

## Newton's Capital Formation Report of Blue Ribbon Subcommittee #2

Public infrastructure – roads, school buildings, police and fire equipment, libraries, parks, museums – is at the heart of the quality of life in a community. In an era of scarce public resources, when there is a temptation to defer major investments, it is especially important that capital spending, and its companion, spending on maintenance of capital assets, be periodically reviewed for adequacy. In its charge, the Blue Ribbon Commission was specifically asked to address this question:

“(The Commission) should examine whether the appropriate balance is being anticipated for allocations between operational expenses and capital investment in the City and School plant and equipment over the next five years to avoid more expensive capital investments in the future.”

### Newton's Investment Policy

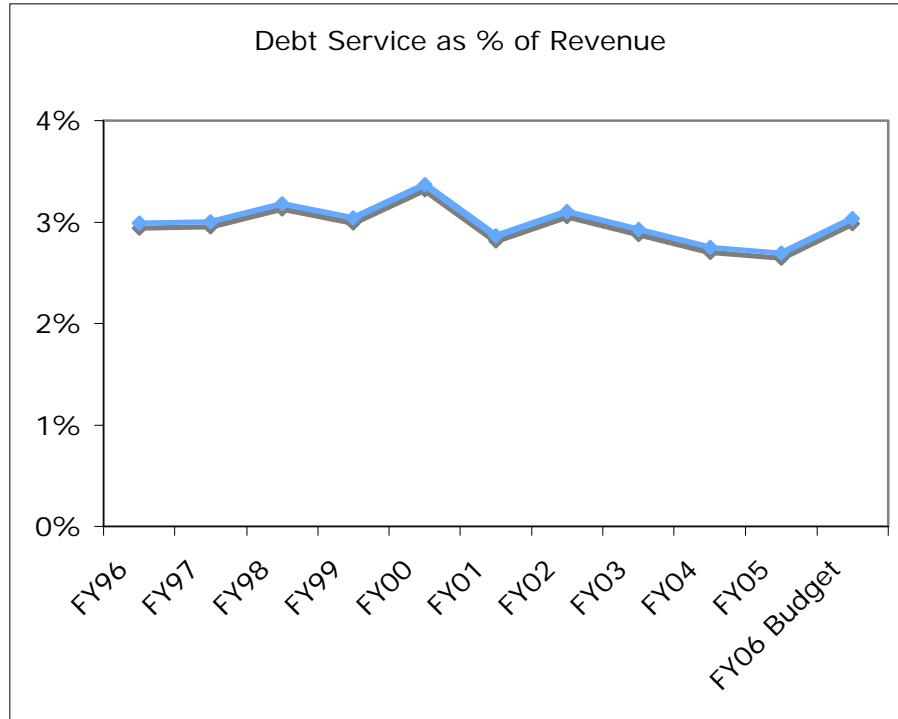
Newton has long recognized the need for explicit guidelines regarding investment. In 1981, Proposition 2 ½ had just been passed and Newton was preparing itself for a new tighter economic future. Fearing that the new fiscal pressure would mean significant budget cuts the executive branch sought to establish guidelines in a number of areas. City Comptroller David Wilkinson recalls these three that were intended to protect capital investment. The first was that free cash, or the end of year surplus, would be used only for capital projects. The second was to establish that items under \$500,000 would not be bonded, and the third was that debt service, or interest and principal on bonded debt wouldn't be less than 3% of the budget and that if it were then the difference would be spent directly on capital items. The 3% was used as a placeholder since that was the percentage that debt service had been in recent years.

In the 1990s, the 3% policy was formalized by incorporation in the five year Capital Improvement Plan (CIP). That policy, as stated in the most recent CIP is:

General Fund Debt Service will be approximately 3% of General Fund Revenue.  
Total capital expenditures will be approximately 5% of General Fund Revenue.

By virtue of the fact that the Capital Improvement Plan is reviewed and approved by the Aldermen, this policy was adopted by both branches of city government.

Throughout the past decade, Newton has been true to this policy: annual interest and principal payments have varied little from the 3% of revenue rule.



Data source: Comptroller's Office, City of Newton

Total capital spending over the past ten years was almost \$110 million, or almost exactly 5% of the \$2.2 billion in revenue available over that time.

### Newton's Credit Standing

Newton has held the highest possible credit rating, without interruption, for more than thirty years from Moody's Investors Service, a nationwide independent credit rating agency.

A credit rating is akin to a report card. While the City's underlying property and income wealth is the foundation for its rating, the City's long-term management diligence and its response to fiscal management issues has earned it (in the MCAS lingo) a highly proficient score.

There are four primary areas measured by an independent credit rating agency:

1. Debt factors – how much debt is issued, for what term and how rapidly will it be repaid? What are the City's future debt issuance plans and will these plans create any unusual stress on the City's ability to repay its debt without constraining its current operations?
2. Economic factors – what are the economic factors of the community and region? Is the tax base diversified? What is the development growth potential and capacity?

3. Administrative factors – what is the community’s record of sound financial management? What is the political environment? What efforts are made in capital investment and long-term fiscal planning?
4. Financial factors – what are operating results over a period of years? Tax collection percentages, reserve position and reserve policies? Capital infrastructure maintenance policies and practices?

There are also areas that are important to city residents that are not measured by a bond rating including the condition of buildings, roads, and parks. There’s not a great deal the City can do about economic factors affecting the wider region and not a lot more development space in Newton. But the three other areas present both opportunities and pitfalls. Ideally the city would continue to manage in such a way as to preserve its Aaa rating, however in the long run a Aaa rating will not be maintained if city infrastructure and services are not maintained. Moving from a Aaa rating to a Aa rating would add approximately 5% to annual borrowing costs.

Is Newton’s capital spending adequate?

Bearing in mind that debt is just one component of a strong credit rating, we reviewed available evidence of the adequacy of Newton’s capital investment policy. As school buildings represent 85% of Newton’s capital assets, this seemed a good place to look.

In April 2006 the Massachusetts School Building Authority (MSBA) released a Needs Survey Report describing the general condition of public school facilities throughout the Commonwealth. Teams of educators and engineers visited every public school in the state, a total of 1,817 schools. Using a standard survey to assess general conditions, they assigned each school a condition rating of 1 to 4.

The Report concludes that the condition of Massachusetts schools overall is generally good. 76% of the buildings received a rating of 1 or 2, meaning that they are generally in good condition, with a few building systems that may need attention. Less than 3% of schools (62 schools in total) received a rating of 4, meaning they are in poor condition and candidates for major renovation or replacement.

The Report found that there was little correlation between the relative wealth of a school district and the general condition of the school buildings within that district. Our city is a case in point. Over 30% of Newton’s schools received a rating of 3, meaning that they are in fair to poor condition and need moderate to major renovation. These schools include: Angier, Cabot, Pierce and Zervas elementary schools, Brown Middle School, Newton North High School and the Newton ECC (pre-K program). 40% of Newton’s schools received a rating of 2 and 27% received a rating of 1.

Massachusetts has spent a substantial amount on school construction and renovation – 63% of the state’s schools are being reimbursed for projects undertaken between 1986

and 2005. During that period in Newton, however, only 41% of schools have received such state funding.

Newton's schools are considerably older than schools in Massachusetts. 32% of our schools were built before 1940, compared with 24% statewide. Only 18% of our schools were built after 1970, compared with 32% statewide.

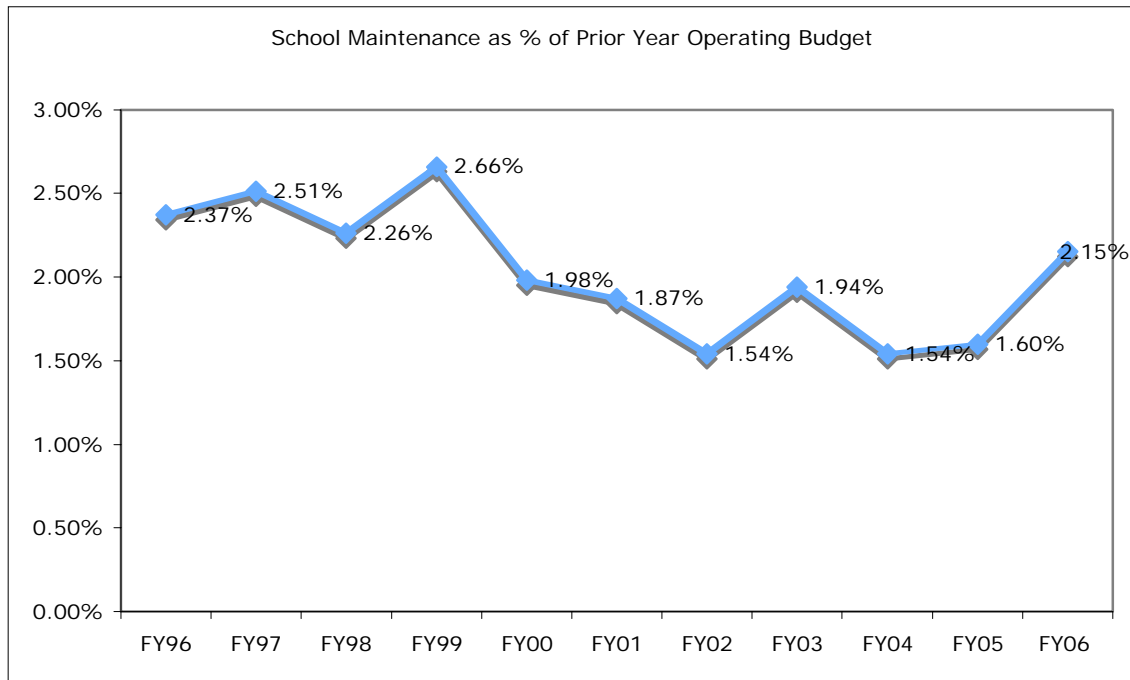
<b>Newton Schools</b>		<b>Year Opened</b>	<b>School Rating</b>
Elementary Schools	A E Angier ES	1921	3
	Underwood ES	1924	1
	Cabot ES	1929	3
	John Ward ES	1927	2
	Franklin ES	1939	2
	Lincoln-Eliot ES	1939	1
	Williams ES	1949	1
	Bowen ES	1950	2
	Pierce ES	1951	3
	Memorial Spaulding ES	1954	2
	Countryside ES	1953	2
	Zervas ES	1954	3
	Mason-Rice ES	1959	2
	Horace Mann ES	1964	2
C C Burr ES	1962	1	
Middle Schools	Bigelow MS	1970	2
	F A Day MS	1971	2
	Oak Hill MS	1930	1
	Charles E Brown MS	1956	3
High Schools	Newton South HS	1960	1
	Newton North HS	1973	3
Pre-Kindergarten	Newton ECC	1975	3

An integral component of the condition of assets is the amount of funds that are invested in their maintenance. Here again, the track record of school maintenance spending was reviewed.

Section 4-3 of the Newton City Charter establishes the following standard for school maintenance spending:

(The School Committee shall) provide ordinary maintenance and repairs on all school buildings up to a maximum expenditure equal to two per cent of the School Department's operating budget adopted for the preceding fiscal year.

Actual school maintenance spending was reviewed with an eye toward this guideline.



For most of this decade, maintenance spending has fallen short of the 2% goal. Each half of a percent point below the goal is worth roughly \$700,000 in annual maintenance.

How does Newton's debt compare with other communities?

It's worth looking at other Massachusetts cities and towns to compare capital investment levels. To do this, we looked at how Newton's debt load compares with other municipalities also holding the highest credit rating. Of the 351 cities and towns in Massachusetts, only 13 hold a Aaa credit rating from Moody's. These include the cities of Newton and Cambridge, as well as eleven other towns: Andover, Belmont, Brookline, Concord, Dover, Hingham, Lexington, Wayland, Wellesley, Weston and Winchester.

Below are tables that compare Newton's debt service and outstanding debt per capita with the other Massachusetts Aaa communities. The data shows that, relative to its peers, Newton is underutilizing its debt capacity and, at least in terms of debt load, is a long way from jeopardizing its bond rating by taking on additional debt.

The table below shows FY05 debt service as a percent of the city or town's operating budget and also on a per capita basis. (In lay terms this would be like your annual mortgage payment on your house, compared to your total income, and divided by how many people live in your house.)

**Massachusetts Municipal Debt Comparison -- "Triple A" Cities and Towns  
Debt Service Percentages**

Massachusetts City or Town	Bond Rating	Population	FY05 Operating Budget	FY05 Debt Service		
				Total	as % of Budget	per Capita
NEWTON	Aaa	83,802	284,263,989	9,268,477	3.26	111
BELMONT	Aaa	23,604	80,522,395	4,753,898	5.90	201
WINCHESTER	Aaa	21,167	69,349,047	4,164,645	6.01	681
WELLESLEY	Aaa	26,515	95,987,511	6,037,175	6.29	228
BROOKLINE	Aaa	56,188	190,006,170	13,297,623	7.00	237
WAYLAND	Aaa	13,063	54,149,052	4,344,097	8.02	333
HINGHAM	Aaa	21,198	65,073,817	5,406,278	8.31	255
CONCORD	Aaa	16,919	59,795,621	5,275,858	8.82	312
DOVER	Aaa	5,657	22,977,082	2,065,215	8.99	365
LEXINGTON	Aaa	30,419	126,855,608	11,456,346	9.03	377
CAMBRIDGE	Aaa	100,771	406,774,722	38,540,434	9.47	382
WESTON	Aaa	11,595	59,968,025	7,439,454	12.41	642
ANDOVER	Aaa	32,141	114,893,386	21,890,543	19.05	681
Average		34,080	125,432,033	10,303,080	8.21	302

Data Source: Municipal Databank, Local Aid Section, Division of Local Services, Mass. Dept. of Revenue. Website: <http://www.dls.state.ma.us/mdm.htm>

Notes: Bond Rating: Moody's 2006 bond rating; Population: 2004 Estimated US Census; Total FY05 Debt Service includes long term retired debt, long term interest and short term interest made this year on bond issues.

The next table shows the total debt outstanding in each community in FY05 and the amount per capita. (In lay terms, this would be like your total mortgage, divided by how many people live in your house.) It also shows the debt burden in relation to each community's assessed market valuation.

**Massachusetts Municipal Debt Comparison -- "Triple A" Cities and Towns  
Total Debt per Capita and Debt Burden as % Full Value**

Massachusetts City or Town	Bond Rating	Population	FY05 Operating Budget	FY05 Total Outstanding Debt		Debt Burden (Direct Net Debt as % of Full Value)
				Total	per Capita	
NEWTON	AAA	83,802	284,263,989	109,108,798	1,302	0.5
BELMONT	AAA	23,604	80,522,395	36,642,476	1,552	1
BROOKLINE	AAA	56,188	190,006,170	113,749,348	2,024	0.8
WELLESLEY	AAA	26,515	95,987,511	58,430,474	2,204	0.6
HINGHAM	AAA	21,198	65,073,817	47,976,087	2,263	1
LEXINGTON	AAA	30,419	126,855,608	69,145,059	2,273	1
WAYLAND	AAA	13,063	54,149,052	33,522,436	2,566	1.4
CONCORD	AAA	16,919	59,795,621	44,113,385	2,607	0.9
CAMBRIDGE	AAA	100,771	406,774,722	276,696,981	2,746	0.6
WINCHESTER	AAA	21,167	69,349,047	62,002,542	2,929	1.2
ANDOVER	AAA	32,141	114,893,386	103,888,000	3,232	1.4
DOVER	AAA	5,657	22,977,082	19,358,799	3,422	1.3
WESTON	AAA	11,595	59,968,025	85,989,710	7,416	2.3
Average		34,080	125,432,033	81,586,469	2,394	1.1

Data Source: Municipal Databank, Local Aid Section, Division of Local Services, Mass. Dept. of Revenue. Website: <http://www.dls.state.ma.us/mdm.htm> Debt burden data provided by First Southwest Company.

Notes: Total outstanding debt refers to remaining principal payments that have not been paid off as of July 1 of the current fiscal year. Debt burden reflects direct net debt as a percentage of the full value of the property tax base.

As the tables indicate, the average debt service percent of budget for the 13 communities listed, including Newton, is 8.21%, compared to Newton's 3.26%. The average per capita debt service for the group is \$302, compared with Newton's \$111. The average debt outstanding per capita is \$2,394, compared to Newton's \$1,302. As a percent of budget and on a per capita basis, Newton's debt load is the lowest of its peers. Newton's debt as a percentage of the full value of its property tax base is also the lowest of its peers.

Maybe Newton could be proud of carrying the lowest level of debt -- if its capital assets were well maintained -- but they are not. Our current level of capital spending is not sufficient to properly maintain our physical assets. Major and minor renovations of schools and other City buildings have been delayed, roadways and sidewalks are not replaced regularly and public recreational facilities are in obvious need of attention. Our

impressive Aaa rating signals our access to favorable borrowing rates, but it is not an indicator of the quality of life in our public buildings and public spaces.

A higher level of borrowing to provide the resources for capital reinvestment could be supported through debt exclusion ballot votes. A debt exclusion vote permits taxpayers to approve or reject additional taxation for dedicated and specific capital purposes. Many of our Aaa peers use this tool frequently, as described in the table below. Every Aaa town has approved debt exclusion measures; only the cities of Newton and Cambridge have refrained from placing such initiatives before their voters.

**Massachusetts Municipal Debt Comparison -- "Triple A" Cities and Towns  
Summary of Debt Exclusion Votes**

Massachusetts City or Town	Number of Elections containing Debt Exclusion Questions (1982 - 2006)	Number of Separate Debt Exclusion Questions posed in these Elections		
		Passed	Failed	Total
ANDOVER	2	3	1	4
BELMONT	7	6	1	7
BROOKLINE	2	2	0	2
CAMBRIDGE	0	0	0	0
CONCORD	10	11	2	13
DOVER	15	27	2	29
HINGHAM	9	12	4	16
LEXINGTON	3	5	0	5
NEWTON	0	0	0	0
WAYLAND	12	12	1	13
WELLESLEY	7	10	1	11
WESTON	29	70	0	70
WINCHESTER	2	2	0	2

Note: A ballot may contain one or more debt exclusion questions. The figures in column two above summarize the number of times towns have had debt exclusion elections over the 1982 to 2006 period. The figures in columns 3, 4, and 5 reflect the total number of separate debt exclusion questions placed those ballots over the 1982 to 2006 period and whether the questions passed or failed.

Data Source: Municipal Databank, Local Aid Section, Division of Local Services, Mass. Dept. of Revenue. Website: <http://www.dls.state.ma.us/mdm.htm>

**Capital Investment Planning**

In his State of the City address, Mayor Cohen announced a \$250,000 funding request for a capital needs study of 25 of the largest municipal sites. Recently the School Department issued a request for proposals for architectural services to perform an assessment of Newton Public Schools' space and facilities needs, including cost and schedule comparisons. The end product will be:



- an electronic database containing current information about the buildings
- a set of standards for elementary schools in the district
- an assessment of how each building conforms to these standards
- a recommended approach and timetable for addressing bringing buildings up to standard; and
- a hierarchy of needs with priorities listed.

These actions are welcomed by the Commission and are long overdue. Capital investment should be needs driven, within fiscal constraints.

#### Recommendation

The Commission has examined the various measurements used by the rating agency and is of the opinion that the City could maintain its existing credit rating while significantly increasing its present level of outstanding debt and modestly extending its currently rapid debt retirement schedule.

While there are many measures used by the credit rating agency, one of the key measures is the City’s debt in relation to its assessed market valuation. Newton ranks very low on this measure. Even if we assume the issuance of debt for Newton North High School, Newton would still have ample room on this measurement to support a more robust annual capital financing effort. It is not concern about maintaining the City’s credit rating that imposes a practical limitation on higher debt levels, but rather the identification of the resources available to repay debt. At June 30, 2006, the City had \$39.3 million in outstanding tax-supported debt. It is likely that this amount could be increased substantially and still remain within the parameters associated with a “Triple-A” rating.

In the following tables, the Commission has attempted to quantify the additional debt issuance for capital infrastructure investments that might be supportable within the existing debt management policy allocating 3% of the City’s budget to debt service. We have also examined the debt financing that might be possible at higher allocation levels (4% and 5%) in each instance.

Fiscal Year	Commission revenue forecast	Debt service Budget @			Increments		Additional Principal that could be supported	
		3%	4%	5%	@ 4%	@ 5%	@4%	@5%
2008	\$268,457,120	\$8,053,714	\$10,738,285	\$13,422,856	\$2,684,571	\$5,369,142	\$26,845,000	\$53,690,000
2009	277,298,476	8,318,954	11,091,939	13,864,924	2,772,985	5,545,970	1,550,000	3,100,000
2010	285,553,085	8,566,593	11,422,123	14,277,654	2,855,531	5,711,062	1,540,000	3,080,000
2011	293,731,332	8,811,940	11,749,253	14,686,567	2,937,313	5,874,627	1,560,000	3,120,000
2012	304,091,067	9,122,732	12,163,643	15,204,553	3,040,911	6,081,821	1,820,000	3,640,000
<b>Total for five-year period:</b>							<b>\$33,315,000</b>	<b>\$66,630,000</b>

Making the simplifying assumption of 20-year debt at 5% interest, adding **1%** immediately to the debt service target cap for FY08 would support debt service on \$26.8 million now and smaller additional amounts in subsequent years, totaling \$33.3 million new issuance for the five-year period. Alternatively, following a strategy of increasing the debt service budget gradually over the five-year period FY08-12, raising the allocation by 0.2% steps to reach a **4%** target in year 5, would support about half as much new debt issuance - about \$16.5 million - spread evenly over the period. Setting a **5%** target, either immediately or gradually, doubles these estimates. To the extent that some debt issuance purposes require a term of issue shorter than 20 years, these estimates would decrease.

The Commission is not prescribing a new debt management policy. Allocating a higher proportion of the City's budget to capital purposes is a complex matter that will involve considerable thought and careful evaluation of trade-offs within the existing budget. However, the Commission does conclude that the present level of annual capital spending is not sufficient to maintain the City's physical assets. A higher level of annual debt issuance to provide the resources for needed capital reinvestment could conceivably be supported through debt exclusion ballot votes – by which the taxpayers would decide whether to approve or reject additional taxation for dedicated and specific capital purposes. Many of the Massachusetts communities with the highest credit ratings use this tool, along with operating overrides, to place before the voters decisions about maintaining the long-term municipal assets. If Newton's capital reinvestment program cannot be supported by a shift from within the existing budgetary resources, then we urge the City's consideration of this additional tool.