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## Summary:

# Mequon, Wisconsin; General Obligation

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**Summary:**

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|---|---|---|
| US$20.305 mil GO corporate purp bnds ser 2018A dtd 04/26/2018 due 10/01/2032 | | |
| *Long Term Rating* | AA/Stable | New |

## Rationale

S&P Global Ratings assigned its 'AA' long-term rating to the City of Mequon, Wis.' series 2018A general obligation (GO) corporate purpose bonds. The outlook is stable.

The series 2018A bonds are secured by the city's unlimited-tax GO pledge. Proceeds for the bonds will be used for a sewer expansion project.

The 'AA' rating reflects our view of the city's:

- 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 (FMA) methodology;
- Adequate budgetary performance, with slight operating deficits in the general fund and at the total governmental fund level in fiscal 2016;
- Strong budgetary flexibility, with an available fund balance that we expect will decrease in the near term from its fiscal 2016 level of 19% of operating expenditures;
- Very strong liquidity, with total government available cash at 136.1% of total governmental fund expenditures and 7.9x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges at 17.2% of expenditures and net direct debt that is 234.7% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of market value and rapid amortization, with 78.5% 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 23,246, is located in Ozaukee County in the Milwaukee-Waukesha-West Allis MSA, which we consider broad and diverse. The city has a projected per capita effective buying income of 190% of the national level and per capita market value of $198,335. Overall, the city's market value grew by 2.9% over the past year to $4.6 billion in 2018. The county unemployment rate was 3.5% in 2016.

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 82% residential, followed by commercial properties at 13.8%. The city has experienced equalized value growth for four consecutive years, with an average annual increase of 4%, primarily reflecting continued home value appreciation. The top 10 taxpayers represent only 4.5% of equalized value, which we consider to be very diverse. The city has recently rezoned certain acreage within its limits for additional housing development within the community. 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 FMA methodology, indicating our view that 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, identifies sources, and extends five years into the future. In addition, the city has an investment policy, which it is in the process of revising, and provides quarterly investment updates to its council. The city also has previously maintained a fairly limited debt management policy, which the city council is expected to revise and approve in April 2018. Finally, the city also has a reserve policy that requires it to keep at least 10% of general fund expenditures for the purpose of enabling to the city to respond to unforeseen expenses.

In June 2016, the city missed an interest payment totaling $12,631 owed pursuant to its series 2008 promissory notes. It did not realize it had missed the payment until early 2017, at which point the payment was made. Management reports that it has adopted and implemented procedures to avoid a similar situation in the future, including the use of multiple calendar reminders and the hiring of additional staff to help monitor payment due dates. Should another missed payment on its debt outstanding occur, which we do not anticipate, our view of the city's management will most likely weaken.

### Adequate budgetary performance

Mequon's budgetary performance is adequate, in our opinion. The city had slight operating deficits of 1.4% of expenditures in the general fund and of 0.9% across all governmental funds in fiscal 2016.

Our analysis of the city's budgetary performance reflects the adjustment for the spending of bond proceeds out of its capital improvement funds in fiscal 2016. As indicated previously, the city has a reserve policy of 10% of expenditures. 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, including in fiscal 2016, when it posted a $222,259 deficit. Despite this, the city outperformed its general fund budget that year, as the original budget had called for a $300,000 use of reserves. Driving this better-than-budgeted result were increased revenue from housing permits and lower expenditures because of a mild winter.

For unaudited fiscal 2017, the city expects to report a $528,000 deficit in the general fund, a better outcome than the budgeted use of $700,000 of reserves. Contributing to this expected result was the city's decision to delay backfilling certain positions and lower-than-budgeted call volume from its fire department. The city has budgeted for another $650,000 drawdown in fiscal 2018 and reports that it is on track with this projection. With the city nearing its fund balance reserve policy floor in 2018, we understand that the city expects to limit its use of reserves beginning in fiscal 2019. Moreover, the city council is expected to consider new revenue enhancements as well as adopt a capital asset management plan, which officials expect will better distribute funds for capital equipment in future years. 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 that we expect could decrease in the near term from the fiscal 2016 level of 19% of operating expenditures, or $2.9 million. Over the past three years, the total available fund balance has been consistent, totaling 19% of expenditures in 2015 and 19% in 2014.

Based on the city's expected deficit in unaudited fiscal 2017, we anticipate its available fund balance will fall to 15.4% of expenditures, or $2.4 million. Similarly, in fiscal 2018, the city's planned drawdown would result in a projected year-end available fund balance of 11% of expenditures, or $1.7 million, which we consider strong.

### Very strong liquidity

In our opinion, Mequon's liquidity is very strong, with total government available cash at 136.1% of total governmental fund expenditures and 7.9x governmental debt service in 2016.

At the end of fiscal 2016, the city had $27.9 million in cash and investments available. We consider the city's access to external liquidity to 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 two equipment leases that have default provisions that we consider non-standard and 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 leases is approximately $176,400, 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 17.2% of total governmental fund expenditures, and net direct debt is 234.7% of total governmental fund revenue. Overall net debt is low at 1.8% of market value, and approximately 78.5% of the direct debt is scheduled to be repaid within 10 years, which are in our view positive credit factors.

We understand the city expects to issue an additional $3.9 million in new money debt within the next two years. We do not expect this future borrowing to worsen the city's debt and contingent liability profile.

Mequon's pension contributions totaled 3.4% of total governmental fund expenditures in 2016. The city made 100% of its annual required pension contribution.

The city participates in the Wisconsin Retirement System (WRS), a cost-sharing, multi-employer defined benefit plan.

The city contributed $641,381 to the plan in 2016. As of Dec. 31, 2016, the city had a liability of approximately $1 million for its proportionate share of the net pension liability. The plan fiduciary net position as a percentage of the total pension liability for WRS was 99.1% in 2017. With regard to other postemployment benefits (OPEB), the city provides eligible employees and their spouses health benefits coverage with retirees paying 100% of the premium, resulting in an implicit rate subsidy. The city's OPEB plan had an unfunded actuarial accrued liability of $1.8 million as of Jan. 1, 2016. We do not consider the city's current pension and OPEB liabilities to be a significant burden for the city.

### 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 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, we could lower the rating. In addition, if the city were to miss a bond payment, which would demonstrate the city's inability to establish a satisfactory procedure to ensure timely payments after missing a payment in 2016, a lower rating would be likely.

## 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
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- 2017 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 the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.