for fall 2026. 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 nonexcluded GO bonds. The city plans to tap its unused levy capacity to support debt service on the project.

Pension and OPEB highlights:

- 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, 2020, the city participated in the following plans:

- Lowell Contributory Retirement System, using a 7.65% discount rate, as of Dec. 31, 2020. The city's unfunded liability was about $252.8 million with a funded ratio of 61.2%.

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. The city's combined required pension and actual OPEB contributions totaled 9.9% of total governmental fund expenditures in 2020. Of that amount, 5.9% represented required contributions to pension obligations, and 4.0% represented OPEB payments. The city made its full required pension contribution in 2020.

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. Lowell 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 $10.6 million as of fiscal 2020. As of the most recent actuarial valuation on June 30, 2020, the net OPEB liability was $835.8 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 for Massachusetts municipalities is strong.

Related Research

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

Ratings Detail (As Of September 10, 2021)		
Lowell GO st qual mun purp loan ser 2020 due 09/01/2050		
Long Term Rating	AA/Stable	Affirmed
Underlying Rating for Credit Program	AA-/Stable	Affirmed

Ratings Detail (As Of September 10, 2021) (cont.)		
Lowell GO st qual rfdg bnds		
Long Term Rating	AA/Stable	Affirmed
Underlying Rating for Credit Program	AA-/Stable	Affirmed
Lowell NONSCHSTPR		
Long Term Rating	AA/Stable	Affirmed
Underlying Rating for Credit Program	AA-/Stable	Affirmed

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