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Summary:

Brookline, Massachusetts; General Obligation

Primary Credit Analyst:

Christian Richards, Boston (1) 617-530-8325; christian.richards@spglobal.com

Secondary Contact:

Victor M Medeiros, Boston (1) 617-530-8305; victor.medeiros@spglobal.com

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Credit Profile

US\$58.58 mil GO mun purp loan ser 2018 due 03/15/2043

Long Term Rating

AAA/Stable

New

Rationale

S&P Global Ratings assigned its 'AAA' long-term rating to the town of Brookline, Mass.' 2018 general obligation (GO) bonds. The outlook is stable.

Brookline's full-faith-and-credit pledge, subject to the limitations of Proposition 2-1/2, secures the bonds. We rate the limited-tax GO debt based on the application of our "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" criteria (published Jan. 22, 2018, on RatingsDirect). We are rating the obligation at the same level with our view of Brookline's general creditworthiness as expressed in our rating on the unlimited-tax GO bonds.

We understand officials intend to use bond proceeds for various capital projects, the largest of which involves the renovation of the Devotion School. The portion of the bonds for that purpose have been exempted from the limits of Proposition 2-1/2.

Brookline'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) because we believe the town can maintain better credit characteristics than the U.S. in a stress scenario. The town has a predominately locally derived revenue source, with 74% of general fund revenue coming from property taxes, and independent taxing authority and independent treasury management from the federal government.

The long-term rating reflects our view of the town'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 (FMA) methodology;
- Strong budgetary performance, with an operating surplus in the general fund and break-even operating results at the total governmental fund level in fiscal 2017;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 12.0% of operating expenditures, and an ability and willingness to raise taxes when needed;
- Very strong liquidity, with total government available cash at 18.2% of total governmental fund expenditures and 5.5x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 3.3% of expenditures and net direct debt that is 51.1% of total governmental fund revenue, and significant medium-term debt plans and a large

pension and other postemployment benefit (OPEB) obligation and the lack of a plan to sufficiently address it, but low overall net debt at less than 3% of market value; and

- Strong institutional framework score.

Very strong economy

We consider Brookline's economy very strong. The town, with an estimated population of 59,995 over 6.8 square miles, is in Norfolk County directly west of Boston and across the Charles River from Cambridge. It is in the Boston-Cambridge-Newton MSA, which we consider to be broad and diverse. The town has a projected per capita effective buying income of 203% of the national level and per capita market value of \$388,950. Overall, market value grew by 7.7% over the past year to \$23.3 billion in 2018. The county unemployment rate was 3.2% in 2016.

The town is connected to Boston by Interstate 90, as well as four branches of the MBTA green line and a commuter rail line. Its location, along with major health care/hospital employers Partners Healthcare (1,300 employees); the Dana Farber Cancer Institute (713); Bournewood (345); and, Arbour HRI Hospital (220), has led to extremely strong and stable wealth and income levels.

Although the town is largely built-out, a number of new developments are expected to contribute to the tax base. These include a 250,000-square-foot medical office building and a 68-room hotel. Town officials also anticipate that ongoing redevelopment surrounding Coolidge Corner will help generate new growth. This area is home to a Trader Joe's, the town's fifth-largest employer (185 employees) and is the major commercial center.

Town officials anticipate that the steady increase in home values, based on families seeking both a good school system and easy access to Boston, will continue. Given that 90% of the town's real estate valuation is from residential properties, and accounting for the historic upward trend in market value as well as incomes, we anticipate that Brookline will maintain its extremely strong and stable economic metrics, which are further enhanced by its participation in the Boston MSA. Therefore, we expect that the town's economy will remain very strong throughout the two-year outlook period.

Very strong management

We view the town's management as very strong, with "strong" financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Brookline maintains detailed financial planning policies and documents, all of which are easily accessible on its website, providing transparency. Highlights of the town's financial planning include examining multiple years of actual revenue and expenditure data and consulting with department heads to identify trends that need to be captured in the financial plan. The five-year financial plan is updated annually and details revenue expenditure assumptions, which are based on observable developments, such as changing school enrollment and new growth, as well as identified or anticipated changes to revenues and expenditures. The six-year capital plan is also updated annually, and includes anticipated debt service and its likely effects on the budget. The town maintains a formal debt management policy, which limits the type and usage of debt, while also setting limits on the amount of debt. The formal reserve policy requires that the town maintain at least 10%, with a target of 12.5%, of budgeted revenue in unreserved general fund balance. Currently, Brookline does not have a formal investment policy and does not regularly report investment

holdings and performance, but management reports that a draft policy has been developed and is being considered. Management does report budget-to-actual performance quarterly to the board.

Strong budgetary performance

Brookline's budgetary performance is strong, in our opinion. The town had surplus operating results in the general fund of 1.7% of expenditures, and balanced results across all governmental funds of 0.3% in fiscal 2017.

For analytical consistency, we adjusted performance to account for recurring transfers into the general fund from nonmajor governmental and enterprise funds, as well as transfers out of the general fund to the capital article fund. Additionally, we adjusted performance to account for one-time revenues and expenditure of bond proceeds.

Town officials continue to make both revenue and expenditure adjustments to ensure that the town remains in operational financial balance. One of the largest budgetary pressures facing Brookline is increasing school enrollment. Between 2013 and 2017, it saw an 8.2% increase in enrollment, without a corresponding increase in total population. To maintain fiscal balance, in calendar year 2015, voters approved an override to the tax levy limit imposed by Proposition 2-1/2. This override provided operating revenues in excess of what would be permitted under the law for fiscal years 2016-2018. Town officials are preparing another proposal for voter approval for later this year, effective for fiscal years 2019-2021, which would again increase operating revenues. We anticipate this measure will be approved.

While we note that the town's residential mill rate, at 9.46, is one of the lowest in the state, but the town's 2018 unused levy capacity was only \$22,800. Thus, the ability of the town to immediately and predictably generate additional revenue beyond the 2.5% growth limitation depends on voters approving levy limit overrides, which the town has a history of doing.

In fiscal 2017, the town raised parking meter rates, while also realizing budgetary savings from staff vacancies. The development around Coolidge Corner also helped building permit revenue to come in over budget. Town officials report that fiscal 2018 budget-to-actual revenues and expenditure are tracking well, and they anticipate at least balanced operating results at the end of the year. The town is in the state's group insurance program. Officials report that the increase in health care costs was well within expectations and should not pose immediate budgetary stress. In fiscal 2017, local property taxes accounted for approximately 74% of general fund revenues, while intergovernmental aid was approximately 16%.

Given the town's strong financial controls and proactive budgeting process, we anticipate that management will continue to make adjustments to both revenues and expenditures to ensure that the town remains financially balanced. We expect that Brookline will maintain strong budgetary performance during the outlook period. However, we also note that future pension and OPEB costs could become a budgetary pressure due to the system's below-average funding ratios and what we view as aggressive assumptions. As long-term liability annual expenses increase, management is actively making budgetary adjustments to absorb this growing expense. We note Brookline is funding the pension actuarially determined contribution (ADC) and is pre-funding OPEBs. We believe adjustments to more conservative assumptions could materially affect annual contributions, pressuring the operating budget, particularly if economic or business conditions worsen.

Very strong budgetary flexibility

Brookline's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 12.0% of operating expenditures, or \$33.7 million. In addition, the town has an ability and willingness to raise taxes when needed, which we view as a positive credit factor.

The town's available fund balance has increased in each of the past three fiscal years, to \$33.7 million (12% of expenditures) in fiscal 2017, from \$24.6 million (10.6%) in fiscal 2015. We believe that its ability and willingness to raise taxes, as demonstrated by voter-approved Proposition 2-1/2 overrides in 2008 and 2015—with the anticipation of another override in 2019—provides additional budgetary flexibility. While we do not expect a drawdown of reserve funds within the next several fiscal years, if the town is unable to secure a voter-approved operating override when required to maintain financial balance, we could revise our view of its flexibility to strong; however, we expect that voters will again approve an override in 2019 and the town's budgetary flexibility will remain very strong.

Very strong liquidity

In our opinion, Brookline's liquidity is very strong, with total government available cash at 18.2% of total governmental fund expenditures and 5.5x governmental debt service in 2017. In our view, the town has strong access to external liquidity if necessary.

Brookline has maintained very strong cash balances over the past three fiscal years. Additionally, we believe the town's strong access to external liquidity is demonstrated by its frequent debt issuances of GO bonds. We do not believe that its investments are risky, and have no indication of cash flow issues. Therefore, we do not anticipate a change to these ratios and expect that the town will maintain very strong liquidity.

Weak debt and contingent liability profile

In our view, Brookline's debt and contingent liability profile is weak. Total governmental fund debt service is 3.3% of total governmental fund expenditures, and net direct debt is 51.1% of total governmental fund revenue. Negatively affecting our view of the town's debt profile is its significant medium-term debt plans. Overall net debt is low at 1.4% of market value, which is, in our view, a positive credit factor.

The town expects to issue approximately \$100 million in new-money debt over the next two fiscal years. We have incorporated the anticipated new debt into our analysis as significant medium-term debt plans. However, once finalized, the effects on the debt ratios may be greater than currently anticipated.

In our opinion, a credit weakness is Brookline's large pension and OPEB obligation, without a plan in place that we think will sufficiently address it. Brookline's combined required pension and actual OPEB contributions totaled 11.3% of total governmental fund expenditures in 2017. Of that amount, 6.4% represented required contributions to pension obligations, and 4.9% represented OPEB payments. The town made 100% of its annual required pension contribution in 2017. The funded ratio of the largest pension plan is 55.0%.

Brookline contributes to the Brookline Contributory Retirement System, a cost-sharing multiemployer, defined-benefit pension plan. We consider the system very low funded, with a funded ratio of 54.67%, measured with a 7.4% discount rate. While we note that the discount rate itself is slightly below the 7.5% rate we consider average, the system's funding schedule currently requires a 7.85% annual increase in contributions to meet the target of fully funding the

system by 2030. We believe that assumption may be aggressive and difficult to meet, particularly if economic pressures were to further increase required contributions. The town's proportionate share of the net pension liability is approximately \$220 million.

The town also participates in the Massachusetts Teachers' Retirement System (MTRS), a cost-sharing multiemployer defined-benefit plan. MTRS is managed by the state on behalf of municipal teachers and municipal teacher retirees. The state is responsible for 100% of contributions and liabilities, so the town has no liability under MTRS.

The town also provides OPEBs in the form of lifetime health care and life insurance for eligible retirees and their spouses. Brookline established an OPEB trust fund, which currently has a funded ratio of 12.9%, measured using a 7.4% discount rate. It has an unfunded OPEB liability of approximately \$254.5 million.

The town's formal unfunded liability policy requires it to increase contributions to the OPEB trust by \$250,000 per year until it achieves full funding of the OPEB trust fund ADC. Additionally, after fully funding the pension fund, monies above the pension normal cost will be redirected to the OPEB trust. However, we note that the town underfunded its fiscal 2017 OPEB ADC by approximately \$8.5 million. We do not anticipate that the incremental increase in contributions by the town will meaningfully affect the compounding of the ADC shortfalls. We anticipate that pension costs will require the town to extend its amortization schedule beyond the 2030 target date, while noting that state law requires full funding by 2040. We expect that both pension and OPEB costs will continue to rise, and may further stress the operating budget in the future.

Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

Outlook

The stable outlook reflects our view of Brookline's very strong local economy, which benefits from its location directly west of Boston and access to a variety of transportation options. The town's strong management practices, which include detailed long-term financial and capital planning as well as the necessary policies to ensure favorable financial outcomes, also lend stability to the rating. Although we do not expect this to occur in our two-year outlook horizon, we could lower the rating if budgetary performance becomes imbalanced, either due to increasing fixed costs or an inability to generate sufficient revenue from Proposition 2-1/2 overrides, leading to a draw on the town's reserve funds.

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

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors,

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