

CREDIT OPINION

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 Rate this Research

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Newton (City of) MA

Update to credit analysis

Summary

Newton (Aaa stable) has a large and wealthy tax base that benefits from its proximity to Boston, MA (Aaa stable). The city has a diverse economy including institutional presence. The city's financial position will likely remain stable over the near term due to strong fiscal management although reserves will remain below regional and national peers for the highest rating category. The debt burden is average and the city is committed to addressing its unfunded pension and OPEB liabilities over the medium term.

Credit strengths

- » Sizeable, wealthy and diverse tax base with favorable location and institutional presence
- » Strong fiscal management including multi-year forecasting, adherence to formalized debt and reserve policies and plans to fully fund pension liability by 2030
- » History of taxpayer support for general overrides and debt exclusions to the tax levy limit

Credit challenges

- » Limited ability to raise property taxes under Proposition 2 ½
- » Large long term liabilities for pensions and OPEB

Rating outlook

The stable outlook reflects our expectation of continued financial stability due to conservative five year budget forecasting and capital improvement plan as well as adherence to comprehensive financial reserve and debt policies. The outlook also incorporates the ongoing strength in the city's tax base and economy.

Factors that could lead to a downgrade

- » A multi-year trend of operating deficits leading to a decline in available reserves
- » Increased reliance on free cash appropriations to balance operating budgets
- » Material increase in the debt burden
- » Failure to reduce the unfunded pension liability over the medium term

Key indicators

Exhibit 1

| Newton (City of) MA | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|--------------|--------------|--------------|--------------|--------------|
| Economy/Tax Base | | | | | |
| Total Full Value (\$000) | \$22,317,333 | \$22,317,333 | \$26,237,044 | \$26,237,044 | \$30,026,625 |
| Population | 87,675 | 88,317 | 88,479 | 88,994 | 88,904 |
| Full Value Per Capita | \$254,546 | \$252,696 | \$296,534 | \$294,818 | \$337,742 |
| Median Family Income (% of US Median) | 244.0% | 251.4% | 250.4% | 250.4% | 250.4% |
| Finances | | | | | |
| Operating Revenue (\$000) | \$347,913 | \$373,457 | \$426,285 | \$442,866 | \$461,493 |
| Fund Balance (\$000) | \$35,518 | \$54,644 | \$63,493 | \$64,087 | \$68,590 |
| Cash Balance (\$000) | \$69,077 | \$81,212 | \$88,975 | \$89,558 | \$93,947 |
| Fund Balance as a % of Revenues | 10.2% | 14.6% | 14.9% | 14.5% | 14.9% |
| Cash Balance as a % of Revenues | 19.9% | 21.7% | 20.9% | 20.2% | 20.4% |
| Debt/Pensions | | | | | |
| Net Direct Debt (\$000) | \$216,517 | \$260,150 | \$284,825 | \$297,287 | \$290,505 |
| 3-Year Average of Moody's ANPL (\$000) | \$526,163 | \$527,267 | \$557,706 | \$574,780 | \$587,875 |
| Net Direct Debt / Full Value (%) | 1.0% | 1.2% | 1.1% | 1.1% | 1.0% |
| Net Direct Debt / Operating Revenues (x) | 0.6x | 0.7x | 0.7x | 0.7x | 0.6x |
| Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%) | 2.4% | 2.4% | 2.1% | 2.2% | 2.0% |
| Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x) | 1.5x | 1.4x | 1.3x | 1.3x | 1.3x |

Source: Moody's Investors Service and issuer's audited financial statements

Profile

Newton is located seven miles west and borders the City of Boston (Aaa stable). The city has a population of about 89,000 and a tax base that is primarily residential but benefits from a diverse commercial presence.

Detailed credit considerations

Economy and Tax Base: City benefits from strong valuation growth, high wealth and diverse economy

Newton's tax base and economy will likely remain stable over the near term due to continued valuation growth, a strong economy and high resident wealth and incomes. The \$30 billion tax base (2019-20 equalized value) is the third largest in the commonwealth. Certified equalized value increased 14.4% from 2017 to 2019, bringing the six year compound annual growth rate to 5.5%. From 2019 to 2020 assessed value increased 4.3% indicating continued steady growth over the near term. City management is committed to increasing the availability of affordable housing by mandating affordable units at many of the new residential developments in progress throughout the city.

Pending major development includes the Riverside transit oriented project located on the MBTA's green line that will include office, retail, hotel and housing. Newton benefits from its prime location neighboring Boston. The local economy is bolstered by favorable access to public transportation and major regional roadways, as well as institutional presence which includes Boston College (Aa3 stable). There is also a large healthcare presence, including Newton-Wellesley Hospital, a member of Partners HealthCare System (Aa3 stable). Resident wealth and incomes are strong, as indicated by the very strong \$337,742 equalized value per capita and \$177,386 median family income which is 189% and 251% of commonwealth and national medians, respectively. In addition, the city's unemployment rate of 1.7% (November 2019) is well below Massachusetts' rate of 2.3% and the 3.3% national rate.

Financial Operations and Reserves: Stability likely to continue given conservative management and history of taxpayer support

The city's financial position will remain stable over the near term due to conservative budgeting and strong fiscal management. Historically, the city has also benefited from added revenue flexibility provided by taxpayers support of general overrides and debt

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exclusions from the tax levy limits of Proposition 2½. The city's financial reserves, while stable, are notably smaller than those of other Aaa rated cities both in Massachusetts and nationally.

Fiscal 2019 audited finances reflect balanced operations with a solid \$4.4 million operating surplus due to positive variance in revenues and expenditures. The operating results increased available fund balance to \$68.6 million representing 14.9% of revenues.

The fiscal 2020 budget increased by \$17.8 million representing 4.3% growth from the prior year driven by increases in salaries, benefits and pension contributions. The budget includes a tax levy increase to the limit and appropriation of only \$1.5 million of free cash. Eight months through the fiscal year, revenues are trending positive and expenditures are on budget.

While the 2021 budget is still in progress, management is not anticipating any major changes from prior years. The budget will likely increase by another \$17 million or so with the school department budget expanding by 3.5%. Going forward, we expect budget growth to be driven, in part, by the city's commitment to improve funding of its pensions by increasing contributions by 9.6% per year.

LIQUIDITY

Cash and investments at the end of fiscal 2019 totaled \$93.9 million representing 20.4% of revenues.

Debt and pensions: Average debt burden and large but well planned for long term liabilities

The city's direct debt burden of 1.1% of equalized value and 0.7 times revenues will remain manageable due to the city's comprehensive capital plan, debt exclusions, and adherence to a debt management policy. The overall debt burden, which incorporates the considerable overlapping debt of the regional transportation, water and wastewater systems, is 2.5% of equalized value. The capital improvement plan (FY2021-25) totals \$352 million which is an increase from \$245 million last year.

DEBT STRUCTURE

The entire debt portfolio is fixed rate. Amortization is slower than average with 49% of principal to be retired over the next ten years. Fiscal 2019 debt service totaled \$24 million representing 5.2% of revenues.

DEBT-RELATED DERIVATIVES

The city is not party to any interest rate swaps or other derivative agreements.

PENSIONS AND OPEB

The city's unfunded pension and retiree health care (OPEB) liabilities are significantly larger than its debt and, though manageable at this time, represent a potential future credit challenge. The city participates in two multiple employer cost-sharing pension plans and funds OPEB on a pay-go basis with additional deposits to an OPEB trust. The table below summarizes the city's 2019 pension and OPEB contributions and unfunded liabilities.

Exhibit 2

Unfunded Pension and OPEB liabilities exceed debt

| | Amount (\$ thousands) | % of Operating Revenues | Discount Rate |
|--|--------------------------|-------------------------|---------------|
| Operating Revenue | 461,493 | | |
| Reported Unfunded Pension Liability | 334,801 | 72.55% | 7.25% |
| Moody's Adjusted Net Pension Liability | 581,399 | 125.98% | 4.22% |
| Reported Net OPEB Liability | 638,827 | 138.43% | 3.87% |
| Moody's Adjusted Net OPEB Liability | 609,022 | 131.97% | 4.14% |
| Pension Contribution | 28,336 | 6.14% | - |
| Pension Tread Water Gap [1] | (8) | 0.00% | - |
| OPEB Contribution | 22,211 | 4.81% | - |
| Net Direct Debt | 311,692 | 67.54% | - |
| Debt Service | 24,082 | 5.22% | - |
| Total Fixed Costs | 74,630 | 16.17% | - |

[1] A negative pension tread water gap reflects pension contribution in excess of the amount required to prevent the unfunded liability from increasing if all plan assumptions are realized. A positive tread water gap reflects the opposite.

Source: Moody's Investors Service and issuer's audited financial statements

The city's 2019 pension contributions slightly exceeded tread water, the amount required to prevent the unfunded liability from increasing if all plan assumptions are realized. To the extent that the multiple-employer pension plans in which the city participates experience returns on assets that fall short of their assumptions, the city's required pension contribution will increase.

The city maintains an OPEB trust with assets of \$11.8 million and the city's unfunded OPEB liability is larger than its pension burden. Management's goal is to fully fund its pension obligations by no later than 2030, and then work to decrease the OPEB liability over time.

Fiscal 2019 fixed costs, comprised of pensions, OPEB, and debt service, represented a manageable 16.2% of operating revenues. Return on assets in the state run pension plans and future escalation of OPEB costs could materially affect fixed costs going forward.

ESG Considerations

Environmental considerations

Warmer temperatures, increased precipitation, and rising sea levels are affecting Newton and its surrounding communities and have contributed to the need for improvements to the city's stormwater drainage system which are ongoing and included in the city's long-term capital plan. In response to climate change, city management has developed a comprehensive climate action plan that puts the city on a path to being carbon neutral by 2050. Actions to reduce the city's greenhouse gas emissions include promoting clean, renewable electricity production and consumption, advancing green building construction, and rehabilitating existing buildings.

Social considerations

Social considerations are not a currently material to the city's credit profile. The city does face an absence of affordable housing which management is addressing by requiring affordable units in new developments.

Management and governance

The city's strong fiscal management and governance are reflected in its conservative budgeting and proactive, long-term financial planning including a five year budget forecasting and capital planning guided by formalized debt and reserve policies. In fiscal 2017, the city adopted a debt management policy that limits annual debt service in the General Fund to between 4% and 7.5% of the budget.

Massachusetts cities have an Institutional Framework score of "Aa", which is strong. The sector's major revenue source of property taxes, are subject to the Proposition 2 1/2 tax levy cap which can be overridden with voter approval only. However, the cap of 2.5% still allows for moderate revenue-raising ability. Expenditures primarily consist of personnel costs, as well as education costs for cities that manage school operations, and are highly predictable given state-mandated school spending guidelines and employee contracts. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally greater than 25% of expenditures. Fixed costs are driven mainly by debt service and pension costs. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

Rating methodology and scorecard factors

The US Local Government General Obligation Rating Methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 3

Newton (City of) MA

| Rating Factors | Measure | Score |
|---|-----------------------------|-------|
| Economy/Tax Base (30%) ^[1] | | |
| Tax Base Size: Full Value (in 000s) | \$30,026,625 | Aaa |
| Full Value Per Capita | \$337,742 | Aaa |
| Median Family Income (% of US Median) | 250.4% | Aaa |
| Notching Factors: ^[2] | | |
| Institutional Presence | | Up |
| Finances (30%) | | |
| Fund Balance as a % of Revenues | 14.9% | A |
| 5-Year Dollar Change in Fund Balance as % of Revenues | 7.5% | A |
| Cash Balance as a % of Revenues | 20.4% | Aa |
| 5-Year Dollar Change in Cash Balance as % of Revenues | 6.9% | A |
| Management (20%) | | |
| Institutional Framework | Aa | Aa |
| Operating History: 5-Year Average of Operating Revenues / Operating Expenditures | 1.0x | A |
| Notching Factors: ^[2] | | |
| Unusually Strong or Weak Budgetary Management and Planning | | Up |
| Debt and Pensions (20%) | | |
| Net Direct Debt / Full Value (%) | 1.1% | Aa |
| Net Direct Debt / Operating Revenues (x) | 0.7x | A |
| 3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%) | 2.0% | Aa |
| 3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x) | 1.3x | A |
| | Scorecard-Indicated Outcome | Aaa |
| | Assigned Rating | Aaa |

[1] Economy measures are based on data from the most recent year available.

[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology.

[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication

Source: US Census Bureau, Moody's Investors Service

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