

RatingsDirect®

Summary:

Sherborn, Massachusetts; General Obligation

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Summary:

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Credit Profile

US\$5.675 mil GO mun purp loan dtd 09/10/2020 due 09/01/2040

Long Term Rating

AAA/Stable

New

Sherborn GO

Long Term Rating

AAA/Stable

Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating to Sherborn, Mass.' series 2020 general obligation (GO) bonds and affirmed its 'AAA' long-term rating on the town's existing GO debt. The outlook is stable.

Sherborn's full-faith-and-credit-GO pledge secures the bonds and bond anticipation notes (BANs). Despite limitations imposed by the commonwealth's Proposition 2-1/2 levy limit law, we did not make a rating distinction between the limited-tax GO pledge and Sherborn's general creditworthiness because the tax limitation imposed on the town's ability to raise revenue is already embedded in our analysis of its financial and economic conditions.

Bond proceeds (approximately \$5.7 million) will permanently finance outstanding BANs and refund outstanding GO bonds for an interest rate savings. Total outstanding debt is approximately \$10.2 million.

Credit overview

Sherborn entered the national recession triggered by the outbreak of COVID-19 with a stable credit profile despite recent planned reserve drawdowns, due to a high reliance on local property taxes, with historically very strong collections, which we expect will continue, and an affluent residential tax base. Further supporting the long-term rating is the town's consistent economic growth. Pension and other postemployment benefit (OPEB) costs are manageable, but could present a budgetary challenge in the future due to our expectation of rising costs.

While we believe the town's credit profile is stable, with limited direct exposure to state aid, there is still much uncertainty on the duration and depth of the current recession. While our outlooks are generally for two years, we continue to see potential pressure across the sector over the next six-to-12 months. We will continue to monitor for any material adverse effects throughout the outlook period. For more information on the coronavirus' effect in U.S. Public Finance, please see our reports titled "The COVID-19 Outbreak Weakens U.S. State And Local Government Credit Conditions" (published April 2, 2020 on RatingsDirect) and "The U.S. Faces A Longer And Slower Climb From The Bottom" (published June 25, 2020).

Sherborn's GO debt is eligible to be rated above the sovereign, because we believe the town can maintain better credit characteristics than the U.S. in a stress scenario. Under our "Ratings Above The Sovereign: Corporate And Government Ratings--Methodology And Assumptions" criteria (published Nov. 19, 2013 on RatingsDirect), Sherborn has a predominantly locally derived revenue source, with approximately 87% of 2019 audited general fund revenue

coming from property taxes. The town also has taxing authority and treasury management independent from the federal government.

The long-term rating further reflects our assessment of the town's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Adequate management, with standard financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with operating results that we expect could improve in the near term relative to fiscal 2019, which closed with operating deficits in the general fund and at the total governmental fund level in fiscal 2019;
- Strong budgetary flexibility, with an available fund balance in fiscal 2019 of 11.2% of operating expenditures;
- Very strong liquidity, with total government available cash at 15.4% of total governmental fund expenditures and 3x governmental debt service, and access to external liquidity we consider strong;
- Very strong debt and contingent liability position, with debt service carrying charges at 5.2% of expenditures and net direct debt that is 30.7% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 67.4% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Environmental, social, and governance factors

We evaluated the town's environmental, social, and governance (ESG) factors relative to its economy, financial measures, management, and debt and long-term liability profile. We acknowledge, absent the implications of COVID-19, that we consider the town's social risks in line with those of the sector. We view environmental risks and their potential effect on taxable properties as average relative to peers. Management, however, has been proactive in identifying and addressing risks. It completed a hazard mitigation plan and is working through the state's Municipal Vulnerability Preparedness grant program to develop a climate resiliency action plan. We view its governance risks as in line with the sector.

Stable Outlook

Downside scenario

We could lower the rating if the town's reserves were to further decline, due to planned or unplanned drawdowns.

Credit Opinion

Very strong economy

We consider Sherborn's economy very strong. The town, with an estimated population of 4,270, is in Middlesex County southwest of Boston. 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 234% of the national level, which we view as extremely high and a positive credit factor and per capita market value of \$307,217. Overall, market value grew by 3.0% over the

past year to \$1.3 billion in 2020. The county unemployment rate was 2.3% in 2019.

Sherborn is an affluent residential community whose residents have access to surrounding employment centers and downtown Boston via interstate and commuter rail. We understand the town has a number of housing developments in various stages of development and approval, which should help tax base growth. While economic pressures could result in slowing new economic growth, we believe the town will remain a desirable community due to its very highly rated school district and access to the city, leading to stability in its economic profile.

Adequate management

We view the town's management as adequate, with standard financial policies and practices under our FMA methodology, indicating the finance department maintains adequate policies in some, but not all, key areas.

We believe Sherborn's budgetary assumptions are realistic, with revenue and expenditure assumptions based on at least three years of actual results. The town's primary revenue source is predictable, with expenditure growth primarily reflecting contractual agreements and employee benefits. While the town does not maintain a formal, forward-looking financial plan, we believe its long-term planning documents, such as its hazard mitigation plan, open space planning, and capital improvement plan (CIP), generate both current budget planning and consideration for future budgets. Management regularly monitors budget performance and presents monthly reports to the Board of Selectmen. The town maintains a formal CIP that looks out at least five years, identifies funding sources, and is updated annually. A basic, informal debt management policy exists, as well as a formal investment policy with holdings and earnings reported to the board annually. The town does not have a formal reserve policy or reserve targets, but informally tries to adhere to the state-recommended maintenance of 3%-5% of budgeted expenditures held in free cash (unassigned reserves), as defined by the state.

Adequate budgetary performance

Sherborn's budgetary performance is adequate, in our opinion. The town had operating deficits of negative 3.9% of expenditures in the general fund and negative 3.4% across all governmental funds in fiscal 2019. Our assessment accounts for the fact that we expect budgetary results could improve from 2019 results in the near term.

The town's negative performance over the past two audited years reflected the planned use of general fund reserves to lower the property tax rate. We believe the use of reserves, while materially lowering available reserves, was well incorporated into the town's budgeting process. We understand Sherborn is expecting at least break-even results on a GAAP basis in fiscal 2020, and we adjusted our view of performance to reflect our expectation of improved financial results. Additionally, we further adjusted our view of performance to account for potential revenue and expenditure uncertainty over the next few years, due to the COVID-19 pandemic and current recession.

The town is highly reliant on local property taxes, which accounted for about 87% of audited general fund revenues in fiscal 2019. We expect the vast majority of property tax revenue will be paid in a timely fashion, given the underlying wealth and income metrics. The town also has limited direct exposure to intergovernmental aid, which accounted for 6.7% of revenue in 2019. We believe it maintains some indirect exposure, should the school district in which the town participates face material state aid cuts, although we acknowledge that the district maintains its own level of budgetary flexibility. The school district accounted for about 59% of expenditures in 2019. As the situation remains developing, with unquantifiable risks, we have adjusted our forward-looking view of performance.

The town operated on a 1/12 budget for July and August. The adopted budget is based on an expected tax rate increase of about 8 cents per \$1,000 in assessed value and meets management's goal of keeping the rate below 20 mills. Contractual obligations, including cost-of-living increases, generate the year-over-year budget growth of approximately 3.2%. The 2021 budget totals \$28.9 million. The state is working to fund local governments and regional school districts at fiscal year 2021 and 2020 levels. Consequently, we believe it is likely that any pressure from the state would not occur until fiscal 2022, unless Massachusetts needs to enact emergency midyear cuts as it did in the last recession. We believe the school department would use its own reserves prior to seeking any supplemental funding from the towns, but believe significant aid cuts to the school could result in unexpected expenditure growth for Sherborn.

Strong budgetary flexibility

Sherborn's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2019 of 11.2% of operating expenditures, or \$3.3 million.

Due to the planned expenditure of reserves in fiscal years 2018 and 2019, the town's available reserves dropped to levels we consider strong. We understand that the town expects at least balanced operations in 2020. At this time, we do not anticipate further material reduction in reserves, despite uncertainty on performance over the next few years. We believe the stable revenue profile and expectation of flat aid in 2021 are likely to limit unplanned drawdowns.

Very strong liquidity

In our opinion, Sherborn's liquidity is very strong, with total government available cash at 15.4% of total governmental fund expenditures and 3x governmental debt service in 2019. In our view, the town has strong access to external liquidity if necessary.

Sherborn is a regular market participant that issues GO debt frequently, supporting our view of its strong market access. It does not have any variable-rate or direct-purchase debt, nor does it have any contingent liquidity risks from financial instruments with payment provisions that change on the occurrence of certain events. We do not view any of its investments as risky and we adjusted its cash position to include general fund investments. We do not expect material variance in its cash on hand due to delayed tax collections in the current health and economic environment.

Very strong debt and contingent liability profile

In our view, Sherborn's debt and contingent liability profile is very strong. Total governmental fund debt service is 5.2% of total governmental fund expenditures, and net direct debt is 30.7% of total governmental fund revenue. Overall net debt is low at 0.9% of market value, and approximately 67.4% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

We expect the town to issue approximately \$1.2 million annually in new-money debt to fund capital projects. We do not expect this to materially alter our view of its debt profile.

Sherborn's combined required pension and actual OPEB contributions totaled 5.1% of total governmental fund expenditures in 2019. Of that amount, 3.1% represented required contributions to pension obligations, and 2.0% represented OPEB payments. The town made its full annual required pension contribution in 2019.

Pension and other postemployment benefits

- Despite low funding levels and our expectation of pension cost growth, we do not view retirement liabilities or costs as a credit pressure for Sherborn.
- While the pension plan uses an actuarially determined contribution, we believe some of the assumptions are likely to lead to cost escalation and volatility. However, we expect costs to remain manageable.
- The town is prefunding its OPEB liability in a trust. We believe costs and the total liability are likely to grow, but are unlikely to pressure the town's finances.

The town participates in the following retirement plans:

- Middlesex County Retirement System: 46.4% funded, \$11.7 million net pension liability
- Single-employer defined-benefit health care plan (OPEBs): 17% funded, \$7.0 million net OPEB liability

Sherborn's combined required pension and actual OPEB contributions totaled 5.1% of total governmental fund expenditures in 2019. Of that amount, 3.1% represented required contributions to pension obligations, and 2.0% represented OPEB payments. The town made its full annual required pension contribution in 2019, which it is required to do annually. The pension plan fell short of meeting both our static and minimum funding progress metrics in the most recent year, indicating it is not making progress in addressing current costs or the unfunded liability. We believe some of the plan's assumptions may underestimate the liability and could lead to cost growth and volatility. In particular, its 7.5% discount rate is high, in our opinion, and could lead to contribution volatility. The town informally committed to adding \$200,000 to its OPEB trust annually.

Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of August 17, 2020)

Sherborn GO (MBIA) (National)

Unenhanced Rating

NR(SPUR)

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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