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**Summary:**

# Worcester, Massachusetts; General Obligation; Note

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## Summary:

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Credit Profile		
US\$38.075 mil GO bnds dtd 11/01/2009 due 11/01/2037		
<i>Long Term Rating</i>	A-/Stable	New
US\$27.95 mil GO BANs ser A&B dtd 11/05/2009 due 11/05/2010		
<i>Short Term Rating</i>	SP-1+	New

## Rationale

Standard & Poor's Ratings Services has assigned its 'A-' rating to Worcester, Mass.' general obligation (GO) bonds, and its 'SP-1+' rating to the city's bond anticipation notes (BANs). At the same time, we affirmed our 'A-' long-term rating and underlying rating (SPUR), with a stable outlook, on the city's existing long-term debt.

The ratings reflect our opinion of the city's general creditworthiness and demonstrated market access.

In our opinion, the ratings also reflect what we view as Worcester's:

- Diversifying local economy, which continues to shift to the service sector from manufacturing and benefits from the presence of 10 colleges and universities and a strong health care sector;
- Large and diverse property tax base that provides the city with, in our opinion, a large \$12 million of levy space under commonwealthwide levy limits, although the city expects a significant reduction in assessed value (AV) for fiscal 2010; and
- Good financial management policies.

In our view, these strengths are mitigated, in part, by the city's:

- Adequate current financial position and management's projection of achieving structural stability; and
- Below-average, but adequate, income levels.

The city's full faith and credit pledge secures the bonds and BANs. Officials will use bond proceeds to retire BANs that were issued for a variety of purposes, including the city's share of the initial phase of the CitySquare construction project, and will use BAN proceeds for a variety of improvement projects.

Officials estimate a year-end deficit of \$5.8 million for fiscal 2009, although \$3.1 million of this is for a snow removal deficit that is being raised on the fiscal 2010 tax levy. Worcester's state aid was cut midyear by approximately \$5 million. Officials reduced the 2009 budget through 130 layoffs and the elimination of about 80 positions that had been held vacant from the beginning of the year; officials began planning for potential state cuts early in the fiscal year. Officials project the stabilization fund to increase by \$1.1 million in accordance with the city's "five point" financial plan. The fiscal 2010 budget included the personnel reductions from fiscal 2009, but lower state aid figures have created a gap of about \$2.0 million in the city's budget, even after the city's recent enactment of local option meals and hotel-motel taxes. Management is currently identifying ways to close that gap.

The budget includes a contingency fund for potential retroactive collective bargaining settlements, and projects additional transfers from the general fund into the general stabilization fund and a high school construction stabilization fund. State aid accounted for 58% of fiscal 2008 general fund revenues.

Although Worcester's combined general and stabilization fund position declined in fiscals 2006 and 2007, both of these balances increased in fiscal 2008. The city's unreserved fund balance increased by nearly \$2.0 million at fiscal year-end 2008 to \$11.9 million, or 2.3% of expenditures. The stabilization fund increased by about \$600,000 in fiscal 2008 to \$3.2 million. Much of the stabilization drawdown in fiscal 2007 was for operating expenditures.

Worcester, with a population estimate of 175,090, is the secondmost populous city in both Massachusetts and New England. The city is 40 miles west of Boston, where it serves as a commercial and industrial center in central Massachusetts. Good highway and rail access facilitates transportation throughout the region and into Boston. City income levels have historically been below commonwealth and national averages. In our opinion, median household effective buying income is an adequate 71% of the commonwealth's level and 83% of the nation's level; per capita effective buying income is similar. We consider, however, that the city's large student population deflates, in part, these income indicators.

The Worcester region has a large concentration of jobs in the biomedical industry, providing more than 7,500 jobs and \$1 billion in economic activity. The city's Biotech Park contains more than 20 companies employing in excess of 2,700, but there is room for expansion. Despite the city's role as a regional economic center, unemployment remains above commonwealth and national rates; city unemployment in August 2009 was 10.8%.

The city's large property tax base exhibits little taxpayer concentration. From fiscal 2008 to fiscal 2009, total AV declined by 4.6% to \$12.14 billion, or, in our opinion, a strong market value of \$69,200 per capita. The administration projects a further AV decline of about 15% for fiscal 2010; however, the administration intends to increase the tax rate sufficiently to offset this. The main AV sectors that declined in fiscal 2009 were single-family homes, down 5%; and two- and three-family homes, down 10%. Many sectors of business personal property increased. We view concentration as low, with the 10 leading taxpayers accounting for 8% of total AV. Property tax collections, which accounted for 35% of fiscal 2008 general fund revenues, are sound in our opinion; current collections were 99% in fiscal 2008, while total collections, including penalties, were in excess of 100% for at least the past four fiscal years.

The property tax base stands to get a substantial boost from numerous ongoing economic development projects planned or under construction--the largest of which is a \$560 million mixed-use project known as CitySquare, which is in the preliminary construction phase. The CitySquare project will consist of three phases and will include \$470 million of private investment and \$93 million of public investment. The project will bring an estimated 2.1 million square feet of new retail, commercial, and residential space into the city's downtown area. Demolition of existing buildings in the project area will start once contracts are signed for a sufficient amount of leased space at the project; officials report that these leases are nearly complete. Despite recent changes to the construction schedule, the final project completion date remains on schedule for 2013.

Standard & Poor's considers Worcester's financial management practices "good" under its financial management assessment (FMA) methodology. An FMA of good indicates financial practices exist in most areas but that governance officials might not formalize or regularly monitor all of them.

Worcester's debt burden remains moderate, in our opinion, with overall net debt at \$2,190 per capita, or 3.2% of

market value. In our view, carrying charges were moderate at 9% in fiscal 2008. We understand that the city is not currently engaged in any swaps or variable-rate debt.

## Outlook

The stable outlook on the long-term rating and SPUR reflects our view of management's budget adjustments for fiscals 2009 and 2010, along with Worcester's large amount of unused levy capacity, which provides revenue-raising flexibility.

## Finances

As of Jan. 1, 2009, the unfunded actuarial accrued liability in the city's pension fund increased to \$297.7 million, a 68.0% funded level, up from a \$130.5 million liability as of Jan. 1, 2008. Worcester has been making 100% of the annual required contribution for its pension fund. The commonwealth recently voted down special legislation that would have extended the final amortization date for the city's pension fund by 10 years, from 2028 to 2038, which the city proposed as a way to lessen the increase in the pension contribution arising from the investment losses. The city's updated actuarial valuation of its other postemployment benefits, as of June 30, 2008, reports an unfunded liability ranging from \$606 million-\$1.15 billion, depending on the funding method. The fiscal 2009 and 2010 budgets do not include funding to begin amortizing this liability.

It is our understanding that Worcester plans to rebuild its general fund balance with the receipt of commonwealth school-construction reimbursements, but the majority of reimbursements for fiscals 2008 and 2009 have been used for increased debt service in those two years. Management is projecting a total reimbursement of about \$28.5 million over a nearly 10-year period beginning in fiscal 2008, and it plans to build up reserve accounts within the general fund over that 10-year span. Under this five-point plan, the city would increase the general fund balance to about \$15 million by fiscal year-end 2012. In addition to the general fund balance, the city maintains a stabilization fund that consists of three funds dedicated to current debt service (the capital campaign fund), the construction of a new high school (the North High School fund), and general financial reserves (the bond rating stabilization fund).

The city has a significant number of expired union contracts, but is, we understand, currently in negotiation for all of them; management has built contingencies into the fiscal 2010 budget for potential retroactive contract settlements. Worcester has achieved savings through health care reforms in recent labor contracts, and it will attempt to structure other contracts to achieve additional savings in this area. The city recently adopted a reform of its retiree health care plan--enabled under Section 18 of Chapter 32B of commonwealth law--that reduced costs beginning in fiscal 2008.

As of fiscal 2009, the city's excess levy capacity under the commonwealth's Proposition 2 1/2 levy limit is \$12 million, which is among the commonwealth's highest. Intergovernmental revenues, primarily state education aid, account for 58% of general fund revenues.

## Related Research

- USPF Criteria: "GO Debt," Oct. 12, 2006
- USPF Criteria: "Short-Term Debt," June 15, 2007

<b>Ratings Detail</b> (As Of October 22, 2009)		
Worcester GO <i>Long Term Rating</i>	A-/Stable	Affirmed
Worcester GO (wrap of insured) (FGIC & FSA) (SEC MKT) <i>Unenhanced Rating</i>	A-(SPUR)/Stable	Affirmed
Worcester GO (ASSURED GTY) <i>Unenhanced Rating</i>	A-(SPUR)/Stable	Affirmed
Worcester GO (FGIC) <i>Unenhanced Rating</i>	A-(SPUR)/Stable	Affirmed
<b>Worcester GO</b> <i>Unenhanced Rating</i>	A-(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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