

RatingsDirect®

Summary:

Groton, Massachusetts; General Obligation

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Credit Profile

US\$6.25 mil GO muni purpose loan of 2020 bnds dtd 02/20/2020 due 02/15/2041

<i>Long Term Rating</i>	AAA/Stable	New
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Groton Twn GO

<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed
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Rationale

S&P Global Ratings assigned its 'AAA' long-term rating to Groton, Mass.' series 2020 general obligation (GO) municipal-purpose loan bonds. At the same time, we affirmed our 'AAA' rating on the town's outstanding GO debt. The outlook is stable.

Security and use of proceeds

The town's full-faith-and-credit pledge, subject to limitations of Proposition 2-1/2, secures the series 2018 GO bonds. While the town voted to exempt a portion of the 2020 bonds from Proposition 2-1/2 levy limitations, we have not made a rating distinction between the town's limited-tax GO pledge and its general creditworthiness. Despite limitations imposed by the commonwealth levy limit law on a portion of the bonds, the tax limitation imposed on the town's ability to raise revenue and the fungibility of those resources are already embedded in our analysis of its financial and economic conditions.

Groton's GO debt is eligible to be rated above the sovereign because we believe the town can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria, titled "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions" (published Nov. 19, 2013, on RatingsDirect), Groton has a predominantly locally derived revenue source, with approximately 86% of general fund revenue coming from property taxes. The town also has independent taxing authority and independent treasury management from the federal government.

We understand that officials intend to use proceeds from the bonds to fund a public works facility, a library roof, and a fire engine.

Credit overview

Groton's comprehensive budget development process and emphasis on long-term capital and financial planning result in consistent financial performance. The primarily residential town is seeing continued appreciation in its tax base, along with material new commercial development. We believe its pension and other postemployment benefit (OPEB) costs could pressure the budget over the long term, along with significant debt plans for a new elementary school. However, we currently expect management to incorporate these rising costs into the budget, without pressuring reserves or liquidity.

The long-term rating further reflects the following factors for the town:

- 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 a slight operating deficit in the general fund but a slight operating surplus at the total governmental fund level in fiscal 2019;
- Strong budgetary flexibility, with an available fund balance in fiscal 2019 of 11.7% of operating expenditures;
- Very strong liquidity, with total government available cash at 20.3% of total governmental fund expenditures and 5.0x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability position, with debt service carrying charges at 4.1% of expenditures and net direct debt that is 54.4% 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
- Strong institutional framework score.

Very strong economy

We consider Groton's economy very strong. The town, with a population of 11,644, is a primarily residential community approximately 18 miles west of Lowell and 42 miles northwest of Boston in Middlesex County. It is in the Boston-Cambridge-Newton MSA, which we consider to be broad and diverse. The town has a projected per capita effective buying income of 182% of the national level and per capita market value of \$166,639. Overall, market value grew by 8.6% over the past year to \$1.9 billion in 2020. The county unemployment rate was 2.7% in 2018.

While many residents commute to nearby regional employment centers, including Lowell and Boston, as well as southern New Hampshire, management reports ongoing residential and commercial development in Groton itself. The local economic base features employers in government, health care, education, business and commercial services, and commercial retail.

Residential property makes up about 94% of total assessed value (AV), while commercial and industrial combined account for about 4.5% of total taxable AV. The town continues to see growth in total AV, reaching \$1.94 billion in 2020, a 16.3% increase from 2018. While the AV growth primarily reflected the 16.5% growth in the residential value over the same period, management notes several commercial properties are helping generate additional revenues. Notably, the Groton Inn--a historic hotel that was closed following a fire in 2011--underwent redevelopment into a hotel and restaurant and become one of the leading employers and taxpayers. The Inn is looking to expand and is generating growth in the local room occupancy tax. Additionally, a local non-profit is constructing a 2,500-set concert arena, which management reports is generating additional commercial development interest.

Due to Groton's stable and primarily residential tax base, in conjunction with new development and access to the broad and diverse Boston MSA, we expect the economy to remain very strong through the two-year outlook period.

Very strong management

We view the town'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.

Key budget development and monitoring practices are set forth in the town charter. Groton's financial management team uses three years of historical data to build annual revenue and expenditure assumptions. In preparation of its annual budget, management works alongside department managers to review annual operation requests and prioritize operating expenditures. Finance officials closely monitor tax base growth to estimate changes in local tax revenue and the tax rate. During each fiscal year, Groton monitors the budget regularly, reporting budget-to-actual results to the board of finance and Board of Selectmen quarterly. Furthermore, it maintains a formal investment policy that adheres to state statutes governing investments and officials report earnings and holdings quarterly.

In accordance with its town charter, Groton also maintains a strong focus on long-term capital planning, evidenced by a five-year capital improvement plan (CIP) that identifies projects and costs across all departments. The town updates its CIP annually and details pay-as-you-go funding and bond financing of all capital projects. Groton also develops a comprehensive five-year financial forecast in its budget development process, which features a sensitivity analysis of key revenue and expenditure assumptions, which allows the town to manage decisions and changes related to future operations, capital projects, and debt service.

Furthermore, management has historically met and sustained reserves in accordance with its fund balance policy. The formal policy calls for its general fund stabilization balance to be maintained at a minimum of 5% of annual operating expenditures. The policy indicates that this minimum reserve target assists with managing cash flows in the event of a revenue shortfall and unexpected changes in expenditures. The town also adopted a formal debt management policy that sets forth guidelines for issuing debt and measurable debt affordability benchmarks. The policy limits annual debt service to 5% or less of operating expenditures.

Strong budgetary performance

Groton's budgetary performance is strong, in our opinion. The town had slight deficit operating results in the general fund of negative 0.8% of expenditures, but a slight surplus result across all governmental funds of 0.7% in fiscal 2019.

We adjusted budgetary performance to account for transfers into and out of the general fund, a one-time expenditure for a capital design study, and the expenditure of bond proceeds. Entering fiscal 2019, the town wanted to reduce excess undesignated reserves in the general fund. The approximately \$593,000 drawdown in the general fund on a GAAP basis was primarily due to a \$296,000 capital project design expenditure and a \$504,000 bond anticipation note (BAN) principal payment. Following adjustments, we view the town's general and total governmental performance as approximately break-even.

We expect Groton to maintain strong budgetary performance over the next several years, largely due to its comprehensive budgeting development and monitoring framework, coupled with its manageable expenditure and fixed-cost profile. Furthermore, the town benefits from an overall stable and strong revenue profile, with local property taxes accounting for 86% of general fund audited revenues in 2019. Excise taxes were about 5%, and intergovernmental aid was 3%.

Fiscal 2020 budgeted expenditures total \$41.9 million, a 4.6% increase from 2019. The 2020 budget includes improved fire department coverage, which management notes is resulting in an increase in ambulance receipts alongside the higher expenditure. At the midpoint of the year, management is forecasting year-end results similar to 2019. The 2021 budget process is underway, with management having submitted its initial budget to the board. Of particular note, the

school district is facing increased special education costs, which are likely to increase the town's assessment. Despite increasing costs, we believe Groton will maintain strong performance over our two-year outlook period.

Strong budgetary flexibility

Groton's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2019 of 11.7% of operating expenditures, or \$4.4 million.

The town's available reserves grew to 14.3% of adjusted general fund expenditures in 2017, or about \$4.96 million. Available reserves declined to 12.8% (\$4.6 million) at the end of 2018, and to 11.7% (\$4.4 million) at the close of 2019. The town actively shifted unassigned general fund reserves to committed, to set aside funds for the school district's capital stabilization fund, essentially prefunding increased district assessments. We do not anticipate reserves materially changing over the next few years.

In accordance with its town charter, its formal reserve policy stipulates that the town maintain a general fund stabilization reserve minimum of at least 5% of current-year operating expenditures. Although we do not incorporate additional reserves into our calculation of the town's flexibility, we note that Groton maintains a municipal capital stabilization reserve at 1.5% of the current town budget and an excess and deficiency (E&D) reserve fund minimum of 1% of the current town budget. Groton has historically built and sustained reserves in excess of these amounts.

Very strong liquidity

In our opinion, Groton's liquidity is very strong, with total government available cash at 20.3% of total governmental fund expenditures and 5.0x governmental debt service in 2019. In our view, the town has strong access to external liquidity if necessary.

Groton is a regular market participant that issued debt frequently over the past 20 years, including GO bonds and short-term BANs. The town has no variable-rate or direct-purchase debt nor does it have any contingent liquidity risks from financial instruments with payment provisions that change on the occurrence of certain events. Town investments are subject to commonwealth laws, and Groton invests its cash in low-risk assets, 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, Groton's debt and contingent liability profile is strong. Total governmental fund debt service is 4.1% of total governmental fund expenditures, and net direct debt is 54.4% of total governmental fund revenue. Overall net debt is low at 1.6% of market value, which is, in our view, a positive credit factor. Weakening our view of the town's debt profile are its significant medium-term debt plans.

After this issuance, Groton will have about \$25 million in total direct debt outstanding, of which about \$3 million is self-supporting enterprise debt. In addition, its proportionate share of overlapping debt is \$8.5 million. We understand that the town expects to issue the local share for a new elementary school on behalf of the school district, which is estimated at \$40 million-\$50 million. While the debt authorization has not gone to voters for approval, we elected to incorporate it into our view of the town's debt plans. Given the size of the issuance relative to the current debt burden

and budget, we could significantly revise our view of the town's debt profile over the next several years.

Groton's combined required pension and actual OPEB contributions totaled 6.1% of total governmental fund expenditures in 2019. Of that amount, 5.1% represented required contributions to pension obligations, and 1.0% represented OPEB payments. The town made its full annual required pension contribution in 2019.

Pension and other postemployment benefits

- Despite the pension system's low funded ratio, we do not currently view retirement liabilities as a credit pressure, due to the town's low fixed costs and significant financial planning.
- 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 OPEB liabilities are funded on a pay-as-you-go basis, costs remain low and the town is prefunding the obligation. The town has a net OPEB liability of \$8.8 million, and the trust is 2.4% funded. Additionally, the electric light enterprise fund has a net OPEB liability of \$140,000 and a trust that is 89% funded.

As of June 30, 2019, the town participates in the following pension plan:

- Middlesex County Retirement System: 46.4% funded with a \$23.3 million proportionate share of the net pension liability.

The Middlesex County Retirement System is a cost-sharing, multiple-employer system. The system has revised certain actuarial assumptions in recent years, including lowering the discount rate to the current 7.5% and the inflation rate to 3.25%. However, we believe the discount rate remains high, along with permissible mortality tables. We believe the 17-year closed amortization schedule is a positive, but the payroll growth assumptions could be optimistic. The system fell short of our static and minimum funding progress calculations in the most recent year, indicating it is neither fully addressing current costs nor making progress in addressing the unfunded liability.

We believe pension and OPEB costs remain manageable. However, if total fixed costs were to rise significantly as a percentage of expenditures, due to the increased debt burden or rising retirement costs, it could pressure the liabilities profile and the overall rating outside of the outlook period.

Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

Outlook

The stable outlook reflects S&P Global Ratings' expectation that Groton's will sustain very strong economic and management conditions that have contributed to stable and overall predictable budgetary performance over the last three years. As a result, we believe Groton will likely maintain its strong flexibility and very strong liquidity profiles. Over the next two years, steady economic development should continue to support steady tax base growth and provide additional future tax revenue, which will likely ensure a stable budgetary environment. For these reasons, we do not expect to change the rating within the two-year outlook horizon.

However, if budgetary performance were to deteriorate--due to pressure from growing fixed costs or otherwise--leading to a significant deterioration in reserves or liquidity, we could lower the rating.

Related Research

- 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 January 29, 2020)		
Groton Twn GO rfdg bnds		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Groton Twn GO		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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