

RatingsDirect®

Summary:

Somerville, Massachusetts; General Obligation; Note

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Credit Profile

US\$26.353 mil GO BANs ser 2016B dtd 06/10/2016 due 06/09/2017		
<i>Short Term Rating</i>	SP-1+	New
US\$18.169 mil GO BANs ser 2016A dtd 06/10/2016 due 10/14/2016		
<i>Short Term Rating</i>	SP-1+	New

Rationale

S&P Global Ratings has assigned its 'SP-1+' short-term rating to Somerville, Mass.' series 2016 A and B general obligation (GO) bond anticipation notes (BANs). Series A is payable Oct. 14, 2016, and series B is payable on June 9, 2017. At the same time, Standard & Poor's affirmed its 'AA+' long-term rating, with a stable outlook, on the city's existing GO debt.

The 'SP-1+' rating reflects our view of Somerville's strong ability to pay principal and interest when the notes come due. The city's market risk profile is low, in our view, because it maintains strong legal authority to issue long-term debt to take out the BANs; and is a frequent issuer, providing regular disclosure to market participants.

Somerville's full-faith-and-credit pledge secures the notes. Note proceeds will refinance previous issued BANs as well as fund various capital projects, according to city officials.

The rating reflects our assessment of Somerville'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 methodology;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2015;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2015 of 16% of operating expenditures;
- Very strong liquidity, with total government available cash at 31.7% of total governmental fund expenditures and 6.8x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges at 4.7% of expenditures and net direct debt that is 44.5% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value, but a large pension and other postemployment benefit (OPEB) obligation and the lack of a plan to sufficiently address the obligation; and
- Strong institutional framework score.

Very strong economy

We consider Somerville's economy very strong. The city, with an estimated population of 79,143, is located in Middlesex County in the Boston-Cambridge-Newton MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 126% of the national level and per capita market value of \$141,500. Overall, the city's market value grew by 6.7% over the past year to \$11.2 billion in 2016. The county unemployment rate was 4% in 2015.

Somerville is a fully developed four-square-mile city adjacent to Boston and Cambridge. The city continues to sustain ongoing economic development within Assembly Square and Union Square, driven by residential and commercial construction. This development has led to continued new growth in the city's tax base, which management projects to be \$3.2 million in fiscal 2016, \$300,000 greater than the \$2.9 million initially budgeted. In addition, a new subway station is scheduled to open by 2018, which would provide additional access to the city limits of Boston.

Leading employers within the city include:

- Tufts University (2,193 employees);
- ABM Industries (2,000);
- Somerville School Dept. (1,100); and
- Cambridge Health Alliance (1,014).

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.

City management is conservative in its budgeting approach, and relies on historical data, as well as budget-to-actual results for revenue and expenditure assumptions. The management team also has biweekly meetings to monitor budget performance, and utilizes "SomerStat, a real-time monitoring program that provides current budget-to-actual comparisons. The city maintains a five-year capital plan that identifies funding sources; the plan is currently being updated. Management has historically maintained a debt policy limiting debt service to 5% of budget and a formal reserve policy of maintaining stabilization reserves of at least 5% of expenditures. The city's investment policy is rooted in state statute, and holdings, as well as earnings are updated monthly internally and reported to the Council as part of the budget update. We understand the city does not currently maintain a long-term revenue and expenditure forecast.

Strong budgetary performance

Somerville's budgetary performance is strong in our opinion. The city had operating surpluses of 1.8% of expenditures in the general fund and of 3.3% across all governmental funds in fiscal 2015.

Our total governmental fund calculation includes a \$12.5 million adjustment for one-time capital outlay financed by bond proceeds in the city's capital projects fund.

Somerville's fiscal 2016 budget totaled \$228 million, and included a free cash appropriation of \$3.5 million. Management is projecting a surplus due to positive variances for budgeted hotel, motel, meals and motor vehicle

taxes. For fiscal 2017's budget, management anticipates a 4.9% increase and a \$2.5 million free cash appropriation, which is in line with historical practice. Going forward, the city will use less free cash to balance the budget and by 2020 will no longer need to appropriate free cash into the budget. The city's leading revenues sources include property taxes, state aid, and excise taxes at 57%, 26%, and 4% of general fund revenues, respectively. Current property tax collections are strong in our opinion, averaging greater than 99% of the levy in the past five fiscal years.

Overall, we anticipate the city's budgetary performance will remain strong. At the same time, the city's leading revenue sources are stable, and management has historically demonstrated an ability to make the necessary budget adjustments to align recurring revenues with recurring expenditures; therefore, we do not expect further deterioration in budgetary performance over the next two fiscal years.

Very strong budgetary flexibility

Somerville's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2015 of 16% of operating expenditures, or \$34.1 million.

Our calculation includes adding \$13.9 million in committed stabilization funds, which are available with Council approval. Somerville closed fiscal 2015 with \$34.1 million in available reserves, including unassigned, assigned, and committed fund balance. While management used about \$3 million in free cash generated and \$2 million in stabilization funds to cover part of the snow and ice shortfall in 2015 the city's budgetary flexibility is improved. We believe the \$2.5 million in free cash appropriated to balance the 2017 general fund budget will be regenerated, as management has historically not drawn on this appropriation and uses it as part of its budgetary practices. Over the next two fiscal years, we expect the city's budgetary flexibility will remain at least strong as management does not have plans to draw on reserves.

Very strong liquidity

In our opinion, Somerville's liquidity is very strong, with total government available cash at 31.7% of total governmental fund expenditures and 6.8x governmental debt service in 2015. In our view, the city has strong access to external liquidity if necessary.

Our calculation includes a \$32.9 million adjustment for bond proceeds and restricted cash in the city's capital projects fund and nonmajor governmental funds. We believe the city's strong access to external liquidity is supported by its frequent debt issuances, including GO bonds and BANs. Despite the use of free cash and stabilization reserves in fiscal 2015, we anticipate the city will maintain its very strong liquidity metrics given its total governmental fund cash position.

Adequate debt and contingent liability profile

In our view, Somerville's debt and contingent liability profile is adequate. Total governmental fund debt service is 4.7% of total governmental fund expenditures, and net direct debt is 44.5% of total governmental fund revenue. Overall net debt is low at 1% of market value, which is in our view a positive credit factor.

After this issue, the city will have \$129.4 million in total direct debt outstanding, of which \$45 million is bond anticipation notes. Management plans to issue approximately \$20 million in new-money debt in each of the next two years outside of the possible long-term financing of this issue of bond anticipation notes.

In our opinion, a credit weakness is Somerville's large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation. Somerville's combined required pension and actual OPEB contributions totaled 9.3% of total governmental fund expenditures in 2015. Of that amount, 5.2% represented required contributions to pension obligations, and 4.1% represented OPEB payments. The city made its full annual required pension contribution in 2015. The funded ratio of the largest pension plan is 65.5%.

We believe the costs associated with the city's long-term liabilities will continue to rise in the medium term given the pension system's current funding level and the size of the unfunded liability. Using updated reporting standards in accordance with Governmental Accounting Standards Board Statement Nos. 67 and 68, the city's share of the net pension liability was about \$127.9 million, with 65.5% funded as of June 30, 2015. At the same time, we do note that the city's efforts to reduce the OPEB liability has resulted in declines in each of the last four actuarial valuations. In addition, Somerville has established an irrevocable trust fund to begin funding its OPEB liability. The projected balance as of June 30, 2016, is about \$1 million. While we believe the establishment of the trust is a proactive step in addressing the liability, which was \$285.3 million as of June 30, 2014, we also note the city has executed reforms on the liability side to manage its exposure. Going forward, the city will increase these payments to \$5 million in which these funds will be made available from a health care trust that is estimated to be overfunded by \$13 million. The city will continue with these increased payments until the health care trust is no longer viewed as overfunded.

Strong institutional framework

The institutional framework score strong.

Outlook

The stable outlook reflects our view of Somerville's access to the Boston MSA and ongoing economic growth, which will continue to benefit the local tax base. We believe the city's strong management conditions and improving economic outlook should provide an environment for a consistent and balanced budgetary performance, as well as maintenance of strong budgetary flexibility. For these reasons we do not anticipate changing the rating in the next two years.

Upside scenario

Over time we could raise the rating if economic indicators and underlying fundamentals improve to levels commensurate with higher-rated credits, and management demonstrates an ability to maintain a strong budgetary performance and sustain growth in available reserves while instituting a credible plan to mitigate the rising fixed costs associated with its pension and OPEB liabilities.

Downside scenario

While unlikely during our outlook period, if Somerville's high pension and OPEB costs have a negative impact on budgetary performance and cause a significant decline in available reserves, we could lower the rating

Related Criteria And Research

Related Criteria

- USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- USPF Criteria: Financial Management Assessment, June 27, 2006
- USPF Criteria: Debt Statement Analysis, Aug. 22, 2006
- USPF Criteria: Bond Anticipation Note Rating Methodology, Aug. 31, 2011
- USPF Criteria: Limited-Tax GO Debt, Jan. 10, 2002
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015

Ratings Detail (As Of May 26, 2016)		
Somerville GO mun purp loan bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Somerville GO		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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