

RatingsDirect®

Summary:

Newton, Massachusetts; General Obligation

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Credit Profile

US\$39.541 mil GO mun purp ln bnds ser 2017 due 02/01/2047

Long Term Rating AAA/Stable New

Newton GO mun purp loan bnds ser 2016 due 01/15/2046

Long Term Rating AAA/Stable Affirmed

Newton GO rfdg bnds ser 2016 due 03/01/2040

Long Term Rating AAA/Stable Affirmed

Rationale

S&P Global Ratings assigned its 'AAA' long-term rating and stable outlook to the City of Newton, Mass.' series 2017 general obligation (GO) bonds. At the same time, S&P Global Ratings affirmed its 'AAA' rating and stable outlook on the city's debt outstanding.

The city's full faith and credit GO pledge, subject to the limitations of Proposition 2 1/2, secures the bonds. We understand that officials will use bond proceeds for elementary school construction and fire station reconstruction, among other capital projects.

Newton's GO bonds are eligible to be rated above the sovereign, under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions" (published Nov. 19, 2013, on RatingsDirect), because we believe the city can maintain better credit characteristics than the U.S. in a stress scenario. The city has a predominately locally derived revenue source, with 92% of general fund revenue derived from property taxes and departmental income, and independent taxing authority from the federal government.

The 'AAA' rating also reflects our view of the city's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with "strong" 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 2016;
- Strong budgetary flexibility, with an available fund balance in fiscal 2016 of 12.8% of operating expenditures;
- Very strong liquidity, with total government available cash at 24.4% of total governmental fund expenditures and 5.3x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges at 4.6% of expenditures and net direct debt that is 73.8% 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
- Strong institutional framework score.

Very strong economy

We consider Newton's economy very strong. The city, with an estimated population of 88,456, 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 213% of the national level and per capita market value of \$295,547. Overall, the city's market value grew by 7.5% over the past year to \$26.1 billion in 2017. The county unemployment rate was 4.0% in 2015.

Newton is an 18-square-mile city, located directly west of Boston on two major highways, a commuter line, and a trolley line. Its location, as well as major employers such as Boston College and Newton-Wellesley Hospital, has given way to extremely strong and stable wealth and income levels.

Although the city is largely built-out, a number of new developments are expected to contribute to the city's tax base. These include large-scale residential and commercial developments along Needham Street and the build-out of Riverside Station, which is the final stop on Newton's trolley line, with 290 new apartments; a 10-story office building and a retail space; and a 68-unit housing and retail complex in the city's northeast corner. We believe Newton will continue to see modest growth over time, and this, combined with very strong tax collection rates at 100%, will contribute to a stable revenue profile for the city.

Very strong management

We revised our assessment of the city's management to "very strong" from "strong" based on the introduction of a debt policy that formalized a historical practice. An assessment of "very strong" indicates that financial practices are strong, well embedded, and likely sustainable.

In developing the budget, the city references 10 years of historical data as well as projections contained within the long-term financial plan. Assumptions have generally been conservative, leading to a track record of balanced budgets. As early as 2010, the city adopted a form of zero-based budgeting to better align rising expenditures with a consistent revenue profile. As a result, expenditures that were not tied to performance outcomes were streamlined. Budgetary surveillance is done regularly with weekly meetings of department heads and monthly budget-to-actuals reported on the city's website. Newton maintains an extensive, annually updated five-year financial plan as well as a five-year capital plan that delineates funding sources and that balances essentiality with level of need. The city recently adopted a debt policy, which formalizes a historical practice of maintaining debt service of 4.5%-7.5% of expenditures. Overall debt is limited by state statute. The city has a formal investment policy that restricts investments to U.S. government agency obligations, certificates of deposits, and money market accounts. Finally, Newton has several reserve accounts including a rainy-day fund, which must sustain a minimum balance of 5% of annual appropriations, as per the city's policy.

Strong budgetary performance

Newton's budgetary performance is strong in our opinion. The city had operating surpluses of 4.2% of expenditures in the general fund and of 3.1% across all governmental funds in fiscal 2016.

In our calculation of total governmental funds performance, we exclude capital expenditures paid for with bond proceeds. The positive operating result in 2016 is a result of a tax settlement relating to personal property, aggressive collections, and building permits that came in \$3.3 million more than anticipated.

The 2017 budget is \$379 million, a 4% increase over the previous year, driven primarily by revenue from new growth. City officials report that revenue continues to outpace projections. Although the school department is reporting a small deficit due to several one-time items, city officials are optimistic that operations will at least be balanced by year-end.

Newton receives 84% of its revenues through property taxes, resulting in a stable revenue profile. Given the city's oversight and careful planning as well as continued new revenue from economic development, we expect our assessment of Newton's budgetary performance to remain strong.

Strong budgetary flexibility

We revised our assessment of Newton's budgetary flexibility to "strong" from "very strong" because the city is not regularly demonstrating a willingness and ability to raise taxes above levy limits. We previously credited the city with the ability to raise taxes when needed based on the approval of an operating override. In 2013, city residents voted to raise taxes above the levy limit, adding an additional \$11.4 million in recurring revenues. We no longer apply an adjustment as the city has not approved an operating override in three years.

Based on reserve levels, we consider Newton's budgetary flexibility strong, with an available fund balance in fiscal 2016 of 12.8% of operating expenditures, or \$45.8 million. Over the last year, reserves grew from \$30.2 million (8.7% of expenditures) due to positive operating performance. City officials intend to use the 2016 surplus toward several one-time items such as the purchase of an emergency communications system and the creation of eight affordable and market rate apartments. Despite an anticipated drawdown, we expect reserves to remain at least strong.

The city maintains a reserve policy that governs its stabilization fund, which is one part of the total fund balance we consider available. As per its policy, Newton targets a minimum of 5% of the current year general fund appropriations to be held within a stabilization account. According to management, the city will continue to contribute to the fund each fiscal year to maintain the goal of 5% of the annual operating budget.

Very strong liquidity

In our opinion, Newton's liquidity is very strong, with total government available cash at 24.4% of total governmental fund expenditures and 5.3x governmental debt service in 2016. In our view, the city has strong access to external liquidity if necessary.

We believe the city's strong access to external liquidity is supported by its regular GO bond and bond anticipation note issuances. Newton has no direct purchase or variable-rate debt, or other contingent liabilities that may put pressure on available cash. The city has consistently had very strong liquidity and we do not anticipate a change to these ratios.

Adequate debt and contingent liability profile

In our view, Newton's debt and contingent liability profile is adequate. Total governmental fund debt service is 4.6% of total governmental fund expenditures, and net direct debt is 73.8% of total governmental fund revenue. Overall net debt is low at 1.2% of market value, which is in our view a positive credit factor.

Total direct debt is \$327 million, of which \$27.5 million is self-supporting enterprise debt. City officials intend to issue \$40 million over the next two years for various projects relating to school upgrades and road paving, among others. We do not believe this additional debt issuance will materially impact Newton's debt burden given its already low carrying costs.

In our opinion, a credit weakness is Newton's large pension and OPEB obligation. Newton's combined required pension and actual OPEB contributions totaled 9.9% of total governmental fund expenditures in 2016. Of that amount, 5.2% represented required contributions to pension obligations, and 4.8% represented OPEB payments. The city made its full actuarial determined contribution in 2016. The funded ratio of the largest pension plan is 47.5%.

Newton contributes to a self-administered pension plan for city employees. Teachers and administrative personnel of the school department participate in a contributory retirement plan administered by the Massachusetts Teachers' Retirement Board to which the city does not contribute. In 2016, the actuarially required contribution for the city pension plan was \$21.5 million. It maintains an unfunded accrued liability of \$317 million.

City management has taken measures to pay down the outstanding pension liability by adopting a new funding schedule that anticipates full actuarial funding by fiscal 2029 (eight years earlier than the previous funding schedule provided for). Newton intends to address its large outstanding OPEB liability after the defined benefit plan is fully funded, which officials expect to achieve by fiscal 2042. In 2016, the unfunded liability for OPEB was \$719 million and the city paid \$19.8 million. Newton has an OPEB trust with a 2017 balance of \$4.4 million. The city contributed slightly more than \$1.5 million to the trust in fiscal 2016, with the expectation that the contribution will increase by approximately \$250,000 each year until 2029, when it will repurpose the pension appropriation to OPEB liabilities.

Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

Outlook

The stable outlook reflects our view of Newton's very strong local economy, which benefits from the city's location directly west of Boston and access to a variety of transportation options. The city's strong management practices, which include detailed long-term financial and capital planning as well as the necessary policies to ensure favorable financial outcomes, lend stability to the rating. Although we don't expect this to occur in our two-year outlook horizon, we could lower the rating if budgetary performance becomes imbalanced, leading to a draw on the city's reserve funds.

Related Research

2016 Update Of Institutional Framework For U.S. Local Governments

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