

RatingsDirect®

Summary:

Danvers, Massachusetts; General Obligation

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Credit Profile

US\$8.63 mil GO mun purp of 2020 bnds due 08/01/2040

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

Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating to Danvers, Mass.' series 2020 general obligation (GO) municipal-purpose bonds. We also affirmed our 'AAA' long-term rating on the town's existing GO debt. The outlook is stable.

Danvers' full-faith-and-credit-GO pledge secures the bonds. The town has both limited- and unlimited-tax debt outstanding. Despite limitations imposed by the commonwealth levy limit law, we do not make a rating distinction between the limited-tax GO pledge and Danvers' general creditworthiness because the tax limitation imposed on the town's ability to raise revenue is already embedded in our analysis of Danvers' financial and economic conditions.

Officials intend to use the bond proceeds, totaling about \$8.6 million, for various municipal purposes, including construction of a school roof, and water and sewer infrastructure work. The approximately \$3.4 million of this issue will refund outstanding debt and provide interest savings.

Credit overview

The rating reflects our view of Danvers' consistently balanced financial results, which have led the town to maintain a very strong reserve position over the past several years, and through various business and economic cycles.

Danvers enters the national recession triggered by the outbreak of COVID-19 with very strong budgetary flexibility, and well-embedded financial management policies, particularly in the areas of budgeting and planning. Strong financial policies, combined with collaboration throughout all government departments, provide a robust budgeting and planning framework, further supporting the strong credit profile.

While we note significant uncertainty around certain revenue shortfalls and potential state aid cuts that could weaken the town's performance as it heads into fiscal year 2021, we understand management has already taken measures to cushion the effects of potential revenue shortfalls and has additional measures at its disposal that it could implement should significant cuts happen. Long term, the town's retirement liabilities could increasingly pressure the operating budget, although we understand officials are considering options to reduce the size of the liability and will likely begin meaningfully contributing toward Danvers' other postemployment benefit (OPEB) trust fund with new revenues

streams and once the pension system is fully funded. Therefore, absent a substantial reversal of budgetary performance and flexibility or a deterioration in its wealth and income conditions, we believe Danvers' credit quality will remain stable.

Lending further stability to the rating and the outlook are the town's very strong liquidity and stable revenue mix, with the predominant revenue stream of property taxes, which have historically been collected upward of 99% during the fiscal year payable. That said, given that there is still much uncertainty related to the potential effects of COVID-19 and the ensuing economic recession on the town's finances, we will continue to monitor for any material adverse effects throughout the outlook period. For more information on the coronavirus' effect in U.S. Public Finance, please see our reports titled "The COVID-19 Outbreak Weakens U.S. State And Local Government Credit Conditions" (published April 2, 2020 on RatingsDirect) and "U.S. Real-Time Economic Data Suggests Hopeful Signs Of A Recovery Could Be Short-Lived" (published July 16, 2020).

Danvers' GO bonds are 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, "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions" (published Nov. 19, 2013), Danvers has a predominately locally derived revenue source and we believe that pledged revenue supporting debt service on the bonds is at limited risk of negative sovereign intervention.

The long-term rating further reflects our assessment of 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;
- Adequate budgetary performance, with balanced operating results in the general fund but a slight operating deficit at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 21% of operating expenditures;
- Very strong liquidity, with total government available cash at 35.8% of total governmental fund expenditures and 7.1x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 5.1% of expenditures and net direct debt that is 67.1% of total governmental fund revenue, and a large pension and OPEB obligation and the lack of a plan to sufficiently address it, but low overall net debt at less than 3% of market value; and
- Strong institutional framework score.

Environmental, social, and governance factors

We evaluated the city's environmental, social, and governance (ESG) factors relative to its economy, financial measures, management, and debt and long-term liability profile. We acknowledge, absent the implications of COVID-19, that we consider the town's social risks in line with those of the sector. We view its governance risks as in line with the sector noting strong policies and practices across many key areas, but with a fairly sizable exposure to long-term pension and OPEB liabilities. We view its environmental risks as generally in line with the sector average. We note, however, the town recently received a municipal vulnerability preparedness certification in 2020, and has

updated its capital improvement programs to address potential climate change concerns, particularly related to its enterprise utilities and water supply into the future.

Stable Outlook

Downside scenario

Should the town's budgetary flexibility weaken due to negative financial performance, and pension and OPEB costs continue to escalate, we could lower the rating.

Credit Opinion

Very strong economy

We consider Danvers' economy very strong. The town, with a population of 27,549, is in Essex County, 20 miles north of Boston, in the Boston-Cambridge-Newton MSA, which we consider to be broad and diverse. It has a projected per capita effective buying income of 131% of the national level and per capita market value of \$198,147. Overall, market value grew by 5.7% over the past year to \$5.5 billion in 2020.

A primarily residential community with a healthy commercial and industrial base, Danvers maintains a diverse economy with sectors in retail, manufacturing, health care, high technology, and higher education. Approximately 76% of the tax base is residential and 21% is commercial and industrial. Top employers include Medtronic Interventional Vascular, a biomedical research and development company (740 employees); IRA Motor Group (530); and Hospice Care Dimensions (522). The top 10 taxpayers constitute 6.9 of assessed value, which we consider very diverse.

Danvers is on Interstate 95 and Route 1, which provide easy access to employment centers in and around the town. Prior to the pandemic, new growth in the tax levy was steady at about 1% since 2016. In addition, officials continue to see strong demand in the housing market with an increase in home prices and housing starts.

Danvers adjusted its zoning bylaws to encourage additional mixed-use development. As a result of this rezoning, the town has identified 1,000 units of potential development in the downtown area. Furthermore, the former municipal hospital, once one of the largest employers with 300 employees before closing in 1990, reopened as a substance-abuse facility with 180 beds and 220 new jobs and now generates roughly \$300,000 per year in tax revenue. Other projects include the redevelopment of a former EconoLodge site to create 200 units of housing and the addition of a medical marijuana facility in the town's business park. With the latter, Danvers has a host agreement in which the town will realize 3% of gross revenue annually at minimum.

As a result of these and other ongoing development projects, we anticipate market value will resume its growth as the local and national economy improves.

We note that the county unemployment rate was 3.0% in 2019. Despite this very low figure, rapidly evolving economic conditions due to the pandemic have significantly affected the labor market (see "U.S. Jobs Market Buckles Under The Coronavirus Pandemic," published April 2, 2020). While the regional economy showed resilience in the past recession, high unemployment, particularly if it exceeds 10%, and the pace of recovery, is a risk we are monitoring.

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.

In developing the budget, Danvers uses conservative assumptions grounded in a historical trend analysis and an understanding of current economic conditions. It maintains strong practices in the areas of budgetary control, with quarterly budget-to-actual reports and investment reports presented to the board of selectmen. The town also has a rolling five-year, long-term financial plan that identifies budgetary pressures in outyears and prioritizes structural balance. Complementing this plan is a five-year capital improvement plan that officials update annually and that identifies funding sources for specified capital projects. Along with the debt policy, the town approved a fund balance policy that targets an unassigned general fund balance of 8%-12% of its annual operating expenditures. If unassigned fund balance drops below 5%, the policy directs officials to restore the balance above that level as soon as possible. The town has been in compliance with these policies since 2016. Danvers maintains a written investment policy that mirrors state guidelines. Finally, in fiscal 2019, the board of selectmen adopted financial policy guidelines to cover remaining policy areas such as funding the OPEB trust fund.

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. The town had balanced operating results in the general fund of 0.4% of expenditures, but a slight deficit result across all governmental funds of negative 1.1% in fiscal 2019. General fund operating results of the town have been stable over the last three years, with results of 0.4% in 2018 and 1.7% in 2017. In our assessment of budgetary performance, we made adjustments for recurring interfund transfers and one-time expenditures.

Prior to the pandemic, the town had strong financial performance as demonstrated by management's conservative budgeting practices, particularly its careful budget planning and in-year performance monitoring. For fiscal 2019, results were positive. On a budgetary basis, the town realized a \$1.8 million positive revenue variance, reflecting good tax levy collections and strong local receipts. On the expenditure side, Danvers realized positive variances of \$2.6 million spread across several departments and line items, reflecting prudent budgeting and monitoring.

For fiscal 2020, despite certain revenue shortfalls in the fourth quarter, the town estimates it will close with balanced operations, which reflects revenues coming in well over budget prior to the pandemic. Throughout the pandemic, Danvers has implemented several cost-containment measures, with any savings rolled into any potential shortfalls in fiscal 2021. Officials anticipate that unassigned general fund balances will remain in line current balances, and that total fund balance will remain above 15%. Furthermore, they indicated that \$1.5 million was added to the general stabilization fund, with an additional appropriation authorized for fiscal 2021. The current estimate for the general stabilization account is \$3.0 million.

The town recently adopted a budget for fiscal 2021 that assumes revenue estimate reductions in state aid and in local receipts upwards of 20%. To offset reductions to revenues, the town has also instituted several cost-saving initiatives such as delaying certain capital initiatives, instituting hiring freezes on all vacant positions, and completing discussions

with employee groups to achieve salary savings. The 2021 general fund budget totals \$109 million, up a modest 1.9% over the previous year.

On the whole, property taxes constitute 76% of budgeted revenues and state aid about 9.1% of budgeted revenues. Tax collections have historically been very strong and stable, with the town typically receiving 99% on a current basis.

While we expect the town's budgetary performance could remain steady, we recognize that its high long-term costs associated with Danvers' pension and OPEB liabilities will remain a long-term budgetary consideration and potentially pose challenges. Management is generally conservative in its budget assumptions, which has historically led to positive budgetary variances, as well as the ability regenerate appropriated free cash. Consequently, over the next two fiscal years, we expect management will continue to align recurring revenues with recurring expenditures as it has historically done.

Very strong budgetary flexibility

Danvers' budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 21% of operating expenditures, or \$22.6 million. Over the past three years, the total available fund balance has remained at a consistent level overall, totaling 21% of expenditures in 2018 and 21% in 2017.

We expect our assessment of budgetary flexibility to remain at least strong if not very strong, based on the town's fund balance policy that calls for the unassigned fund balance to remain at 8%-12% of expenditures, and total fund balance in excess of 15%. Calculation for available reserves includes assigned, unassigned, and committed stabilization reserves. The town has maintained reserves above the policy target for the past several fiscal years and above 20% for the past five. Management expressed a commitment to maintaining fund balance level in fiscal years 2021 despite the uncertainty related to the pandemic.

Very strong liquidity

In our opinion, Danvers' liquidity is very strong, with total government available cash at 35.8% of total governmental fund expenditures and 7.1x governmental debt service in 2019. In our view, the town has strong access to external liquidity if necessary.

Danvers retains strong access to external liquidity as a regular market participant. Over the past several years, the town has frequently issued debt to support its capital project endeavors. It has no variable-rate or direct-purchase debt. We expect the town's liquidity profile to remain very strong.

Weak debt and contingent liability profile

In our view, Danvers' debt and contingent liability profile is weak. Total governmental fund debt service is 5.1% of total governmental fund expenditures, and net direct debt is 67.1% of total governmental fund revenue. Overall net debt is low at 1.8% of market value, which is, in our view, a positive credit factor.

The town has \$100.9 million in total direct debt outstanding. It anticipates continuing to issue bonds for additional water and sewer projects and may also issue upward of \$12 million of additional debt toward a school project. The final timing and amount is not yet determined. We do not expect this additional debt to materially affect the debt profile.

Pension and other postemployment benefits

- In our opinion, a credit weakness is Danvers' large pension and OPEB obligation, particularly given the pension system's and OPEB trust's 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 predominantly funded on a pay-as-you-go basis, costs remain manageable despite the large liability, and we expect the town will continue adding to its OPEB trust fund.

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

- Danvers Contributory Retirement System, which covers substantially all employees of the town except for teachers and school administrators: 53% funded with a \$90.55 million net pension liability

Danvers' combined required pension and actual OPEB contributions totaled 11.4% of total governmental fund expenditures in 2019. Of that amount, 6.1% represented required contributions to pension obligations, and 5.3% represented OPEB payments. The town made its full annual required pension contribution in 2019.

Danvers has adopted a funding schedule for its pension liability, aiming to fully fund it by 2035. It has also adopted a more conservative plan by revising its projected rate of return downward again to 7.50% from 7.75%, although we still believe this figure could lead to contribution volatility. Notably, the plan did not meet either our static or minimum funding progress metrics in the most recent year, indicating that the current plan assumptions are not making progress in funding the outstanding liability. Although the town continues to pay its full ADC, if pension costs increase faster than the overall budget, the operating budget could be pressured.

In regard to the OPEB obligation, the town is committed to increasing its contribution amount, as well as establishing an OPEB trust fund in place of the OPEB stabilization fund. Excluding the enterprise divisions, Danvers had a net OPEB liability of \$192.3 million. Officials estimate the trust fund had a balance of \$7.9 million at the close of 2020. In addition, the town plans to begin meaningfully contributing toward the OPEB trust fund with new revenue streams, and redirect annual pension contributions to OPEBs when the pension plan is fully funded.

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

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