MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aaa to Boston, MA's $269.9M GO bonds

Global Credit Research - 06 Mar 2015

Affirms Aaa on outstanding debt; city has $1.3B in post-sale debt

BOSTON (CITY OF) MA
Cities (including Towns, Villages and Townships)
MA

Moody's Rating

ISSUE		RATING
General Obligation Bonds 2015 Series A		Aaa
Sale Amount	$140,000,000	
Expected Sale Date	03/18/15	
Rating Description	General Obligation	
General Obligation Refunding Bonds, 2015 Series B		Aaa
Sale Amount	$129,900,000	
Expected Sale Date	03/18/15	
Rating Description	General Obligation	

Moody's Outlook STA

NEW YORK, March 06, 2015 --Moody's Investors Service has assigned a Aaa rating to the City of Boston's (MA) $140 million General Obligation Bonds 2015 Series A and $129.9 million General Obligation Refunding Bonds 2015 Series B. Concurrently, Moody's affirms the Aaa rating on the city's outstanding GO debt. The city will have $1.3 billion of GO debt, post-sale.

SUMMARY RATING RATIONALE

The Aaa rating reflects Boston's sound fiscal management of a stable financial position and the city's substantial and economically diverse tax base bolstered by strong government, health care and higher education sectors. The rating also incorporates a significant but conservatively-structured debt profile and comparatively high long-term liabilities for pension and post-employment benefits (OPEB).

OUTLOOK

The stable outlook reflects the city's conservative approach to budgeting and expenditure control, as well as continuing tax base growth from residential and commercial development projects.

WHAT COULD MAKE THE RATING GO DOWN

- Weakened financial flexibility and reserve levels

- Trend of structurally imbalanced financial operations

- Inability to maintain aggressive funding of pension and OPEB liabilities

- Downturn in commercial, institutional and residential development

- Significant increase in debt burden

STRENGTHS

- Strong regional economy stabilized by state capital, regional economic hub and home to higher education and health care institutions

- Positive financial performance with solid reserves and plan to fund long-term liabilities

- High reliance on stable property tax revenues

- Adherence to comprehensive financial policies

- Conservative debt portfolio: all fixed-rate, no derivatives

CHALLENGES

- High personnel-related costs subject to collective bargaining with very strong collective bargaining groups

- Large long-term liabilities (pension and OPEB) with limited flexibility to reduce obligations

- Revenue raising constraints of Proposition 2 ½

RECENT DEVELOPMENTS

The fiscal 2014 audited financials reflect an operating surplus of $32.9 million attributed to positive variance in revenues and expenditures. The 2015 tax base has also experienced another year of strong growth in both assessed and equalized value. Further developments are incorporated in the Detailed Rating Rationale.

DETAILED RATING RATIONALE

ECONOMY AND TAX BASE: STRONG INSTITUTIONAL PRESENCE PROVIDES ANCHOR TO LARGE RESIDENTIAL AND COMMERCIAL GROWTH IN RECENT YEARS

Boston has a substantial and diverse tax base and is the capital of the Commonwealth of Massachusetts (Aa1 stable). The city is the center of economic activity for New England and boasts a substantial tax base of over $109 billion. Commonwealth estimates indicate that the city's total value, inclusive of tax exempt property, approaches $127 billion. Assessed values continued to grow for the fourth consecutive year in 2015, with an increase of 10.9%, the largest since 2007, attributable to 12% residential growth and 8.8% commercial growth.

Boston's development and redevelopment efforts remain strong throughout the city's neighborhoods, with the Boston Redevelopment Authority's current pipeline including 272 projects with over 56 million square feet and $23 billion in value. The city continues to benefit from what is considered its biggest expansion in history. For comparison, in 2012 the city had only 4.5 million square feet under construction coming out of the recession. In both 2014 and 2015 the city maintained 15.3 million square feet under construction. Major projects include One Seaport Square, the Millennium Tower and Boston Landing. The result is very strong new growth which is expected to remain above the $32 million ten-year average over the next few years. In 2015, new growth equaled $44.3 million, attributed to completed construction on the Longwood medical center, the Vertex building, residential condos and personal property. In addition, hotel occupancy rates continued their year-over-year improvement with an 81.6% occupancy rate in 2014.

Boston remains a center for life sciences, finance, business and professional services, with a concentration of hospital and higher education facilities that continue to act as an economic stimulus. Although the majority of the hospital and university property remains tax-exempt, the city benefits not only from the sectors' stable employment base, but also from the receipt of $73.3 million (2.6% of General Fund revenues) in payments-in-lieu of taxes (PILOTs) in fiscal 2014. Unemployment in Boston remains favorable at 4.5% in December 2014, below the state (5.4%) and US (4.8%).

Residential wealth and income levels are weak relative to those of the state, but on par with the US, with median family income equivalent to 97.9% of the nation. This relative weakness partially reflects the estimated 152,000 students who reside in the city with low personal income, but typically higher spending ability. Although equalized value per capita is strong at $177,399, reflecting the significant commercial sector and its high quality of development, it is significantly understated given the significant portion of the city that is tax-exempt.

FINANCIAL OPERATIONS AND POSITION: STABILITY EXPECTED TO CONTINUE, BOLSTERED BY STRONG PROPERTY TAXES AND NEW GROWTH

Boston's financial position will remain stable with adequate reserve levels and flexibility to address future budget challenges. Strong and proactive management strategies enabled the city to generate a third consecutive operating surplus in fiscal 2014. Audited results reflect an operating surplus of $32.9 million attributed to positive variance in both revenues and expenditures. Both property tax and excise taxes were above budget while expenditures were favorable in all major line items except for public safety and public works, which ran deficits of $20.7 million and $4.3 million, respectively. The surplus increased the available fund balance to $784.3 million, or 28.2% of revenues and continues the long-term trend of maintaining healthy reserve levels.

The city's largest revenue source is the property tax (64% of 2014 revenues), with strong collection rates of 99% within the current year. The second largest revenue source is state aid (18%), which continues to pressure the city's financial position given the increase in state assessments for charter school tuition. As a result of increasing state assessments, net state aid has declined annually since 2008, totaling $136.7 million, or 37.5%. The annual decline in the state aid will continue to be the city's primary revenue constraint going forward. Positively, property taxes and new growth remain very strong and have been large enough to offset the pressures in state aid funding.

The fiscal 2015 budget of $2.7 billion increased by 4.6% ($121 million) from the prior year's budget. Additionally, based on fiscal 2014 actual results, revenues are projected to increase 3.1%, departmental appropriations increased 1.7% and health insurance is up only 0.1%. The city also continues to appropriate $40 million of reserves toward the OPEB trust, although this has replenished through recurring revenues in recent years. The budget also absorbs large collective bargaining settlements for contracts set to expire in 2016 and 2017. Year-to-date revenues and expenditures are on budget except for snow and ice expenditures which are well over budget due to one of the largest snowfall totals in history. The snow and ice budget was $18.5 million and the city expects a total cost of between $40 and $50 million. The city expects to have sufficient funds to cover the deficit given positive variance in revenues and other expenditures. Also, the city and state have submitted requests for FEMA reimbursement.

City management currently develops two-year budget forecasts and has identified budget gaps of $6.6 million in 2016 and $5.5 million in 2017. The gaps are manageable, representing less than 1% of revenues, and management has an established history of balancing current year operating budgets by maintaining tight expenditure control measures on all departments. Future budget drivers will continue to be education (4% compound annual growth rate) as well as pension, debt, capital and state assessments, all of which are projected to experience a 9% growth rate.

Liquidity

Boston's net cash position at the end of fiscal 2014 was $1 billion, or a healthy 36.2% of revenues.

DEBT AND OTHER LIABILITIES: CONSERVATIVE DEBT PROFILE; AGGRESSIVE FUNDING OF LONG-TERM LIABILITIES MITIGATES SIGNIFICANT SIZE

Boston's direct debt burden will remain moderate at 1.3% of equalized value over the medium term due to a sound debt policy and capital improvement plan. At this level, the city remains at less than half of the city's adopted 3% limit. Significant overlapping debt from Boston Water and Sewer Commission (Aa1 stable), Massachusetts Water Resources Authority (Aa1 stable) and Massachusetts Bay Transportation Authority (Aa2 stable) raise the overall debt burden to 3.2%, reflecting the significant investment in infrastructure required to support the mature and densely-populated greater Boston service area. The city's fiscal 2015-2019 capital plan proposes $1.1 billion in projects over the next five years, and includes $918 million in authorized but unissued debt. Capital needs are expected to be financed from both city and non-city sources, with trust funds and grants from state and federal programs supporting roughly 30% of the CIP. The majority of Boston's capital plan (69%) will be supported by annual GO borrowing of roughly $150 million.

Debt Structure

The city's debt is all fixed rate, with level debt service which represented a manageable 5.4% of fiscal 2014 General Fund expenditures, below the city's annual debt service cap of 7% of expenditures. Principal amortization is average at 74% retired within 10 years.

Debt-Related Derivatives

Boston has no derivatives.

Pensions and OPEB

The city contributes to the State-Boston Retirement System (SBRS), a cost-sharing multi-employer pension plan. As of January 1, 2014, the plan was 70.2% funded and had an Unfunded Actuarial Accrued Liability (UAAL) of $5.7 billion. The city is required by the state to fully fund its Annual Required Contribution (ARC), which was $153 million in 2014, representing 5.6% of expenditures. Currently, the plan assumes a 7.75% rate of return with a plan to be fully funded by 2025, 15 years shorter than the maximum funding deadline of 2040 allowed by the state. This aggressive funding schedule mitigates the large pension liability. The city's adjusted net pension liability in 2014, under Moody's methodology for adjusting reported pension data, is $7.8 billion, or a high 2.82 times General Fund revenues. Moody's uses the adjusted net pension liability to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities.

In addition, despite pressure on the city's operating budget, Boston has substantially increased annual payments toward funding its liability for OPEB. The city has taken steps to reduce its OPEB liability, including mandatory Medicare, co-pay changes and premium shifts, which have contributed to reducing the UAAL to $2.1 billion based on the 2013 valuation report from $5.6 billion in 2007. The latest 2013 valuation report reflects an improved funding ratio of 9%, above most local governments. In fiscal 2014 the city contributed $153.6 million or 90% of the ARC as well as deposited $40 million of recurring revenues into its OPEB trust fund increasing the current balance to $264 million.

Fiscal 2014 total fixed costs for pension, OPEB and debt service represented $454.2 million, or 16.5% of expenditures, a level that has remained stable over the past four years. The city's pension and health care liabilities are substantial, however, and will continue to pressure the operating budget. Going forward, the city's ability to continue to practice long-time conservative fiscal practices in dealing with those challenges will be an important credit factor in future rating reviews.

MANAGEMENT AND GOVERNANCE

Massachusetts municipalities have an institutional framework score of 'Aa' or strong. The primary revenue source for Massachusetts municipalities is property taxes which are highly predictable and can be increased annually as allowed under the Proposition 2 ½ levy limit. Expenditures are largely predictable and cities have the ability to reduce expenditures.

Under a new mayor and chief financial officer in 2014, the city's management team maintained sound and conservative fiscal management including formal financial, debt and capital policies and planning. The budget includes a two-year forecast.

KEY STATISTICS

- 2015 Equalized Valuation: $109 billion

- 2015 Equalized Value Per Capita: $177,399

- Median Family Income as % of US Median: 97.90%

- Fiscal 2014 available General Fund balance as a % of Revenues: 28.21%

- 5-Year Dollar Change in Fund Balance as % of Revenues (2010-2014): -0.25%

- Fiscal 2014 Cash Balance as % of Revenues: 36.21%

- 5-Year Dollar Change in Cash Balance as % of Revenues, adjusted (2010-2014): 5.15%

- Institutional Framework: "Aa"

- 5-Year Average Operating Revenues / Operating Expenditures (2010-2014): 1.00x

- Net Direct Debt as % of Full Value: 1.27%

- Net Direct Debt / Operating Revenues: 0.50x

- 3-Year Average of Moody's ANPL as % of Full Value: 6.17%

- 3-Year Average of Moody's ANPL / Operating Revenues: 2.40x

OBLIGOR PROFILE

Boston is the capital and largest city in Massachusetts, with a population of 645,966, and represents the economic driver for much of New England.

LEGAL SECURITY

All debt is a general obligation of the city, secured by an unlimited tax pledge, as provided in Boston's Bond Procedure Act (Chapter 643 of the Acts of 1983 of the Commonwealth of Massachusetts) which allows the city to levy property taxes, without limit and in excess of Proposition 2 ½ limits, to the extent debt service is not otherwise provided for in the tax levy or from other sources, with no allowance made for any other expenditures of the city.

USE OF PROCEEDS

Series A proceeds will go to finance various capital projects of the city. Series B bonds will refund, in part, the city's Series 2005A, 2006A, 2007A, 2008A and 2009A bonds for an estimated net present value savings of $9.3 million or 6.5% of refunded bonds with no extension of maturity.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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