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# Wellesley (Town of) MA

Update to credit analysis

## Summary

Wellesley, MA (Aaa stable) benefits from its favorable location just west of Boston with a sizable tax base and high resident wealth and income levels. The town's fiscal management is strong with stable financial operations aided by a history of voter support for general overrides and debt exclusions to the tax levy limits of Proposition 2½. The debt burden is moderate but is expected to increase considerably over the next five years due to new school projects. Importantly, most, if not all of that debt, will be excluded from Proposition 2½. Additionally, we expect the town's formal fiscal policies and long term planning to mitigate the increase in the debt burden. The town is aggressively funding its pension and other post employment benefits (OPEB) liabilities.

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. We do not see any material immediate credit risks for Wellesley. However, the situation surrounding Coronavirus is rapidly evolving and the longer term impact will depend on both the severity and duration of the crisis. If our view of the credit quality of Wellesley changes, we will update our opinion at that time.

## Credit strengths

» Wealthy tax base with favorable location and institutional presence

» Conservative fiscal management aided by formalized policies

» Strong voter support for debt exclusions to Proposition 2½

» Aggressive funding of pension and OPEB liability

## Credit challenges

» Large capital plans mostly for new school buildings

» Rising education costs

## Rating outlook

The stable outlook reflects the town's conservative budgeting and adherence to formalized financial policies that will support balanced operations in the future. The outlook also incorporates the additional financial flexibility provided by the strong tax base with voter approved debt exclusions to the tax levy limits of Proposition 2½.

## Factors that could lead to an upgrade

» Not applicable

## Factors that could lead to a downgrade

» Material growth in the debt burden without corresponding debt exclusions to Proposition 2½

» Trend of operating deficits resulting in a significant decline in cash and available reserves

» Increased financial pressure due to unsuccessful votes for tax levy overrides or debt exclusions

» Large and sustained deterioration of the tax base or resident wealth and income levels

## Key indicators

Exhibit 1

| Wellesley (Town of) MA | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| Economy/Tax Base | | | | | |
| Total Full Value ($000) | $10,212,969 | $10,212,969 | $11,749,687 | $11,749,687 | $12,421,188 |
| Population | 28,832 | 28,909 | 29,004 | 29,201 | 29,201 |
| Full Value Per Capita | $354,223 | $353,280 | $405,106 | $402,373 | $425,369 |
| Median Family Income (% of US Median) | 290.7% | 295.9% | 303.9% | 319.3% | 319.3% |
| Finances | | | | | |
| Operating Revenue ($000) | $147,799 | $163,474 | $171,310 | $177,839 | $182,980 |
| Fund Balance ($000) | $22,489 | $24,916 | $28,467 | $29,348 | $31,148 |
| Cash Balance ($000) | $31,395 | $31,760 | $35,443 | $40,305 | $37,780 |
| Fund Balance as a % of Revenues | 15.2% | 15.2% | 16.6% | 16.5% | 17.0% |
| Cash Balance as a % of Revenues | 21.2% | 19.4% | 20.7% | 22.7% | 20.6% |
| Debt/Pensions | | | | | |
| Net Direct Debt ($000) | $147,019 | $138,861 | $133,341 | $133,944 | $126,546 |
| 3-Year Average of Moody's ANPL ($000) | $148,482 | $136,172 | $133,835 | $136,202 | $139,721 |
| Net Direct Debt / Full Value (%) | 1.4% | 1.4% | 1.1% | 1.1% | 1.0% |
| Net Direct Debt / Operating Revenues (x) | 1.0x | 0.8x | 0.8x | 0.8x | 0.7x |
| Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%) | 1.5% | 1.3% | 1.1% | 1.2% | 1.1% |
| Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x) | 1.0x | 0.8x | 0.8x | 0.8x | 0.8x |

As of June 30 fiscal year end
*Source: Moody's Investors Service and Wellesley's audited financial statements*

## Profile

Wellesley is located 15 miles west of Boston (Aaa stable) with a population of 29,000. It is primarily residential in composition and is home to Wellesley College (Aa1 stable) and Babson College (A2 stable).

## Detailed credit considerations

### Economy and tax base: Sizeable and affluent tax base benefits from proximity to Boston and institutional presence

Wellesley will continue to grow given its favorable proximity to Boston and strong residential market along with the benefits of the institutional presence of Wellesley College (Aa1 stable) and Babson College (A2 stable). The presence of the colleges, along with Harvard Pilgrim healthcare and Sun Life Assurance Company of Canada (Aa3 stable), provide stability to the diverse suburban economy. The sizable $12.4 billion tax base (2019-20 equalized value) will continue to experience modest growth over the medium term given the very strong housing stock and primarily residential composition. The two-year equalized value increased 5.7% from 2017. The 2020 assessed value increased by 2.8% bringing the five year compound growth rate to 4.3%. Residential tear downs and renovations are driving the increase in valuation. The town is also benefitting from new development projects that includes a 44-unit new single family housing development called Fieldstone Way. The project includes 11 units of affordable housing. The Boston Sports Institute also was completed and opened in fiscal 2020, providing a large increase in the tax roll.

Wealth levels are very strong with a median family income at 240% and 319% of the state and nation, respectively, and an equalized value per capita of $443,899.

### Financial operations, reserves and liquidity: Conservative fiscal management expected to maintain a stable financial position

Wellesley's strong financial management is expected to maintain a stable operating position over the near term. While the 2.5% tax levy limit does constrain operating flexibility, the town benefits from strong taxpayer support that has historically approved tax levy overrides when needed. Additionally, the town funds a large portion of capital needs with available funds as well as makes large contributions toward OPEB liabilities, both of which could be reduced over the short term if the operating budget needs additional flexibility.

The fiscal 2019 audited financials reflects another year of balanced operations with a general fund surplus of $1.8 million due to additional revenue from building permits and investment income while expenditures were below budget in all major departments. The surplus increased the available general fund balance to $31.1 million equal to 17% of general fund revenue. The primary revenue source is property taxes representing 77% of general fund revenue. The largest expense is education representing 42% of general fund expenditures followed by employee benefits representing 12%.

Fiscal 2020 operations are trending on budget with positive variance in both revenue and expenses through March helping to offset an anticipated drop in local excise tax revenue due to the stay-at-home order related to the coronavirus pandemic. The town expects to end the year balanced with little change in the amount of available reserves. The town has also issued a hiring freeze for nonessential positions and spending freeze for nonessential, non-COVID-19 related costs that is expected to remain through at least the beginning of fiscal 2021.

The proposed fiscal 2021 budget would increase by just under 2% compared to the prior year budget driven by education and employee benefits. The town's initial response to the expected economic impact from the pandemic included in the proposed budget is the reduction of $1.7 million in revenue and expenses. Revenue cuts included a decline in expected new growth and local receipts while keeping state aid level funded. On the expense side the town has reduced its capital cash funding.

#### LIQUIDITY

Cash and investments at the end of fiscal 2019 were $37.8 million equal to a healthy 20.6% of general fund revenue. We expect the cash position to remain relatively level at the end of fiscal 2020. Additionally, the liquidity position provides over 6.5 times coverage on the 2020 BANs.

### Debt, pension and OPEB liabilities: debt burden will increase but remain manageable; strong commitment to funding pension and OPEB

The direct net debt burden is currently an average 1.1% of equalized value net of water and sewer self-supporting debt. However, the debt burden is expected to increase given a large capital plan mostly related to new school projects. Positively, voters have historically excluded a significant amount of the town's outstanding debt from Proposition 2½ levy limits. The town has also formalized a debt policy to manage its rising capital needs. The policy includes maintaining cash capital and inside the levy debt service between 6.2% and 6.8% of recurring operating revenue.

The 2021-2025 capital budget program totals $239 million, and increase from the $218 million last year. The program averages $7.7 million spent annually with available cash, althought this could change if the town shifts some of these funds toward operations. The plan also includes $196 million funded with debt, of which approximately 81% is projected to be excluded from the levy limit. Renovations to two elementary schools represent the largest project with an estimated of $118 million. The two projects are expected to be financed beginning in fiscal 2021 and 2023.

### DEBT STRUCTURE

The entire debt portfolio is fixed rate with 67% of principal retired in ten years. Fiscal 2019 debt service represented $16.7 million equal to 9.2% of general fund expenditures.

### DEBT-RELATED DERIVATIVES

The town is not party to any interest rate swaps or other derivative agreements.

### PENSIONS AND OPEB

Wellesley's pension and OPEB liabilities are relatively equal to the debt burden and, though manageable at this time, represent a potential future credit challenge. The town participates in the Wellesley Contributory Retirement System, a multi-employer defined benefit plan and makes annual required contributions based on at least its proportional share. The retirement plan is likely to be fully funded by 2030 and currently uses a 6.625% discount rate. The town's teachers participate in the Massachusetts Teachers Retirement System in which the town receives on-behalf payments toward the liability that is covered by the Commonwealth. The town also funds its OPEB liability on a pay-go basis plus annual budgeted deposits into an OPEB trust. The table below summarizes the town's 2019 debt, pension and OPEB unfunded liabilities and contributions.

Exhibit 2

**Wellesley's fiscal 2019 debt, pension and OPEB contributions and liabilities**

| 2019 | Amount ($ thousands) | % of Operating Revenues | Discount Rate |
|---|---|---|---|
| Operating Revenue | 182,980 | | |
| Reported Net Pension Liability | 61,059 | 33.37% | 6.625% |
| Moody's Adjusted Net Pension Liability | 141,195 | 77.16% | 4.22% |
| Reported Net OPEB Liability | 50,916 | 27.83% | 6.625% |
| Moody's Adjusted Net OPEB Liability | 97,244 | 53.14% | 4.1% |
| Pension Contribution | 8,306 | 4.54% | - |
| Pension Tread Water Gap [1] | -3,029 | -1.66% | - |
| OPEB Contribution | 8,725 | 4.77% | - |
| Net Direct Debt | 126,546 | 69.16% | - |
| Debt Service | 16,665 | 9.11% | - |
| Total Fixed Costs | 33,696 | 18.42% | - |

[1] A positive pension tread water gap reflects a pension contribution smaller than the amount required to prevent the unfunded liability from increasing if all plan assumptions are realized. A negative tread water gap reflects a contribution larger than the amount required to keep the unfunded liability from increasing if all assumptions are realized.

*Source: Moody's Investors Service and Wellesley's audited financial statements*

The town's annual pension contributions over the past five years (2016-2019) have averaged a strong 132% of the tread water indicator which is the amount required to keep the unfunded liability from increasing if all actuarial assumptions are realized. Failure to realize the assumed return on pension assets could result in larger required increases to meet the funding schedule. Additionally, the town makes aggressive annual contributions toward its OPEB liability which has a strong fiduciary net position of 57.89% of the total OPEB liability.

## ESG considerations

Wellesley does not have material environmental credit risk. The town has a high risk of water stress exposure given its land lock location but there are sufficient mitigating factors to keep this from becoming a long term challenge.

The town's social risks are incorporated into the economy and tax base section above. The town benefits from strong wealth and income levels.

The town's management team has shown a long term trend of consistent and conservative fiscal management with multi-year capital and operating budgets. In addition, the town has developed a long term plan to address its unfunded pension and OPEB liabilities.

Massachusetts towns have an Institutional Framework score of "Aa," which is strong. The sector's major revenue source of property taxes, are subject to the Proposition 2 1/2 tax levy cap which can be overridden with voter approval only. However, the cap of 2.5% still allows for moderate revenue-raising ability. Expenditures primarily consist of personnel costs, as well as education costs for towns that manage school operations, and are highly predictable given state-mandated school spending guidelines and employee contracts. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally greater than 25% of expenditures. Fixed costs are driven mainly by debt service and pension costs. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

## Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 3

| Wellesley (Town of) MA | | |
|---|---|---|
| **Scorecard Factors** | **Measure** | **Score** |
| Economy/Tax Base (30%) [1] | | |
| Tax Base Size: Full Value (in 000s) | $12,421,188 | Aaa |
| Full Value Per Capita | $425,369 | Aaa |
| Median Family Income (% of US Median) | 319.3% | Aaa |
| Notching Factors:[2] | | |
| Institutional Presence | | Up |
| Other Analyst Adjustment to Economy/Taxbase Factor: strong resident wealth and income levels above scorecard thresholds | | Up |
| Finances (30%) | | |
| Fund Balance as a % of Revenues | 17.0% | Aa |
| 5-Year Dollar Change in Fund Balance as % of Revenues | 4.8% | A |
| Cash Balance as a % of Revenues | 20.6% | Aa |
| 5-Year Dollar Change in Cash Balance as % of Revenues | 4.9% | A |
| Management (20%) | | |
| Institutional Framework | Aa | Aa |
| Operating History: 5-Year Average of Operating Revenues / Operating Expenditures (x) | 1.0x | A |
| Notching Factors:[2] | | |
| Unusually Strong Budgetary Management and Planning | | Up |
| Debt and Pensions (20%) | | |
| Net Direct Debt / Full Value (%) | 1.1% | Aa |
| Net Direct Debt / Operating Revenues (x) | 0.7x | A |
| 3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%) | 1.1% | Aa |
| 3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x) | 0.8x | Aa |
| | Scorecard-Indicated Outcome | Aaa |
| | Assigned Rating | Aaa |

[1] Economy measures are based on data from the most recent year available. [2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology. [3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication.
*Source: Moody's Investors Service and US Census Bureau*

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## CLIENT SERVICES

| | |
|---|---|
| Americas | 1-212-553-1653 |
| Asia Pacific | 852-3551-3077 |
| Japan | 81-3-5408-4100 |
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