

# RatingsDirect®

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## Summary:

# Somerville, Massachusetts; General Obligation; Note

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## Summary:

# Somerville, Massachusetts; General Obligation; Note

### Credit Profile

US\$12.665 mil GO rfdg bnds ser 2022 due 05/15/2042

*Long Term Rating*

AA+/Stable

New

Somerville GO mun purp loan bnds

*Long Term Rating*

AA+/Stable

Affirmed

## Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating and stable outlook to Somerville, Mass.' roughly \$12.665 million series 2022 general obligation (GO) refunding bonds and affirmed its 'AA+' long-term rating, with a stable outlook, on the city's existing GO debt.

S&P Global Ratings also affirmed its 'SP-1+' short-term rating on the city's bond anticipation notes (BANs).

Somerville's full-faith-and-credit pledge secures the GO debt and BANs. The city's debt is subject to Proposition 2 1/2 limitations, but we do not make a rating distinction because we rate the limited obligation at the same level as our view of Somerville's general creditworthiness. We rate the limited-tax GO debt based on the application of our criteria, titled "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness," published Nov. 20, 2019, on RatingsDirect.

Officials intend to use series 2022 bond proceeds to refund series 2012 GO improvement-financing bonds.

### Credit overview

The property tax base continues to grow with the ongoing Massachusetts Bay Transportation Authority (MBTA)'s green line project and ongoing developments townwide. Market value continues to increase, as does expected new-growth numbers. Building permits and associated miscellaneous revenue continue to outpace budgeted levels despite pressure from supply chain and inflationary pressure. Despite the positive momentum, we postulate our concerns surrounding elevated fixed costs, with pension and other postemployment benefits (OPEB), and how rapid growth will likely affect borrowings to the extent it could crowd out other necessary expenses somewhat constrain the rating.

The rating reflects our opinion of the city's:

- Very strong, expanding local economy;
- Very strong management with strong financial-management policies and practices under our Financial Management Assessment (FMA) methodology and a strong Institutional Framework;
- Stable budgetary performance and very strong budgetary flexibility and liquidity; and

- Sizable debt and overall fixed costs that continue to grow.

### **Environmental, social, and governance**

Due to Somerville's location, we find environmental risks slightly elevated compared with its peers. However, we think the city's multipronged approach for stormwater management; reduction in carbon emissions; and commitment to climate change vulnerability assessment, as outlined in the management section, somewhat mitigate these risks. We have also evaluated social and governance risks relative to Somerville's economy, financial measures, management, and debt-and-long-term-liability profile and have determined both factors are in-line with the sector standard.

## **Stable Outlook**

### **Upside scenario**

We could raise the rating if Somerville were to address its unfunded retirement liabilities meaningfully and mitigate cost volatility through market downturns while managing growing debt.

### **Downside scenario**

While not expected, we could lower the rating if growing fixed costs were to lead to budgetary pressure that causes operating performance to deteriorate and reserves to decrease.

## **Credit Opinion**

### **A growing local economy**

Somerville, five miles north of Boston, is a key economic hub in the greater Boston metropolitan statistical area. Somerville continues to experience significant development and population growth, resulting in ongoing market value and income growth. We expect development will likely continue because of the city and commonwealth's plan to fund an extension to MBTA's light rail, adding five green line stops in Somerville; its most recent stop opened in March 2022.

Somerville's Assembly Row development has been a notable contributor to increased market value and the growing economy during the past few years. The large development has so far created more than 860,000 feet of office space; 500,000 square feet of retail, restaurant, and entertainment space; and more than 1,000 new high-end residential units. It also includes a 750,000-square-foot headquarters for Partners HealthCare, the commonwealth's largest medical group, which the company built to consolidate its Boston area operations. Puma now occupies its new North American headquarters in Assembly Row. The Assembly Row site also remains an attractive and desirable area due to its direct access to Boston and Cambridge, Interstate 93, and an onsite subway station serviced by Massachusetts Bay Transportation Authority.

Other parts of Somerville continue to grow and develop, which the city markets and supports with infrastructure projects. Union Square has steadily become a center for more tech-focused development with Greentown Labs Inc. and other startups moving into the area and expanding during the past few years. In our opinion, the green line extension's completion in 2022 should support continued area growth. We also expect other areas--such as Boynton Yards, where a new 1.5 million-square-foot commercial, retail, and residential project is planned--to experience

economic expansion.

Additional development in the Boynton Yards neighborhood is ongoing; it was designated as a transit-oriented development. Developer interest in the area is increasing, and a new second lab is breaking ground. Once it achieves full buildout, there will be more than 3.4 million square feet of mixed-use development. Cambridge Crossing is home to Bristol Meyers Squibb's new regional office and lab space. The Inner Belt/Brickbottom neighborhood is undergoing a neighbor plan for possible redevelopment. Somerville recently completed its SomerVision 2040, a comprehensive plan that should provide development guidelines within the city.

Overall, with numerous completed, ongoing developments and transportation projects, the tax base continues to increase by an average of 10.6% annually during the past five years. We expect the tax base will likely continue to expand as development comes online and real estate values appreciate.

**Very strong management with strong financial-management policies, practices and a focus on resilience**

In our opinion, management budgets conservatively and relies on historical data, forward-looking projections, and budget-to-actual results for revenue and expenditure assumptions. Management has biweekly meetings to monitor budget performance; it uses SomerStat, a real-time monitoring program that provides current budget-to-actual comparisons. The city maintains a five-year capital plan that identifies funding and a 10-year, long-term financial forecasting plan; it updates both annually. Management has formal debt-management and reserve policies, maintaining stabilization reserves of, at least, 5% of expenditures.

An investment-management policy has roots in Massachusetts statutes. Management internally updates holdings and earnings monthly and reports results to the board of aldermen annually as part of the budget process. Management discloses policies and practices as part of budget documents, which are publicly available on Somerville's website; it currently complies with all policies.

Furthermore, Somerville has taken steps to mitigate exposure to cyber-related risks. It has also been addressing concerns related to climate change that could directly affect taxable properties. In particular, in 2016, the city released a robust climate change vulnerability assessment to further understand what effect climate change can have on the community and inform decision-making. This assessment led to the creation of Somerville Climate Forward, the city's priority-based climate-change plan, including a timeline of implementable actions it will undertake to reduce the overall effect of climate change on the community. Plan items include exploring the feasibility of a net-zero emissions-based performance standard, improving stormwater management, and creating a community leadership programs. The plan is designed to be revisited every five years to reassess short-term (zero to three years) and medium-term (four years to six years) metrics for each action item. More recently, the city led a regional grant called the Lower Mystic Vulnerability Assessment that identified structural and social infrastructure vulnerabilities in a hypothetical super winter storm. The city has incorporated these findings in the recently updated hazard-mitigation plan.

**Stable budgetary performance with very strong reserves, liquidity**

We have adjusted budgetary performance for transfers, one-time revenue, and capital expenses. Fiscal 2021 performance was very strong, in our view; however, we expect surpluses will likely still occur during the next few fiscal

years, albeit slightly more modest. Revenue outpaced budgeting by roughly \$9.4 million, primarily due to increases in departmental income. Expenses were underbudget with roughly \$13.8 million in expenditure savings.

The fiscal 2022, \$286.4 million budget is a 9% increase compared with the fiscal 2021 budget. As a part of the budget, the city is incorporating council-approved changes in salaries for certain employees while providing funding for new positions. In addition, the city is funding positions for sustainability and environmental and newly created social-and-racial-justice offices. It is also investing in technology and other modernization projects. Officials increased funding for the school department by roughly 8%. Management reports budget-to-actual results are trending well, and it expects balanced fiscal year-end 2022 results.

Somerville received roughly \$77 million in American Rescue Plan Act of 2021 funds, which the city plans to use to finance infrastructure, social, and economic-recovery initiatives.

Officials are in the middle of the fiscal 2023 budget process. We note that as the city continues to grow, revenue, such as building permits, will continue to grow, as will property taxes; however, increasing service demands and increased hiring needs will likely partially offset this. We expect management will likely adjust and maintain operations.

Our calculation includes about \$47 million in committed stabilization funds, which are available with council approval. In fiscal 2020, Somerville established a COVID-19 stabilization fund with a \$3 million appropriation of free cash; it did not need to draw down reserves materially during the year. With no expected inclusion of fund-balance use in the fiscal 2022 budget, with balanced performance expected, we posit budgetary flexibility will likely remain very strong. Our calculation excludes restricted cash in Somerville's American Rescue Plan fund, capital-projects fund, and nonmajor governmental funds. We imagine the city will likely maintain very strong liquidity due to total governmental fund cash and an ability to maintain stable operations and regenerate reserves.

### **Sizable debt that should grow during the next few years as the city expands**

With this series 2022 issuance, Somerville will have about \$370 million of total direct debt outstanding, including \$103.9 million in BANs. To be conservative, we have not included the BANs, with the exception of \$30 million in our 10-year amortization calculation. The city received \$30 million in reimbursements from MBTA to offset its share of the cost of the green line construction. It has \$199.3 million in authorized, but unissued, debt remaining. We recognize commonwealth grants will likely offset a portion of the total amount of unissued debt. We expect debt will likely remain elevated.

### **Pension and OPEB costs remain manageable but should grow due to a large unfunded liability**

Somerville's annual retirement costs remain affordable; however, some assumptions used to build the pension actuarially determined contribution reflect, what we view as, weak assumptions and methodologies we think increase unexpected contribution-escalation risk.

In addition, the adopted pension-funding schedule includes annual pension-cost growth of more than 5% annually during the final 10 years. This could outpace overall budgetary growth; if assumptions are not met, it will likely increase further.

Somerville expects to increase appropriations to the OPEB trust prior to projected full pension funding in fiscal 2033, with increased contributions thereafter. However, while the city is prefunding the OPEB liability in a trust, we expect

costs will likely continue to increase. We recognize weak pension assumptions could result in a delay in the city making material progress in funding the OPEB liability

The city contributes to:

- Somerville Contributory Retirement System (SCRS), which is 79% funded, with a \$97.7 million proportionate share of the net pension liability; and
- Somerville's single-employer health-care plan, which is 8% funded, with a \$151.7 million net OPEB liability.

SCRS recently revised its discount to 7.75% from 8%. We continue to view the discount as high relative to our 6% guideline, and we theorize it could lead to volatile contributions if assumptions are not met. While Massachusetts requires all pension systems to achieve full funding no later than fiscal 2040, SCRS has planned to achieve full funding by fiscal 2033. We generally view closed, short amortization schedules as positive; however, for SCRS to meet its adopted funding schedule to achieve full funding in fiscal 2033, costs must increase, which market volatility could exacerbate. The city expects to continue adding about \$1 million more than annual benefit payments to the OPEB trust, consistent with the past several years; however, we do not expect it to make material OPEB funding progress until it funds the pension plan.

### Strong Institutional Framework

The Institutional Framework score for Massachusetts municipalities is strong.

Somerville, Massachusetts Select Key Credit Metrics				
	Most recent	--Historical information--		
		2021	2020	2019
<b>Very strong economy</b>				
Projected per capita effective buying income as a % of U.S.	150.6			
Market value per capita (\$)	252,195			
Population			82,686	81,486
County unemployment rate(%)			7.3	
Market value (\$000)	20,853,025	19,297,892	17,996,461	
10 leading taxpayers as a % of taxable value	6.4			
<b>Strong budgetary performance</b>				
Operating fund result as a % of expenditures		5.1	2.3	1.8
Total governmental fund result as a % of expenditures		7.7	1.4	5.8
<b>Very strong budgetary flexibility</b>				
Available reserves as a % of operating expenditures		30.3	25.7	21.1
Total available reserves (\$000)		83,978	68,412	55,222
<b>Very strong liquidity</b>				
Total government cash as a % of governmental fund expenditures		48.7	35.7	36.3
Total government cash as a % of governmental fund debt service		1,009.7	849.6	786.2
<b>Very strong management</b>				
Financial Management Assessment	Strong			

## Somerville, Massachusetts Select Key Credit Metrics (cont.)

	Most recent	--Historical information--		
		2021	2020	2019
<b>Very weak debt and long-term liabilities</b>				
Debt service as a % of governmental fund expenditures		4.8	4.2	4.6
Net direct debt as a % of governmental fund revenue	106.9			
Overall net debt as a % of market value	3.4			
Direct debt 10-year amortization (%)	38.2			
Required pension contribution as a % of governmental fund expenditures		4.6		
Other postemployment benefits actual contribution as a % of governmental fund expenditures		2.9		
<b>Strong Institutional Framework</b>				

Data points and ratios may reflect analytical adjustments.

## 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
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- 2021 Update Of Institutional Framework For U.S. Local Governments
- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

## Ratings Detail (As Of March 23, 2022)

Somerville GO muni purp loan ser 2020 due 10/15/2050		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Somerville GO BANs		
<i>Short Term Rating</i>	SP-1+	Affirmed

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