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Summary:

Mequon, Wisconsin; General Obligation

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Credit Profile		
US$9.62 mil GO prom nts ser 2022A dtd 03/24/2022 due 03/01/2032		
Long Term Rating	AA/Stable	New
Mequon GO corporate purp bnds		
Long Term Rating	AA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA' long-term rating to the City of Mequon, Wis.' anticipated $9.6 million series 2022A general obligation (GO) promissory notes. 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 2022A notes are secured by the city's unlimited tax, ad valorem GO pledge. Although not formally pledged, officials anticipate a portion of the notes will be payable from tax increment revenues. Note proceeds will finance street and interchange improvements and tax increment district (TID) no. 3 project costs.

Credit overview

Mequon's key credit strengths include the city's very strong economy, with high income and wealth metrics strengthened by participation in the broad and diverse Milwaukee metropolitan statistical area (MSA). In addition, Mequon's historically stable revenues, the majority of which are property taxes, and good financial management practices, have contributed to the city's mostly breakeven operations in recent years. City officials have committed to maintain reserves at a level near Mequon's reserve policy of 10%-12% of expenditures. Compared with higher-rated peers, we view Mequon's reserve policy as relatively low and potentially exposing the city to more risk in the event of a significant, unforeseen expenditure. Nevertheless, we base the stable outlook on our expectation that the city's very strong economy, stable revenues, and good management practices will continue to support a strong financial profile.

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

- Very strong economy, with well above-average income and wealth metrics and access to the broad and diverse Milwaukee MSA;
- Adequate budgetary performance, with mostly breakeven operations supporting strong budgetary flexibility, with an available fund balance in fiscal 2020 of 13.8% of operating expenditures;
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology, and a strong institutional framework; and
- Adequate debt and contingent liability position, with rapid principal amortization and low debt relative to total market value, and a fully funded pension.

Environmental, social, and governance

The rating incorporates our view of Mequon's environmental, social, and governance (ESG) risks relative to the city's economy, management, financial measures, and debt and liability profile, which we view as in line with the sector.

Stable Outlook

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 experience prolonged deterioration in financial performance, 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.

Credit Opinion

High income and wealth metrics and participation in a broad and diverse MSA support a very strong economy

Mequon spans 47 square miles and is approximately 14 miles north of Milwaukee along Lake Michigan in the broad and diverse Milwaukee-Waukesha-West Allis MSA. The city is made up of mostly residential properties, with its property classified as approximately 81% residential, followed by commercial at 15%. The city has experienced a consistent trend of value growth, reflecting continued home value appreciation and ongoing commercial, industrial, and residential development. Of note regarding recent development is the city's Town Center in tax increment district (TID) no. 3, the majority of which has been completed with remaining projects to be funded with series 2022A note proceeds. Based on the city's high income and wealth levels, as well its access to a broad and diverse MSA, we expect Mequon's economy to remain very strong.

For S&P Global Economics' latest U.S. forecast, see "Economic Outlook U.S. Q1 2022: Cruising At A Lower Altitude," published Nov. 29, 2021, on RatingsDirect.

Strong management, with good policies and practices under our FMA methodology

Highlights to the city's FMA include:

- Reference to five to 10 years of historical data, as well as outside sources such as the Wisconsin Department of Revenue and use of zero-base budgeting when developing the annual budget.
- Quarterly budget-to-actual updates to its council, with annual budget amendments in a typical year.
- A formal five-term capital plan that is updated annually with funding sources identified.
- A formal investment policy, with quarterly investment updates to its council.
- A formal debt management policy that limits GO debt to 50% of the level allowed under state law.
- A formal reserve policy requiring an unassigned general fund balance of 10%-12% of general fund expenditures, for

the purpose of enabling to the city to respond to unforeseen expenses.

Mequon discusses long-term financial planning matters annually with its council but does not currently maintain a formal long-term financial forecast. We also note the city is taking step to mitigate cybersecurity risks and maintains cyber insurance.

Adequate budgetary performance and strong budgetary flexibility based on 10%-12% fund balance policy

The city's formal reserve policy requires a general fund unassigned balance of 10%-12% of expenditures, and Mequon has historically been above this range, leading to planned drawdowns in the past to maintain a stable tax rate. Nevertheless, we anticipate that Mequon's budgetary performance will likely remain at least adequate based on its conservative budgeting practices and historically stable general fund revenues, which primarily consist of property taxes (64%), intergovernmental sources (13%), and licenses and permits (10%).

The fiscal 2022 budget is breakeven and reflects status quo general fund operations. The city was allocated a total of $2.5 million under the American Rescue Plan Act (ARPA), of which half was received in fiscal 2021, the remainder is anticipated in 2022. So far, the city has spent $40,000 of its total ARPA allocation primarily on library operations. Officials have discussed tentative future uses involving stormwater management improvements, development of a land management program, and funding parks and library operations.

Management expects the fiscal 2021 audit to reflect at least a breakeven general fund result. Mequon incurred approximately $200,000 of unbudgeted expenses in 2021 related to the citywide revaluation, community development strategic plan, and IT strategic plan, which are expected to be offset by higher revenues, notably from licenses and permits, relative to budget.

In fiscal 2020, the city reported a breakeven result, representing positive variance relative to its originally planned $400,000 use of reserves. The positive variance is largely due to expenditure reductions, including a hiring freeze, implemented in response to expected revenue shortfalls because of the pandemic.

Mequon's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2020 of or $2.3 million (13.8% of operating expenditures). Based on the city's formal 10%-12% fund balance policy, we do not expect reserves to increase to levels more comparable with that of higher-rated peers. Nevertheless, the total available fund balance has remained at a consistent level overall, totaling 13.7% of expenditures in 2019 and 13.5% in 2018.

Liquidity consists of $16.6 million of total cash and investments. The city currently has no privately placed debt or leases outstanding, and we anticipate its liquidity position will remain very strong.

Adequate debt profile, with rapid principal amortization and low debt relative to total market value

Mequon's total direct debt is $51.7 million. Mequon's overall net debt is low at 1.9% of market value, and approximately 98% of the direct debt is scheduled to be repaid within 10 years, which are in our view positive credit factors. The city does not plan to issue new debt over the two-year horizon. Based on Mequon's lack of future debt plans and considering its debt limitations outlined in its formal debt policy, we expect its debt profile to remain at least adequate.

Fully funded pension leads to low pension and other postemployment benefit costs

Mequon's pension and other postemployment benefit (OPEB) costs are low as a share of total spending and are not likely to accelerate significantly in the medium term, especially given the pension plan's strong funded status. The city participates in the Wisconsin Retirement System (WRS), a multiple-employer, defined-benefit pension plan that has in recent years routinely been among the best-funded multiple-employer pension plans in the country. Mequon also participates in a single-employer, defined-benefit pension plan (the stipend plan) for certain eligible employees, which provides eligible employees two full working days of pay for each year of continuous service, up to 30 years. Although the city funds its OPEB on a pay-as-you-go basis, exposing it to potential cost acceleration, we expect that medium-term costs will remain only a small share of total spending and, therefore, not a significant budgetary pressure.

Mequon participates in the following pension and OPEB plans:

- WRS: 105.3% funded (as of Dec. 31, 2020), using a 7.0% discount rate, with a city proportionate share of the plan's net pension asset of $4.2 million.
- Stipend pension plan: 0% funded (as of Dec. 31, 2019), using a 2.75% discount rate, with a net pension liability of $426,000.
- A single-employer, defined-benefit OPEB plan: 0% funded (as of Dec. 31, 2019) ,with a net OPEB liability of $993,000.

WRS contributions are actuarially determined, and the city funds 100% of the required contribution annually. The system's investment-rate-of-return assumption decreased to 7.0% in late 2018 from 7.2%. Although the revised return assumption exceeds our 6.0% guideline, WRS employs a shared-risk model, mitigating market-volatility exposure. With this model, changes in active-employee contributions and benefit-payment adjustments offset investment-performance fluctuations. Because of these features, we expect contributions will likely remain relatively stable. Because of WRS' strong funding and contribution practices, we expect contributions will likely remain affordable.

Strong institutional framework

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

Mequon, Wis.--Key Credit Metrics

	Most recent	Historical information		
		2020	2019	2018
Very strong economy				
Projected per capita EBI % of U.S.	179			
Market value per capita ($)	225,846			
Population (no.)		23,924	23,688	23,596
County unemployment rate(%)		5.4		
Market value ($000)	5,403,150	5,048,795	4,797,857	4,610,493
Ten largest taxpayers % of taxable value	4.9			

Mequon, Wis.--Key Credit Metrics (cont.)				
	Most recent	**Historical information**		
		2020	**2019**	**2018**
Adequate budgetary performance				
Operating fund result % of expenditures		0	1.0	(2.0)
Total governmental fund result % of expenditures		(2.0)	12.8	(0.1)
Strong budgetary flexibility				
Available reserves % of operating expenditures		13.8	13.7	13.5
Total available reserves ($000)		2,313	2,251	2,127
Very strong liquidity				
Total government cash % of governmental fund expenditures		68	80	67
Total government cash % of governmental fund debt service		381	425	366
Strong management				
Financial Management Assessment	Good			
Adequate debt & long-term liabilities				
Debt service % of governmental fund expenditures		18.0	18.9	18.2
Net direct debt % of governmental fund revenue	118			
Overall net debt % of market value	1.9			
Direct debt 10-year amortization (%)	98			
Required pension contribution % of governmental fund expenditures		3.4		
OPEB actual contribution % of governmental fund expenditures		0		
Strong institutional framework				

EBI--Effective buying income. OPEB--Other postemployment benefits. Data points and ratios may reflect analytical adjustments.

Related Research

- Credit Conditions: U.S. Regions' Economies Perk Up As The Pandemic's Impact Ebbs, April 16, 2021
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 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
- 2021 Update Of Institutional Framework For U.S. Local Governments