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## Summary:

# Winchendon, Massachusetts; General Obligation

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### Credit Profile

Winchendon st qual GO mun purp loan bnds ser 2015 dtd 11/16/2015 due 12/01/2032

<i>Long Term Rating</i>	AA/Negative	Affirmed
<i>Underlying Rating for Credit Program</i>	A+/Stable	Upgraded

## Rationale

S&P Global Ratings raised our underlying rating (SPUR) rating to 'A+' from 'A-' on Winchendon, Mass.' general obligation (GO) debt. The outlook on the SPUR is stable. We also affirmed our 'AA' rating on the town's series 2015 bonds, reflecting our assessment of the security provided by the Massachusetts Qualified Bond Act. The outlook on the Massachusetts Qualified Bond Enhancement is negative.

The upgrade is based on improvements in the town's available fund balance levels as a result of recently strong operating performance as well as state-approved issuance of deficit financing to eliminate the town's negative fund balance position. We anticipate the town will end fiscal 2017 with another surplus, sustaining recent improved performance and further improving the town's available reserves, while allowing the town to pay off its deficit financing at an accelerated pace when compared to the state-mandated 10-year amortization period.

The town's faith-and-credit pledge, subject to the limitations of Proposition 2-1/2, secures the bonds. Despite the limitations imposed by the state levy limit law, we did not make a rating distinction for the limited-tax GO pledge given the town's reserves and budgetary flexibility under the levy cap. Additionally, we note that debt service on the town's series 2015 bonds was excluded from this limit.

Our rating on the town's series 2015 bonds reflects our assessment of the security provided by the Massachusetts Qualified Bond Act. Under the Qualified Bond Act (Massachusetts General Law, Chapter 44A), 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. The series 2015 bonds have received approval by the municipal finance oversight board; the board is required to oversee and monitor the program.

The rating reflects the town's:

- Adequate economy, with projected per capita effective buying income at 83% and market value per capita of \$60,160, though that is advantageously gaining from access to a broad and diverse metropolitan statistical area (MSA);
- Adequate management, with "standard" financial policies and practices under our Financial Management Assessment methodology;
- Adequate budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2016;
- Adequate budgetary flexibility, with an available fund balance in fiscal 2016 of 10.8% of operating expenditures, as

well as limited capacity to raise revenues;

- Very strong liquidity, with total government available cash at 20.3% of total governmental fund expenditures and 15x governmental debt service, and access to external liquidity we consider strong;
- Very strong debt and contingent liability position, with debt service carrying charges at 1.3% of expenditures and net direct debt that is 37% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 74.2% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

### **Adequate economy**

We consider Winchendon's economy adequate. The town, with an estimated population of 10,554, is located in Worcester County in the Worcester MSA, which we consider to be broad and diverse. The town has a projected per capita effective buying income of 83% of the national level and per capita market value of \$60,160. Overall, the town's market value grew by 3.3% over the past year to \$634.9 million in 2017. The county unemployment rate was 3.9% in 2016.

Winchendon is located on the border of New Hampshire, with U.S. Route 202 providing access to State Route 2, which provides further access to I-190 and I-91. The town experienced 3.3% market value growth year over year and approximately 90% of the town's property tax revenue is from residential property. The town does not suffer from taxpayer concentration because its largest taxpayers make up less than 5% of the total levy. Building permits have remained fairly steady over the past few years, supporting the aforementioned market value growth. Large town employers include Ray Plastic, Rural Housing Improvement, and Kamenstein, a manufacturer.

### **Adequate management**

We view the town's management as adequate, with "standard" financial policies and practices under our Financial Management Assessment methodology, indicating the finance department maintains adequate policies in some but not all key areas.

The town's management practices and policies have been enhanced and in some cases, formalized, since the state commenced oversight as part of the state's deficit legislation. The town maintains an active relationship with the state's Department of Revenue (DOR) as a condition of the legislation, and the town is required to provide DOR with monthly updates on budget to actuals, which are also provided to the Board of Selectmen.

While the town's budgeting assumptions and updates have experienced significant improvement under DOR, we note the town did not manage to undertake its own conservative budgeting or regular monitoring while outside of state control, however we understand the town has installed new processes which will support monitoring and reporting of the town's budget closely, including after deficit financing has been paid off and state oversight is no longer in place.

The town maintains a rolling five-year capital plan, with sources and uses outlined, but does not maintain a formal long-term financial plan. The town also has a formal investment policy and provides investment holding and earning information to the Board of Selectmen monthly. The town does not have formal debt management or reserve policies, but is required to maintain \$100,000 in reserves as a result of state oversight.

### **Adequate budgetary performance**

Winchendon's budgetary performance is adequate in our opinion. The town had operating surpluses of 2.9% of expenditures in the general fund and of 4.1% across all governmental funds in fiscal 2016.

The town experienced improved performance in fiscal 2016 after two years of very weak performance. In 2014, the town experienced significant health care claims, which reached \$2 million in 2014, a cost the town self-insured at the time. These claims were further compounded by significant negative variance when compared to those budgeted, partially due to what we believe was weak fiscal oversight of day to day expenditures. Fiscal 2015 also ended with an operating deficit, which the town attributes to the runoff of its self-funded health insurance plan as well as some continued negative expenditure variance. We note the town issued its first deficit note in fiscal 2015. We adjust the town's results for bond proceeds spent down for capital purposes and recurring transfers in and out of the general fund.

The town had an operating surplus in fiscal 2016, which management attributes to improved departmental revenue, lower general government costs, and lower than budgeted pension and fringe benefit costs. Management attributes some of the better than budgeted discretionary expenses to improved monitoring and oversight of the town's operations, which we note further improved as a result of state involvement. Town officials anticipate another operating surplus in fiscal 2017, based on continued streamlining of departmental expenses, manageable health care premium growth, and greater monitoring and oversight of education costs, particularly for transportation, which management believes will allow sustainable savings over time.

Management anticipates increasing the amount spent on capital in coming years, and we note that some capital items have been deferred due to the town's recent negative reserve position; we believe the town will have to catch up on paying for some capital items in the near to medium term and this may result in the town managing adequate performance over that period.

### **Adequate budgetary flexibility**

Winchendon's budgetary flexibility is adequate, in our view, with an available fund balance in fiscal 2016 of 10.8% of operating expenditures, or \$3.1 million. Negatively affecting budgetary flexibility, in our view, is the town's limited capacity to raise revenues.

After two years of improved results and issuance of \$3.5 million in deficit financing over the same period, the town experienced significant improvement in its available reserves. However, the town's resorting to deficit notes to eliminate its negative fund balance position, after the town's voters did not pass an override to fund the deficit, which highlights local resistance to raising revenues in a time of fiscal stress, and limits the town's budgetary flexibility, in our opinion.

### **Very strong liquidity**

In our opinion, Winchendon's liquidity is very strong, with total government available cash at 20.3% of total governmental fund expenditures and 15x governmental debt service in 2016. In our view, the town has strong access to external liquidity if necessary.

From fiscals 2013 through 2015, the town experienced appropriation and health insurance claim deficits, which led to

significant cash flow pressures resulting in a \$2 million advance of state aid to sustain operations and meet payroll. In January 2015, the state passed legislation allowing the town to use deficit borrowing up to \$5.7 million, with an additional \$300,000 available through the state Department of Revenue. The town has used \$3.5 million of this capacity, and does not intend to use additional notes out of the total \$6 million authorized; we note the town currently has \$2.2 million in deficit notes outstanding.

Given these recent issuances to shore up the town's negative fund balance positions and general improvements in the town's operating performance, the town's liquidity profile has improved. We note that the town, which had significant negative variance and cash flow pressure associated with its self-insured health trust fund in the past, no longer self-insures, and instead participates in the state health plan, which we believe reduces the potential for contingent liability risks.

The town has issued GO bonds within the past 15 years, demonstrating its strong access to external liquidity. It does not have investments we consider permissive or aggressive nor any contingent liquidity risks from financial instruments with payment provisions that change on the occurrence of certain events. We expect the town's liquidity position to remain very strong over the near term.

### **Very strong debt and contingent liability profile**

In our view, Winchendon's debt and contingent liability profile is very strong. Total governmental fund debt service is 1.3% of total governmental fund expenditures, and net direct debt is 37% of total governmental fund revenue. Overall net debt is low at 2.5% of market value, and approximately 74.2% of the direct debt is scheduled to be repaid within 10 years, which are in our view positive credit factors.

The town has approximately \$16 million in debt outstanding. Management expects to issue approximately \$500,000 in short-term debt over the next two-to-three years for a library renovation project. The town also has approximately \$6 million in deficit financing authorized by the state, to settle its outstanding health insurance claims; however, it does not anticipate issuing additional deficit notes beyond what is already outstanding.

Winchendon's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 6.1% of total governmental fund expenditures in 2016. Of that amount, 3.8% represented required contributions to pension obligations, and 2.3% represented OPEB payments. The town made its full annual required pension contribution in 2016.

Despite some acceleration in the town's pension costs, in our view, Winchendon's pension and OPEB liabilities remain manageable. The town participates in the Worcester County Retirement System. As of June 30, 2016, the town's share of the system's unfunded actuarial accrued liability (UAAL) was \$19.3 million; the plan's fiduciary net position as a share of total pension liability was 44.5% as of Dec. 31, 2015. The plan's discount rate of 7.75% is also higher than average. We note the plan's weak funded ratio is likely to contribute to a continued acceleration in pension expenses, which may result in increases which we would consider unmanageable.

The town also provides OPEB benefits, which it contributes to through pay-as-you-go financing. In fiscal 2016, OPEB contributions totaled \$753,570. According to the most recent actuarial valuation, the OPEB UAAL was \$28.1 million as of July 1, 2014.

## **Strong institutional framework**

The institutional framework score for Massachusetts municipalities is strong.

## **Outlook**

The stable outlook reflects our view of the town's strong recent performance, which has allowed the town to maintain its strong liquidity position as well as improve its available reserves, when coupled with recent deficit note issuance. We do not anticipate changing the rating over the two-year outlook period.

### **Upside scenario**

If the town were to experience improvement in its economic indicators, as it finishes paying off all outstanding deficit notes, while managing to sustained strong performance, improving fund balance to levels we consider very strong, we could raise the rating.

### **Downside scenario**

If the town were to experience weak performance as a result of its increased debt and long-term liabilities or efforts to accelerate capital spending, requiring drawdowns on the town's available fund balance, we could lower the rating.

## **Massachusetts Qualified Bond Enhancement**

The negative outlook on the 'AA' rating reflects our outlook on the Commonwealth of Massachusetts.

## **Related Research**

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015

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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com). All ratings affected by this rating action can be found on the S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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