

# S&P Global Ratings

## Massachusetts Association of Town Finance Committees Annual Meeting

November 3, 2018



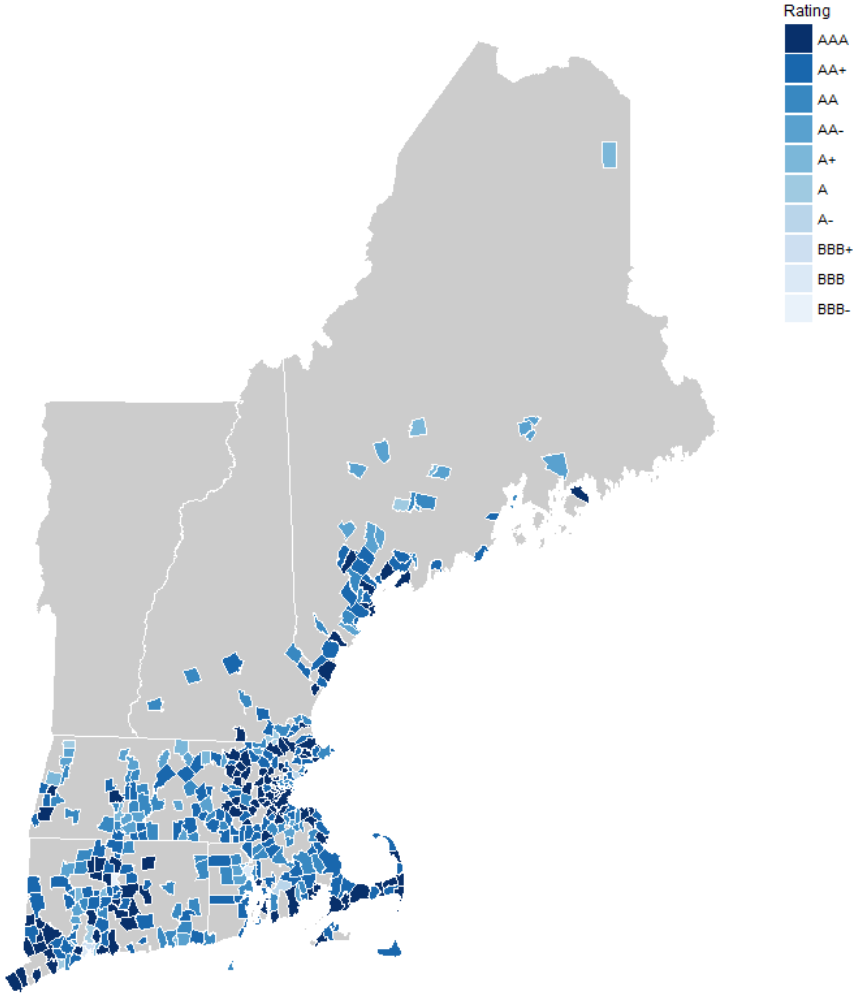
# Agenda

- Provide snapshot of Massachusetts Local Ratings
- Discuss risks, opportunities and uncertainties for Massachusetts local governments
- Talk about what municipalities can do can do to mitigate credit deterioration with a focus on strong financial management policies

# S&P Global Ratings Distribution for New England Locals

*Credit Ratings throughout New England remain strong and high investment grade*

	Mass	New England	Broader USPF Tax Secured
AAA	29%	27%	6%
AA	67%	67%	42%
A	4%	5%	47%
BBB	0%	1%	5%
NIG	0%	0.30%	0.50%



# Recent Ratings Trends for Massachusetts municipalities

- Municipal credit quality remains stable with the exception of a few pockets of municipal distress
- Falling reserves caused by budgetary misalignment due to rising fixed obligations, and limits to revenue generation have been key rating factors in the downgrades
- Lack of prudent budgetary planning and monitoring between municipal officials and board of education has also led to some credit deterioration
- Extraordinary support from the state government in the form of fiscal oversight to emergency loans and liquidity assistance has helped in credit stability

# Medians & Means

## Massachusetts Municipalities: Medians

	Rating							Total
	AAA	AA+	AA	AA-	A+	A	A-	
Projected per capita EBI (%)	178	134	119	86	81	77	80	133
Market value per capita (\$)	231,258	155,269	105,212	67,712	58,624	55,022	66,814	151,585
Available general fund (%)	17	16	11	10	11	5	3	15
General fund performance (%)	1.1	1.6	1.3	1.1	0.8	(1.5)	(0.2)	1.2
Cash and expense (%)	38	34	29	25	25	14	10	32
Carrying charge (%)	5.3	4.2	3.9	3.7	3.5	4.5	3.0	4.3
Pension ARC + OPEB as % expense	6.8	6.3	6.6	7.2	9.0	8.0	11.8	6.8

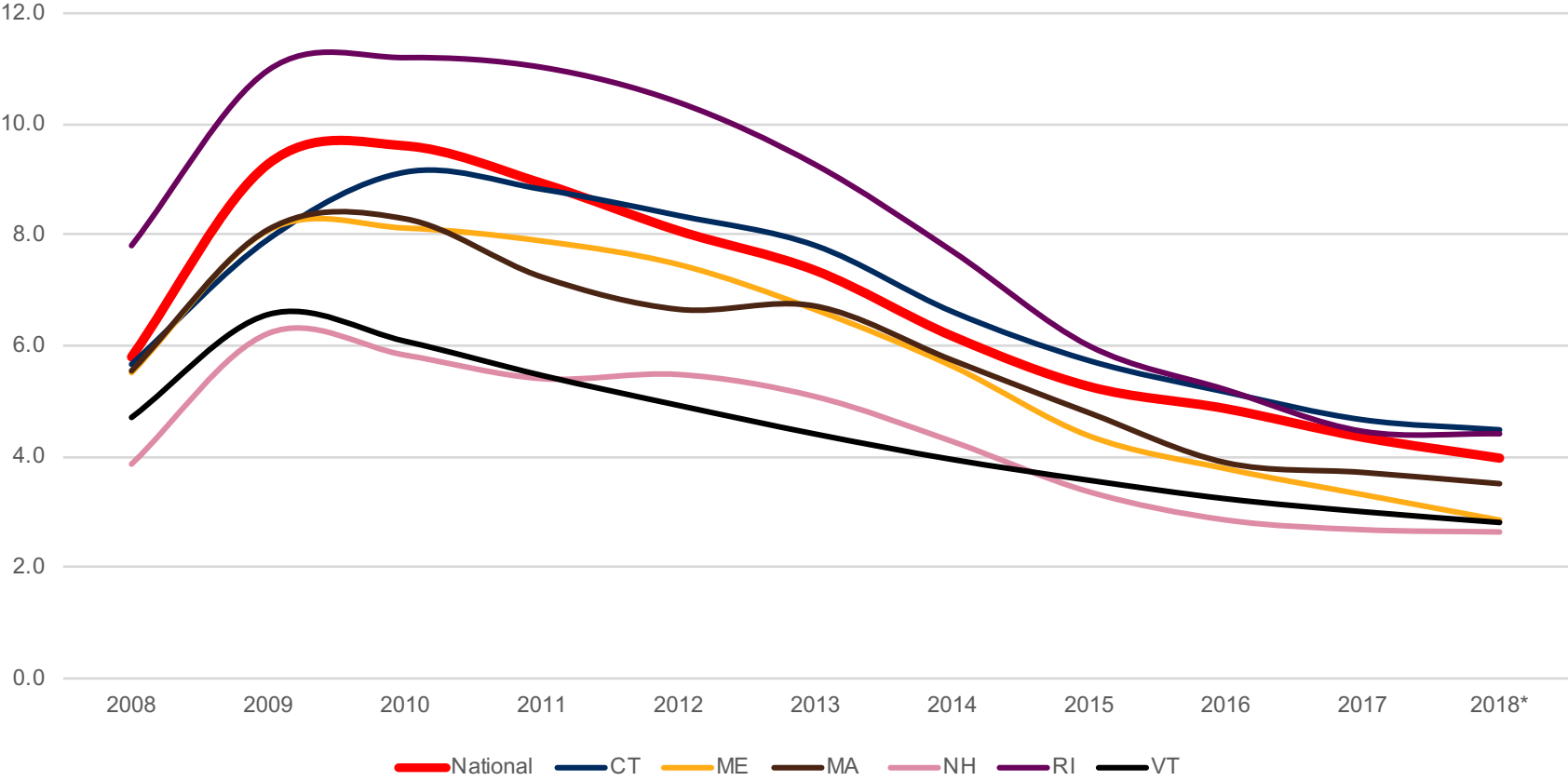
EBI--Effective buying income. ARC--Annually required contribution. OPEB--Other postemployment benefits.

# What are some Economic trends affecting Massachusetts?



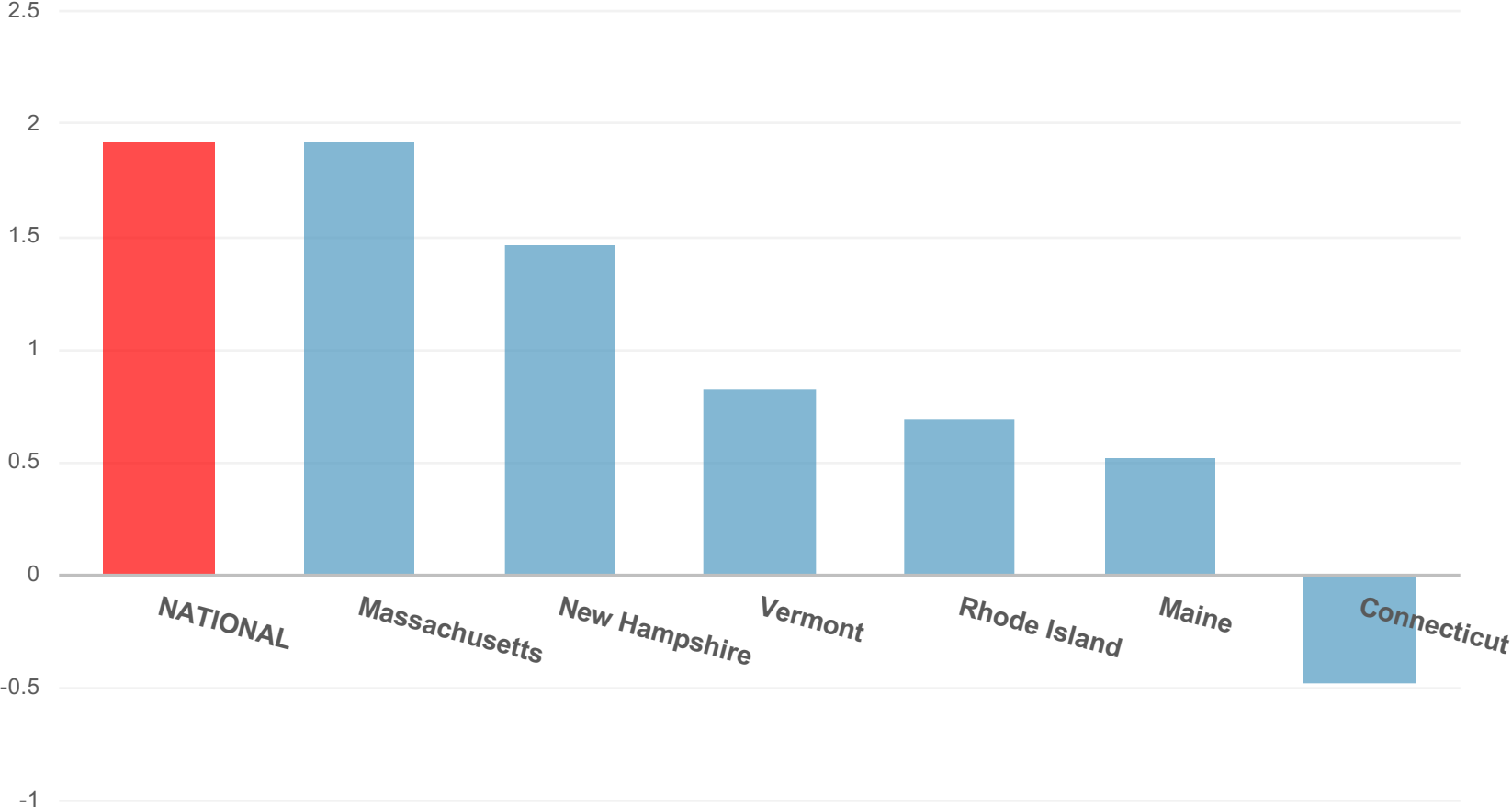
# New England Unemployment tracks to the nation

## Unemployment in New England States



# Economy: Real GDP growth trends vary between states

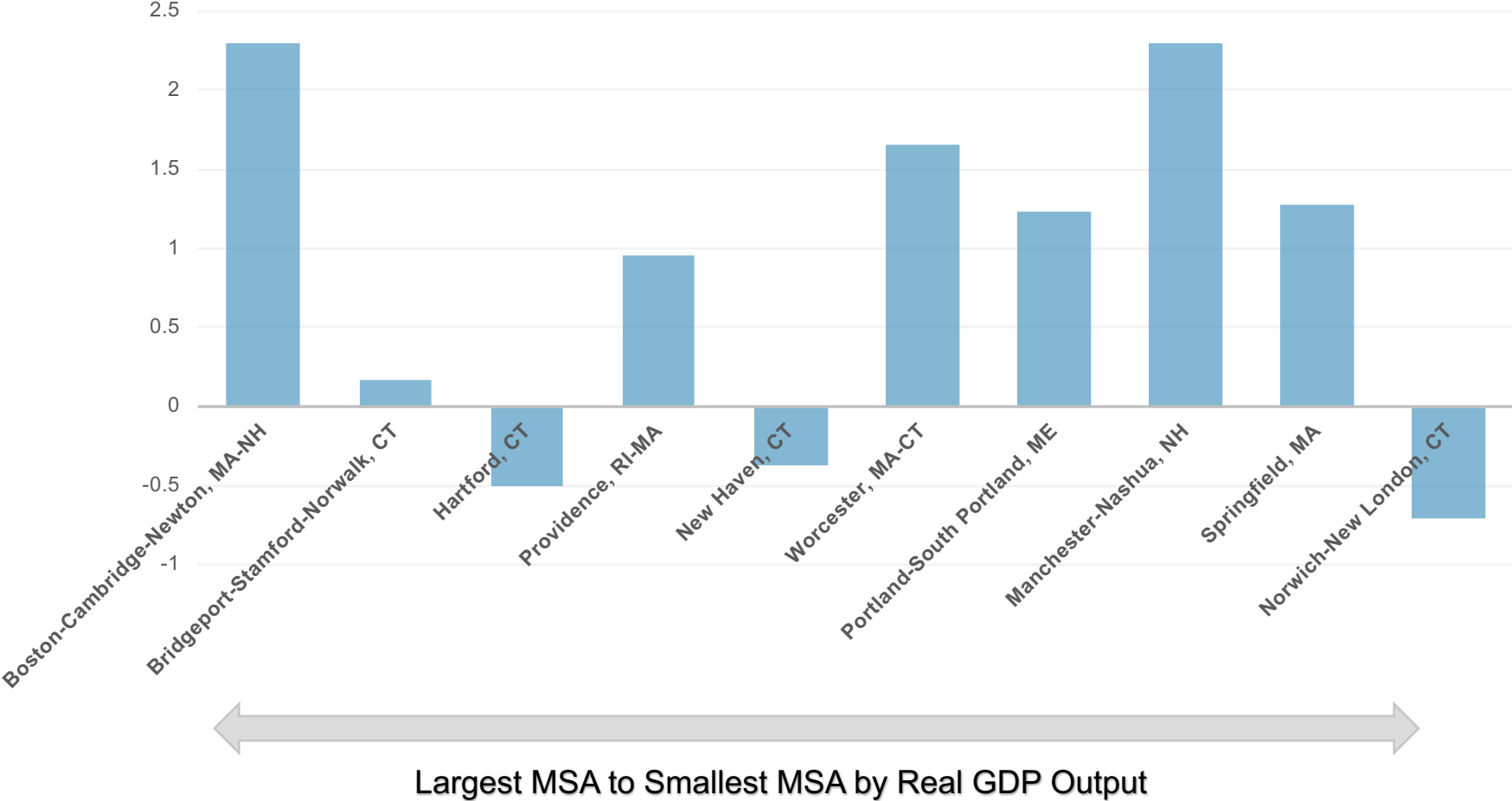
2010 - 2017 CAGR %





# Economy: Real GDP growth among the ten largest MSA's

2010 – 2017 CAGR %



# What are risks, opportunities, and uncertainties going forward?



# S&P Global: Risks, Opportunities, And Uncertainties

## Risks

- Budgetary pressures caused by legal or practical limitations on local source revenue generation will be an ongoing theme
- Potential for flat state-shared revenues as state's manage their own challenges is the new reality
- Pension and OPEB funding challenges will persist for some time

# S&P Global: Risks, Opportunities, And Uncertainties

## Opportunities

- Potential for economic growth following the tax overhaul bill enacted in December 2017 should cater to new tax base growth in the near-term
- Interest rate environment remains historically low
- Constituent support for bonding programs remains strong

# S&P Global: Risks, Opportunities, And Uncertainties

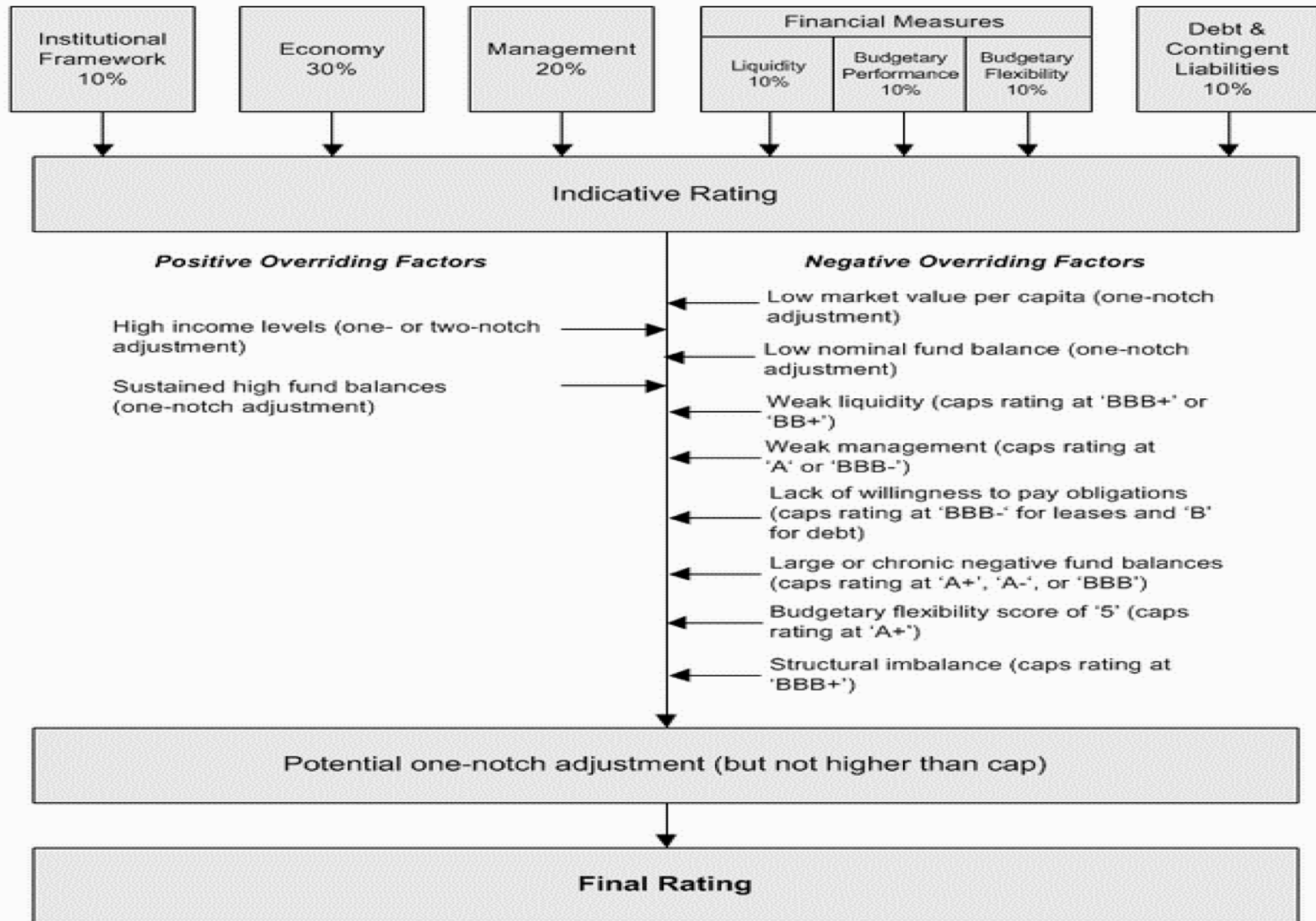
## Uncertainties

- The impact of tax reform on local government operations as the changes take hold
- Ongoing potential threat from cyber security breaches
- Risks related to climate change and other episodic weather events

# What can I do to preserve my credit rating?



# Analytical Framework for Local GO Ratings



# Financial Management Assessment

## What is the Financial Management Assessment?

- S&P Global Ratings has established an analytical methodology that evaluates established and ongoing management practices and policies in the seven areas most likely to affect credit quality.
- This assessment is based primarily on the existence and implementation of management practices, and not necessarily the results achieved by such practices.
- The purpose of the focus on policies and practices is to evaluate the potential for credit quality to move away from those currently indicated by results.

## • What is not included in the Financial Management Assessment?

- The FMA is not an evaluation of the competency or aptitude of individual finance professionals; nor is it an evaluation of a finance department's ability to handle unique challenges.
- The nature of the entity's governing body, the effectiveness of its governance practices, and issues of public policy pursued by the government are beyond the scope of this analysis.



# Financial Management Assessment

**FMA focuses on policies and practices in the areas of:**

1. Revenue and Expenditure Assumptions
2. Budget monitoring practices
3. Financial Forecasting
4. Capital Planning
5. Investment Management Policies
6. Debt Management Policies
7. Reserve and Liquidity Policies

# Revenue and Expenditure Assumptions

**Are the organizations' financial assumptions and projections realistic and well grounded from both long-term and recent perspectives?**

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***Strong*** Formal historic trend analysis is performed and updated annually for both revenue and spending; regular effort is made to determine whether revenues or expenditures will deviate from their long-term trends over the next couple of years; evidence of independent revenue forecasting exists(when possible).

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***Standard*** Optimistic assumptions exist that, while supportable, add risk; assumptions are based on recent performance, but little evidence of questioning or validating assumptions exists.

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***Vulnerable*** Assumptions neglect likely shortfalls, expenditure pressures or other pending issues; assumptions exist which enjoy no prudent validation.

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# Budget Amendments and Updates

**Are there procedures for reviewing and amending the budget based on updated information and actual performance to ensure fiscal targets are met?**

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**Strong** At least quarterly budget surveillance is maintained to identify problem areas and enable timely budget adjustments; management exhibits ability and willingness to address necessary intra-year revenue and expenditure changes to meet fiscal targets.

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**Standard** Semiannual budget reviews exist; management identifies variances between budget and actual performance.

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**Vulnerable** No formal process exists for regular review and timely updating of budget during the year.

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# Long-term Financial Planning

**Does management have a long-term financial plan that allows them to identify future revenues and expenditures as well as address upcoming issues that might affect these?**

***Strong*** A multi-year financial plan exists where future issues are identified and possible solutions are identified, if not implemented; revenue and expenditure decisions are made primarily from a long-term perspective. Structural balance is a clear goal.

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***Standard*** Multi-year projections are done informally; multi-year projections are done, but without discussion of pending issues, so that issues are not addressed; some one-shot actions exist, but the long-term consequences of these actions are acknowledged and communicated.

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***Vulnerable*** No long-term financial planning exists; operational planning is done on a year-to-year (or budget-to-budget) basis; one-shot budget fixes are used with little attention to long-term consequences.

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# Long-term Capital Planning

Has the organization created a long-term capital improvement program?

**Strong** A five-year rolling CIP with funding identified for all years exists and is linked to the operating budget and long-term revenue and financing strategies.

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**Standard** A five-year CIP is done, but is generally limited to projects to be funded from the current budget plus a four-year wish list; some funding for out-year projects is identified, but not all.

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**Vulnerable** No five-year CIP exists; capital planning is done as needs arise.

# Investment Management Policies

Has the organization established policies pertaining to investments?

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<i>Strong</i>	Investment policies exist and are well defined; strong reporting and monitoring mechanisms exist and are functioning.
<i>Standard</i>	Informal or non-published policies exist; policies are widely communicated and followed.
<i>Vulnerable</i>	Absence of informal or non-published policies

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# Debt Management Policies

**Has the organization established policies on debt issuance; maturity and debt service structure; use of security and pledges, credit enhancement, and derivatives?**

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<b><i>Strong</i></b>	Debt policies exist and are well defined; strong reporting and monitoring mechanisms exist and are functioning. If swaps are allowed, a formal swap management plan that follows S&P's guidelines (see the DDP) has been adopted.
<b><i>Standard</i></b>	Basic policies exist; policies are widely communicated and followed. If swaps are allowed there is a swap management plan in place, but it does not follow S&P's guidelines.
<b><i>Vulnerable</i></b>	Absence of basic policies or clear evidence that basic policies are followed. Swaps are allowed but there is no swap management plan in place, and/or there is no local (non-FA) knowledge about the swap.

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# Reserve and Liquidity Policies

**Has the organization established a formalized operating reserve policy, which takes into account the governments cash flow/operating requirements and the historic volatility of revenues and expenditures through economic cycles?**

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***Strong*** A formal operating reserve policy is well defined. Reserve levels are clearly linked to the government's cash flow needs and the historic volatility of revenues and expenditures throughout economic cycles. Management has historically adhered to it.

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***Standard*** A less defined policy exists, which has no actual basis but has been historically adhered to it.

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***Vulnerable*** Absence of basic policies or, if they exist, are not followed.

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# Evaluating additional Management Risks

- Event Risk, how ably can management react to natural disasters
- Political Instability, Turnover or Gridlock
- Inability to execute approved structural reforms
- Management team lacks relevant management skills
- Timeliness of financial disclosure could alert to material negative financial restatements and/or Auditor's ongoing concern
- Is Management actively considering bankruptcy, or are they unwilling to support capital lease or appropriation debt.

# FMA Distribution in Massachusetts

## Massachusetts Municipalities: Financial Management Assessment

Score (%)	Rating							Total
	AAA	AA+	AA	AA-	A+	A	A-	
Strong	42	10	2	17	0	0	0	18
Good	55	63	33	28	0	33	0	49
Standard	3	27	65	56	100	33	50	33
Vulnerable	0	0	0	0	0	33	50	0

# Top 10 Management Characteristics of Highly Rated Credits S&P has observed.

1. Focus on structural balance
2. Strong liquidity management
3. Regular monitoring of revenues and economic trends to identify shortfalls early
4. An established “rainy day”/budget stabilization reserves
5. Prioritized spending plans and established contingency plans for operating budgets
6. Strong long-term and contingent liability management, including pension, OPEB and other obligations and risks
7. A multiyear financial plan in place that considers the affordability of actions or plans before they are part of the annual budget
8. A formal debt management policy in place to evaluate future debt profile
9. A pay-as-you-go strategy as part of the operating and capital budgets
10. Well-defined and coordinated economic development strategies

# Thank you

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