

RatingsDirect®

Summary:

Mequon, Wisconsin; General Obligation

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Credit Profile

US\$6.21 mil GO rfdg bnds ser 2020A due 08/01/2028

Long Term Rating AA/Stable New

Mequon GO corporate purp bnds

Long Term Rating AA/Stable Affirmed

Rationale

S&P Global Ratings assigned its 'AA' long-term rating to the city of Mequon, Wis.'s series 2020A general obligation (GO) refunding bonds. At the same time, S&P Global Ratings affirmed its 'AA' rating on the city's existing GO debt. The outlook is stable.

The series 2020A GO bonds are secured by the city's unlimited tax, ad valorem GO pledge. Proceeds from the series 2020A GO bonds will be used to refund the city's series 2009B and series 2011A GO bonds for interest cost savings.

Mequon's available general fund balance has declined in recent years, reflecting a conscious decision by city officials to draw down reserves in its general fund to a level consistent with its reserve policy of 10% to 12% of expenditures, which we consider relatively low. Compared to other, higher-rated entities, we view the city's reserve policy as potentially exposing it to more risk in the event of a significant, unforeseen expenditure. Buttressing the city's credit profile are its very healthy incomes and market value, which are well above national averages, as well as its participation in the broad and diverse Milwaukee MSA.

The 'AA' rating reflects the following characteristics of the city:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good financial policies and practices under our Financial Management Assessment methodology;
- Adequate budgetary performance, with an operating deficit in the general fund but break-even operating results at the total governmental fund level in fiscal 2018;
- Strong budgetary flexibility, with an available fund balance in fiscal 2018 of 13.5% of operating expenditures;
- Very strong liquidity, with total government available cash at 66.6% of total governmental fund expenditures and 3.7x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges at 18.2% of expenditures and net direct debt that is 200.3% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 92.6% of debt scheduled to be retired in 10 years; and
- Adequate institutional framework score.

Very strong economy

We consider Mequon's economy very strong. The city, with an estimated population of 23,596, is located in Ozaukee County in the Milwaukee-Waukesha-West Allis, WI MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 162% of the national level and per capita market value of \$213,968. Overall, the city's market value grew by 5.2% over the past year to \$5.0 billion in 2020. The county unemployment rate was 2.5% in 2018.

The city spans 47 square miles and is located approximately 20 miles north of Milwaukee along Lake Michigan. The city is made up of mostly residential properties, with its property classified as approximately 80.7% residential, followed by commercial properties at 15.2%. The city has experienced a consistent trend of tax base growth, reflecting continued home value appreciation and commercial development. Of note regarding recent development is the city's Town Center tax increment district (TID), a portion of which has completed one year ahead of schedule and will be added to the tax roll in 2020. The top 10 taxpayers represent only 4.7% of equalized value, which we consider to be very diverse. Because of the city's high incomes and wealth levels, as well its access to the Milwaukee-Waukesha-West Allis MSA, we expect the local economy to remain very strong.

Strong management

We view the city's management as strong, with good financial policies and practices under our Financial Management Assessment methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

In developing its annual budget, the city examines five to 10 years of historical data and reviews outside sources such as the Wisconsin Department of Revenue. The city also uses zero-based budgeting. The city typically amends its budget once a year, and provides quarterly budget-to-actual updates to its council. The city also discusses long-term financial planning matters annually with its council, but does not maintain a formal long-term financial forecast. The city does have a long-term capital plan that is updated annually that identifies sources, and extends five years into the future. In addition, the city has an investment policy, which it recently updated in June 2018, and provides quarterly investment updates to its council. The city also revised its debt management policy recently, providing greater clarity with respect to the nature and amount of permitted levels of future debt issuance. The city also made a revision to its reserve policy that mandates a range of 10% to 12% of general fund expenditures, from 10%, for the purpose of enabling to the city to respond to unforeseen expenses.

Adequate budgetary performance

Mequon's budgetary performance is adequate in our opinion. The city had deficit operating results in the general fund of negative 2.0% of expenditures, but a balanced result across all governmental funds of negative 0.1% in fiscal 2018.

As indicated previously, the city has a reserve policy providing for a minimum of 10% of expenditures in its general fund. The city has been well above this level in recent years, leading to planned drawdowns in recent fiscal years to maintain a stable tax rate. Despite this, the city has historically outperformed its budget, with smaller-than-budgeted drawdowns. In audited fiscal 2018 (year-ended Dec. 31), the city posted a \$308,000 general fund deficit, which represented a better outcome than budget, which called for the use of \$650,000 in reserves. This result was driven, in part, through higher-than-anticipated building permit revenue. The city structured its fiscal 2019 budget without the

use of reserves, and preliminary results indicate a \$134,000 surplus in the general fund. Driving this result are stronger revenue for interest income, cell phone tower leases and savings in its police department. The fiscal 2020 budget is structured with a \$409,000 use of reserves, which is being distributed toward emerald ash borer remediation, pay raises, city-wide valuation costs, and costs for a development study. We anticipate that the city's budgetary performance will remain adequate, though if certain cyclical revenue such as building permit fees does not continue to produce strong revenue, leading to a worse-than-budgeted result, the city's budgetary performance could deteriorate to a level that we consider weak.

Strong budgetary flexibility

Mequon's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2018 of 13.5% of operating expenditures, or \$2.1 million.

With the city's planned deficit in its fiscal 2020 budget, we anticipate its available fund balance may fall to approximately 11% of expenditures, or \$1.8 million. With the city planning to adhere to its reserve policy of 10% to 12% of expenditures, we expect its budgetary flexibility to remain strong.

Very strong liquidity

In our opinion, Mequon's liquidity is very strong, with total government available cash at 66.6% of total governmental fund expenditures and 3.7x governmental debt service in 2018. In our view, the city has strong access to external liquidity if necessary.

On a nominal basis, the city's cash and investment position declined significantly in fiscal 2017. We understand this reduction was due to a change in accounting practice recommended by the city's auditor. Specifically, in previous years, the city's auditor reported advance tax collections as cash received. Beginning in audited fiscal 2017, it was determined that advance tax collections were not available to be until the statutory distribution date in the subsequent year, or on Jan. 15. This accounting change led to a drop in the city's cash and investments in 2017. The nominal amount of cash and investments held by the city at fiscal year-end 2018 was approximately \$14.5 million. We consider the city's access to external liquidity to be strong, as it has issued debt through the public markets within the past 20 years. The city's investments consist of investments in U.S. agencies and Treasuries, which we do not consider aggressive. The city has entered into equipment leases that have default provisions that we consider non-standard that can lead to an acceleration of certain amounts owed in the event of a default. Despite this, the current maximum accelerable principal amount on these obligations is approximately \$27,000, which we do not consider material, given the city's liquidity position. We anticipate that the city's liquidity position will remain very strong in the near term.

Adequate debt and contingent liability profile

In our view, Mequon's debt and contingent liability profile is adequate. Total governmental fund debt service is 18.2% of total governmental fund expenditures, and net direct debt is 200.3% of total governmental fund revenue. Overall net debt is low at 1.5% of market value, and approximately 92.6% of the direct debt is scheduled to be repaid within 10 years, which are in our view positive credit factors.

The city may issue an additional \$5 million in debt for capital improvements within the next two years. We do not believe this proposed debt issuance would materially influence the city's debt profile.

Mequon's pension contributions totaled 3.4% of total governmental fund expenditures in 2018. The city made its full annual required pension contribution in 2018.

The city participates in the Wisconsin Retirement System (WRS), a cost-sharing, multiple-employer defined benefit plan. The city contributed \$743,538 to the plan in 2018, and the WRS plan was 96.4% funded in 2018. The city also participates in another single employer defined benefit plan for certain eligible employees. The total pension liability under the plan was \$453,537 at fiscal year-end 2018. With regard to other postemployment benefits (OPEB), the city provides eligible employees and their spouses' health benefits coverage. The city's OPEB plan had a net liability of \$908,193 as of Dec. 31, 2018. The city also provides benefits under the local retiree life insurance fund, which provides postemployment life insurance benefits for eligible employees. The city's proportionate share of the net OPEB liability was \$534,167 in 2017. We do not consider the city's current pension and OPEB liabilities to be a significant burden.

Adequate institutional framework

The institutional framework score for Wisconsin cities and villages with a population less than 25,000 is adequate.

Outlook

The stable outlook reflects our view that the city will maintain at least strong budgetary flexibility and very strong liquidity during the next two years. The city's participation in the broad and diverse Milwaukee-Waukesha-West Allis, WI MSA provides additional support for the rating.

Upside scenario

If the city were to demonstrate consistently strong budgetary performance, leading to an improvement in its budgetary flexibility to very strong, while maintaining its other credit factors, we could raise the rating.

Downside scenario

Should the city continue to experience significant deficits, leading to a decline in its available fund balance to a level that we consider only adequate or no longer in compliance with its reserve policy, we could lower the rating.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- 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
- 2019 Update Of Institutional Framework For U.S. Local Governments

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