

Somerville, Massachusetts

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Credit Profile

Somerville GO bnds

Unenhanced Rating

AA-(SPUR)/Stable

Upgraded

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services raised its long-term rating on Somerville, Mass.' bonds to 'AA-' from 'A+', reflecting the strength of the city's economy and financial position. The outlook is stable. The ratings reflect our assessment of the city's:

- Proximity to and participation in the greater Boston metropolitan statistical area economy;
- Large and developing tax base;
- Strong financial position; and
- Low debt burden.

Somewhat offsetting these strengths is a large unfunded other postemployment benefits (OPEB) liability and low pension funded ratio of 66%.

The bonds are secured by the city's full faith and credit pledge.

Somerville is a fully developed 4-square-mile city of approximately 74,000, adjacent to Boston ('AA+' GO rating) and Cambridge, Mass. ('AAA' GO rating). The fiscal 2011 assessed value is \$8.30 billion, which is equal to \$112,500 per capita, which we consider extremely strong. Unemployment in the city has been historically below the state and national averages, and the October 2010 level was 5.9%, again better than the state and nation. The largest employer is Tufts University (50% of the campus is in adjacent Medford) with about 2,200 employees. Somerville's median household effective buying income is strong, in our view, at 110% of the national average.

Significant economic development is occurring in the city, including at the Assembly Square, which is a 145-acre area near Boston where retail and residential development is under way. The city plans to issue tax increment revenue bonds in 2012 to fund infrastructure costs for this area, and city management indicates that a new subway station is expected to open in 2013.

Despite a large decline in fiscal 2009, the city's financial position remains strong, in our view. At the end of fiscal 2009, the unreserved general fund balance was \$12.0 million and the separate stabilization fund was \$10.1 million, a combined level of \$22.1 million or 12% of expenditures. Management indicates that the fiscal 2010 audited financial will be completed in early April 2011; unaudited figures indicate a \$1.2 million general fund surplus and a combined unreserved general fund and stabilization balance of \$22.0 million, or 12% of expenditures. The fiscal 2011 budget appropriates \$2.0 million of general fund balance, but management projects that the fund balance will decline by about \$500,000. Most of the city's collective bargaining contracts are expired, some for multiple years, but Somerville does have some funds reserved for the potential settlement of these contracts.

The city is currently developing its fiscal 2012 budget. The current plan projects a \$2.5 million decline in state aid and has a budget gap of about \$6.0 million. However, management expects to reduce the budget gap but expects that it will include some level of fund balance appropriation. The city has essentially no unused levy capacity under the state's Proposition 2 1/2 limit, which is similar to most cities and towns in the commonwealth. Somerville's management practices are considered "good" under Standard & Poor's Financial Management Assessment (FMA), indicating practices exist in most areas, although not all may be formalized or regularly monitored by governance officials.

Somerville's unfunded pension liability as of Jan. 1, 2008, which is the latest valuation but doesn't include the large asset losses of 2008, is \$90.1 million, a 66% funded level. The city's OPEB liability was \$571 million as of June 30, 2008, the fiscal 2009 annual OPEB cost was \$34.4 million, and the actual payment was \$15.1 million, or 44%.

Full OPEB funding would have been about 17% of total general fund expenditures in fiscal 2009. The pro forma fixed charges for fiscal 2009, including full OPEB funding, pension funding, and debt service would have been 27% of general fund expenditures. However, Somerville recently adopted legislation requiring retirees to join Medicare when eligible and also increased the retiree healthcare premiums. Management projects that these changes significantly reduced the OPEB liability, but an actuarial study has not been completed since they were adopted. Management indicates that an OPEB trust fund may be established in fiscal 2012, but does not believe that significant funding will be directed into the fund in fiscal 2012.

Including state support for school debt, the city's debt levels are low, in our opinion, at \$900 per capita and less than 1% of market value. Somerville's largest future debt plan is for \$25 million of GO bonds that management expects to issue in fiscal 2012 and to service with incremental revenues from the Assembly Square project.

Outlook

The stable outlook reflects our expectation that Somerville will adjust its budget in response to any state revenue reductions and that the city's tax base will remain a sound source of tax revenue, enabling the city to maintain a strong financial position. We do not expect that the rating will change within the two-year parameter of the stable outlook as we anticipate Somerville will continue to maintain consistently strong reserve levels.