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Ratings

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Summary:

Natick, Massachusetts; General Obligation

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Natick GO		
Long Term Rating	AAA/Stable	Affirmed

Rating Action

S&P Global Ratings affirmed its 'AAA' long-term rating on the Town of Natick, Mass.' existing general obligation (GO) debt. The outlook is stable.

We previously assigned the 'AAA' rating to the town's series 2020 general obligation (GO) refunding bonds totaling $23.8 million on Feb. 27, 2020. These bonds were being issued to refund bonds originally dated June 15, 2011.

Natick's full-faith-and-credit pledge, subject to Proposition 2 1/2 limitations, secures the GO debt. Despite commonwealth levy-limit laws, we did not make a rating distinction between the town's limited-tax GO pledge and general creditworthiness because our analysis of Natick's financial and economic conditions already includes the tax limitation imposed on the town's revenue-raising ability.

Under our criteria, "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions," published Nov. 19, 2013, on RatingsDirect, we rate Natick higher than the sovereign because we believe the town can maintain better credit characteristics than the nation in a stress scenario based on its predominantly locally derived revenue base and our view that pledged revenue supporting bond debt service is at limited risk of negative sovereign intervention. In 2019, local property taxes generated 71% of revenue, which demonstrated a lack of dependence on central government revenue.

Credit overview

The rating reflects our view of the town's very strong economy, supported by a wealthy property tax base and high income. In addition, the town's maintenance of very strong budgetary flexibility, with available reserves averaging more than 20% in the past three fiscal years, is due to positive financial performance and strong management, supporting our view of the rating. While the scope of economic and financial challenges posed by the COVID-19 pandemic remains unknown, we believe a prolonged disruption could weaken the town's local economy and impact revenues received from the state. (For more information, see "All U.S. Public Finance Sector Outlooks Are Now Negative," published April 1, 2020, on RatingsDirect.) However, due to very strong management conditions and historically consistent positive results, we expect management to make the necessary budgetary adjustments to maintain balanced operations. Although we think retirement liabilities and costs could pressure the long-term budget, we expect management will likely manage these costs appropriately due to its conservative budgeting and active funding of an other postemployment benefits (OPEB) trust fund. Therefore, we do not expect to change the rating within the outlook period.

The rating further reflects our opinion of the town's:

- 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 methodology;
- Adequate budgetary performance, with balanced operating results in the general fund and at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 19% of operating expenditures;
- Very strong liquidity, with total government available cash at 27.4% of total governmental fund expenditures and 5.2x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability position, with debt service carrying charges at 5.3% of expenditures and net direct debt that is 96.4% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 67.5% of debt scheduled to be retired in 10 years, but a large pension and other postemployment benefit (OPEB) obligation; and
- Strong institutional framework score.

Stable Outlook

Downside scenario

We could lower the rating if finances were to deteriorate significantly or the town were to experience budgetary pressure due to low pension funding, especially given potential market volatility during the current economic recession, leading to a draw down on reserves.

Credit Opinion

Very strong economy

We consider Natick's economy very strong. The town, with an estimated population of 36,450, is located in Middlesex County in the Boston-Cambridge-Newton, Mass.-N.H. MSA, which we consider to be broad and diverse. The town has a projected per capita effective buying income of 194% of the national level and per capita market value of $245,044. Overall, the town's market value grew by 1.9% over the past year to $8.9 billion in 2020. The county unemployment rate was 2.3% in 2019.

Natick, a primarily residential community, approximately 18 miles from Boston, is part of the Greater Boston area. The town's location along U.S. routes 9 and 128 provides residents with a broad range of employment opportunities across the Boston MSA. In addition, the commuter rail line into Boston enables easy travel to the downtown core.

The local economy remains very strong, in our view, supported by a stable real estate market and continued commercial and residential developments that should underpin near-term stability. The property tax base is 79.3% residential and 20% commercial and industrial. Mathworks, which operates MATLAB, the town's leading employer, is a software developer that has recently expanded its Lakeside campus and has completed a second campus; the company expects to add an estimated 700-1,000 jobs overtime. Additional developments include construction of the Cochituate Rail Trail, the redesign of the Route 27 North Main Street corridor, and the development of a 164-unit apartment complex for those aged 55+. Natick is also making improvements to the MBTA system that serves the town and the region. According to management, the state has invested $40 million in the local MBTA station. Further, the state has also invested $18 million on a major throughway that serves the town and $12 million on the town's rail trail.

We believe because of the town's location and management's intentional economic planning, the incremental tax base will continue to grow. We expect Natick's underlying wealth and income metrics will remain stable, and with access to the broad and diverse Boston MSA, the economy will remain very strong.

The COVID-19 pandemic, in our view, presents an evolving credit risk that could accelerate volatility. We understand that the situation will remain fluid in the short term, and will watch for latent credit stressors for the town, including deterioration in economic and financial performance. Given Natick's stable residential tax base, we believe any economic effects related to COVID-19 will be felt over the long term. (For more information, see "An Already Historic U.S. Downturn Now Looks Even Worse, "published April 16, 2020)

Very strong management

We view the town's management as very strong, with strong financial policies and practices under our Financial Management Assessment methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Natick's management highlights include:

- Conservative budgeting;
- Strong budgetary monitoring; and
- Long-term financial and capital plans.

Management submits quarterly reports on budget-to-actual results to the board of selectmen with adjustments made when needed. The town performs a five-year forecast for all long-term financial needs. Management maintains a five-year, semiannually updated capital improvement plan that identifies funding sources for each project. The town has adopted commonwealth guidelines for its investment policy. Management reports holdings, prepared quarterly by the treasurer, to the board through an annual audit.

Natick maintains its own formal debt and reserve policies under its financial management principles. The reserve policy calls for the town to maintain a general stabilization fund balance at a minimum of 2% of revenue with a target of 5%.

Furthermore, the town has taken steps to mitigate exposure to cyber-related risks, and it has been addressing concerns related to climate change that could directly affect taxable properties. For example, it has instituted sustainable practices in its public buildings to save energy. Further, the new Kennedy Middle School and West Natick fire station both will have solar panels. Officials have also indicated that the town has received grants from the municipal vulnerability preparedness grant program, providing support to begin the process of planning for climate change and resilience and implementing priority projects.

Adequate budgetary performance

Due to the sudden rapid economic deterioration, we have revised our budgetary performance assessment to adequate from strong. This assessment incorporates heightened near-term uncertainty that exists due to the recessionary pressures related to the COVID-19 pandemic and resulting financial pressures.

Natick's budgetary performance is adequate in our opinion. The town had balanced operating results of negative 0.4% of expenditures in the general fund and of negative 0.3% across all governmental funds in fiscal 2019.

Fiscal 2019 results include adjustments for one-time capital expenditures paid for with bond proceeds. According to management, the fiscal 2019 positive performance was primarily due to overall conservative budgeting that led to higher-than-anticipated revenues. Some of these better performing revenue items included motor vehicle excise taxes, tax titles, and property taxes.

The town's fiscal 2020 budget totals $172.3 million, a 6.7% increase over fiscal 2019. Officials indicate budget-to-actuals are tracking favorably and they do not expect any major revenue and expenditure changes for the remainder of fiscal 2020 due to COVID-19. Officials indicate that they have halted projects and that current COVID-19-related costs remain very small. In addition, the town is applying for state aid to cover any COVID-19 related costs. Officials do not currently expect any major delinquencies from the last set of property tax revenue; the town collects these revenues quarterly. We believe potential revenue and expenditure volatility is likely due to the current economic and health environment beginning in fiscal 2021, which could pressure the town's financial performance.

Recurring revenues and expenditures have generally come in on budget, at year-end. Property taxes are the largest general fund revenue source, accounting for 71% of audited revenues in 2019. State aid was 19% and excise taxes 4%. Along with local excise taxes, we believe that school and unrestricted aid is likely to be the largest revenue pressure over the next few years, although the state has not yet released fiscal 2021 aid figures. We understand management is adjusting its fiscal 2021 budget to account for revenue reductions in these areas, but we believe significant uncertainty remains in projecting actual receipts. Looking ahead, while Natick has not yet completed its fiscal 2021 budget, which it is in the process of doing, we do not anticipate a significant change in its revenue or expense profile. Officials indicate that they are adjusting their originally proposed budget to account for potential COVID-19-related impacts. As towns statewide are finalizing their 2021 budgets, the state has not yet released projected aid figures, and we believe the likelihood of midyear cuts in 2021 is high. Consequently, we believe the economic shock from COVID-19 restrictions presents an indeterminable revenue risk to many municipalities in the state, including Natick, which we have reflected in our assessment of the town's budgetary performance. If the town is able to manage revenue reductions while producing approximately balanced results, we could revise our view of budgetary performance to strong.

Very strong budgetary flexibility

Natick's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 19% of operating expenditures, or $29.9 million.

Available funds include assigned and unassigned fund balances, as well as a variety of stabilization funds within the general fund that management could make available for general operational use. While Natick recognizes that the effects of the COVID-19 pandemic and the current recession are uncertain, it is modifying its fiscal 2021 budget accordingly. Management has approval from the board of selectmen to use 25% of general stabilization, over $1 million, for fiscal 2021. If available reserves were to decline materially and management was unable to replenish them, we could revise our view of budgetary flexibility to strong and, should reserves decline significantly, this could pressure the rating.

Very strong liquidity

In our opinion, Natick's liquidity is very strong, with total government available cash at 27.4% of total governmental fund expenditures and 5.2x governmental debt service in 2019. In our view, the town has strong access to external liquidity if necessary.

Natick regularly accesses the bond market by frequently issuing debt, supporting its strong access to external liquidity. We also believe Natick's liquidity profile is conservative with no high exposure to refinancing risk, debt, or other potential obligations that could pose a risk to liquidity. Therefore, we expect the liquidity profile will likely remain very strong over the next two fiscal years.

Strong debt and contingent liability profile

In our view, Natick's debt and contingent liability profile is strong. Total governmental fund debt service is 5.3% of total governmental fund expenditures, and net direct debt is 96.4% of total governmental fund revenue. Overall net debt is low at 1.9% of market value, and approximately 67.5% of the direct debt is scheduled to be repaid within 10 years, which are in our view positive credit factors.

Natick has approximately $184.2 million of direct debt outstanding. We understand that the town expects to issue debt in the next two to three years for various capital projects including preservation of infrastructure. However, due to the current recession, officials have not solidified issuance amounts. Depending on how much the town decides to issue for these projects, we could weaken our view of the town's debt profile.

Pension and other postemployment benefits

- In our opinion, a credit weakness is Natick's large pension and OPEB, particularly given the pension system and OPEB trust low funded ratios.
- 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 despite the large liability, and we expect the town will continue adding to its OPEB trust fund.

As of June 30, 2019, the town participates in the following pension and OPEB plans:

- Natick Contributory Retirement System: 60.2% funded with a $92.8 million proportionate share of the net pension liability.
- Town of Natick OPEB plan, a single-employer, defined-benefit plan that provides health, dental, and life insurance to retirees and their beneficiaries: 2% funded with and a net OPEB liability of $181.7 million.

In our opinion, a credit weakness is Natick's large pension and OPEB obligation. Natick's combined required pension and actual OPEB contributions totaled 8.2% of total governmental fund expenditures in 2019. Of that amount, 5.4% represented required contributions to pension obligations, and 2.8% represented OPEB payments. The town made its full annual required pension contribution in 2019. The Natick Contributory Retirement System is a multiple-employer, defined-benefit pension plan. However, the town accounts for nearly 98.5% of the total system liability. We understand that the system revised its discount rate downward from 7.38% to 7.25%. However, we still believe this discount rate is high for municipal systems and could lead to volatile contributions. While Massachusetts requires all pension systems to achieve full funding no later than 2040, Natick has planned to achieve full finding by 2030. We generally view closed amortization schedules as positive but for the Natick system to meet its adopted funding schedule to achieve full funding in 2030 costs must rise, given the low funded ratio. The town met our static funding metric in the most recent year, but did not meet the minimum funding progress calculation, indicating that the system is addressing current costs but not fully making headway addressing its unfunded liabilities. However, the adopted schedule shows the unfunded liability decreasing, suggesting the system's performance might improve in the near future.

Natick also provides OPEB to retirees, which is funded on a pay as you go basis. The town established an OPEB trust fund in fiscal 2011 to finance this liability. The trust fund balance was $4.1 million. We believe that Natick's large pension and OPEB liabilities could pressure the budget during the next few fiscal years, particularly if actuarial assumptions are not met. Should costs grow, particularly if OPEB pay-as-you-go costs were to rise, with no material progress in prefunding the liability, we could revise our view of the town's plan for addressing its retirement liabilities.

Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

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 May 19, 2020)		
Natick GO		
Long Term Rating	AAA/Stable	Affirmed
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