

## MOODY'S ASSIGNS MIG 1 RATING TO THE CITY OF SOMERVILLE'S (MA) \$1.0 MILLION BOND ANTICIPATION NOTES AND TO \$2.6 MILLION BOND ANTICIPATION NOTES

Affirms A1 Rating on Total of \$63.2 Million Outstanding Long-Term General Obligation Debt

Moody's Investors Service has assigned MIG 1 ratings to the City of Somerville's (MA) \$1.0 million Bond Anticipation Notes (dated June 29, 2007 and due October 18, 2007) and \$2.6 million Bond Anticipation Notes (dated June 29, 2007 and due February 20, 2008).

Concurrently, Moody's has affirmed the city's long-term A1 rating, affecting \$63.2 million of outstanding general obligation debt. The notes are secured by the city's general obligation limited tax pledge as voters have not exempted debt service from the levy limitations of Proposition 2 ½. Proceeds of the issue maturing in October 2007, which the city expects to permanently finance with bonds prior note maturity, provide new money financing for ongoing construction of the city's Lincoln Park School. The issue maturing in February 2008, which the city also plans to permanently finance with bonds prior to maturity, will finance \$2.1 million of departmental equipment purchases, \$400,000 for construction of a fieldhouse building and the remainder for fire alarm and computer needs. The MIG 1 rating reflects the city's demonstrated market access and upper-medium quality credit characteristics. Affirmation of the long-term A1 rating reflects a large and diverse tax base experiencing ongoing development, adequate and improving fund equity and above-average debt burden partially mitigated by commonwealth aid.

### DEMONSTRATED MARKET ACCESS

Moody's expects the city to enjoy satisfactory access to the capital markets given a history of competitive bids on previous borrowings. The city received seven bids on its most recent note sale in December 2006, seven bids on its August 2006 note sales and five bids on each of its June 2006 and August 2005 sales. All bids were from major regional and national financial institutions. Moody's believes that this strong history of market access indicates an ability to refund these notes at their December 2006 maturity.

### DIVERSE AND SIZEABLE TAX BASE IN METROPOLITAN BOSTON EXPECTED TO GROW

Moody's believes that the city's already large \$8.8 billion tax base will continue to expand and diversify given the city's favorable location and a number of substantial projects expected in the near to medium term. The city itself has a strong local employment base, and residents additionally benefit from close proximity to Cambridge (G.O. rated Aaa) and Boston (G.O. rated Aa1/stable outlook), which is accessible by Interstate 93, subway, and commuter rail stops in the city. As typical in the Greater Boston region, the city's housing values have appreciated significantly, contributing to the growth in equalized value which has averaged 14.6% annually since 2002. Primary drivers of this expansion are condominium conversions of rental units, new commercial development and ongoing market value appreciation. Portions of Tufts University (rated Aa3/stable outlook) lie within the city; the university's presence provides economic stability and significant employment opportunities. Although a tax-exempt entity, the city benefits from annual payments-in-lieu of taxes of \$125,000 and affordable rental rates of university-owned property utilized for city operations. The city's sizeable student population (about 14% of total population according to the 2000 census), drawn from Tufts, as well as nearby Harvard (rated Aaa) and MIT (rated Aaa), partially depresses the city's income indices,

expressed by median family income and per capita income at 83% and 91%, respectively, of commonwealth medians.

To capitalize on Somerville's desirable location and to facilitate continued growth, city management has embarked on an ambitious economic development plan, including commissioning various feasibility studies to identify potential projects, rezoning initiatives to facilitate investment and pursuit of state and federal grant funds. The principal driver for future growth is the 145-acre Assembly Square project, including two million square feet of office space, over 2,000 housing units, and a 500,000-square-foot IKEA. Previously delayed due to zoning litigation, a recent favorable ruling will permit construction to commence in late 2008. An initial \$64 million investment by Federal Realty Investment Trust (FRIT) to purchase the Assembly Square Mall and development rights to adjacent properties has already led to FRIT's location of regional headquarters to the district and full tenancy at the mall. Longer-term development is partially contingent upon the opening of new Orange subway line stop currently under consideration by the Massachusetts Bay Transportation Authority (MBTA, assessment bonds rated Aa1/stable outlook). While management expects Orange line construction to begin in 2009, Moody's believes that without a firm commitment from the MBTA, future development may not be as robust as currently anticipated if the project is delayed or not undertaken. Additional projects are in various stages of planning and include development of the city's riverfront area, industrial zone, and condominium development in the city's Boynton section. An expansion of the Green light rail line through the city's Union Square, currently anticipated for 2014 is expected to spur additional development. As a result of these projects and ongoing development Somerville conservatively expects to realize up to \$11.7 million in new growth revenues over the next five years.

#### STABILIZED FINANCIAL OPERATIONS SUPPORTED BY CONSERVATIVE BUDGETING

Moody's anticipates that continued conservative budgeting, increasing property tax revenues, and strong financial management will continue to support favorable financial operations. Fiscal 2006 operations produced the city's fourth consecutive surplus adding nearly \$2.8 million to reserves despite nearly \$2 million expended for retroactive payments to settle outstanding collective bargaining agreements. The total \$25.9 million general fund balance (a healthy 19.2% of revenues), includes a \$7.6 million reserve for employee benefits as the city maintains employee contributions for its self-funded health insurance fund within the General Fund. As these balances are not available for general operations, Moody's views Somerville's unreserved fund balance as more accurately reflecting the city's financial position. This measure also increased in fiscal 2006 to \$16.9 million (a solid 10.3% of revenues). The city also appropriated \$400,000 into its stabilization fund and transferred the existing \$189,593 balance to the water enterprise for capital purposes. Fiscal 2005 financial statements show a considerable addition to the General Fund balance of nearly \$8 million in addition to full replenishment of the \$3.7 million of free cash appropriated for operations. These positive results are due largely to a revenue surplus achieved through a \$1.2 million asset sale, \$950,000 in unbudgeted state lottery aid, and strong tax lien collection of \$1.1 million. Consequently, general fund balance rose to a satisfactory \$23.1 million, (14.8% of revenues), with undesignated unreserved fund equity rising by \$2.7 million to \$11.7 million (7.5% of revenues). Additionally, the sewer enterprise fund reversed a 2005 negative fund balance of nearly \$680,000 to positive fund equity of \$3.9 million, due to the reinstatement of real estate liens for delinquent accounts and improved billing practices. Going forward, management projects these improvements, coupled with new meter installation will contribute to the health of the enterprise, and anticipates that the general fund will begin to recoup administrative costs in the next few years.

As fiscal year-end 2007 approaches, management projects a fifth consecutive General Fund operating surplus, primarily generated from expenditure savings. In addition, lower than

expected employee health insurance claims will allow that reserve to grow by an estimated \$2 million. Developer payments of \$2 million have been applied to the city's Capital Stabilization Fund, boosting that fund's balance to approximately \$2.3 million. Following its plan to apply a third of annual free cash balances to the Capital Stabilization Fund, city officials expect to deposit an additional \$2.5 million into the fund upon state certification of its free cash. These funds will provide the city with additional flexibility to fund renovations to city buildings and parks on a pay-as-you-go basis. The fiscal 2008 budget, scheduled for final adoption later this month, currently includes \$3.5 million of free cash as revenue, an increase of \$500,000 over fiscal 2007 due to net declines in state aid. Despite this increased free cash appropriation, Somerville's history of careful financial management indicates its ability to replenish these balances through favorable budgetary variances.

#### DEBT POSITION EXPECTED TO REMAIN MANAGEABLE

Moody's believes that the city's debt position will remain manageable given anticipated school construction assistance and rapid retirement of outstanding debt. Somerville's overall debt burden is above average at 3.2% of equalized valuation due to significant overlapping obligations attributable to the Massachusetts Water Resources Authority (senior lien debt rated Aa2/stable outlook) and the Massachusetts Bay Transportation Authority (Aa2/stable outlook). After adjusting for 90% commonwealth school construction reimbursement, this number falls to a more favorable 2.8%. Debt service payments accounted for a manageable 4.5% of general fund expenditures in fiscal 2006. Amortization of outstanding debt is rapid with 82.4% of principal repaid within ten years. Near-term borrowing plans include \$15 million for construction cost overruns associated with the Lincoln Park school project, \$8.7 of which the city plans to borrow through a low-interest commonwealth loan program in fiscal 2007. The city is also considering issuing energy conservation bonds within the next 18 months, although specific borrowing amounts have yet to be determined.

#### KEY STATISTICS:

2000 population: 77,478

2007 Equalized Valuation (proposed): \$8.7 billion

2007 Equalized Value per capita: \$116,862

Overall debt burden: 3.2%

Adjusted overall debt burden: 2.8%

Payout of principal (10 years): 82.4%

Per Capita Income: \$23,628 (91% of commonwealth median)

Median Family Income: \$51,243 (83% of commonwealth median)

FY06 General Fund balance: \$25.9 million (19.2% of general fund revenues)

FY06 Unreserved Undesignated General Fund balance: \$13.9 million (8.5% of general fund revenues)

FY06 Stabilization Fund balance: \$400,000 (0.2% of General Fund revenues)

Post-sale Long-term G.O. debt outstanding: \$65.7 million