
Analysis of Outstanding Debt for the Town of Natick

Presented to the Natick Board of Selectmen

John Ciccariello, Chairman
Jay H. Ball, Vice Chairman
Charles M. Hughes, Clerk
Paul R. McKinley
John Connolly

Philip E. Lemnios,
Town Administrator

February 25, 2005

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The Honorable John Ciccariello and
Members of the Board of Selectmen
Town of Natick
13 East Central Street
Natick, MA 01760

Dear Chairman Ciccariello:

I am pleased to provide you with the enclosed analysis of the Town of Natick's existing debt. This report is intended as a user-friendly examination of the debt issued on behalf of the residents of our community.

Like cities and towns across the United States, the Town of Natick has issued debt to finance investment in its capital infrastructure. These investments have been made for numerous purposes, including for the construction and renovation of school buildings, for the construction of our public library, our police and fire headquarters and other buildings. Debt has also been issued to finance other capital assets, including large public safety vehicles (fire apparatus) as well as heavy duty vehicles used to maintain our roads and parks.

Development of a common understanding of the Town's debt is very important. Debt is the first obligation a government must pay, having greater priority than payroll. The ramification for a community that does not pay its debts is much greater than the ramifications on individual citizens who miss credit card or mortgage payments. Because debt must be repaid and can come at a significant cost, developing a common understanding of our community's financial debt is important to ensuring we make informed decisions about our finances, about spending priorities and about future capital investments.

The enclosed analysis shows a number of interesting trends in the Town's prior expenditure patterns and provides insight into future decisions the Town will be required to make. While based on the same technical approach used by credit rating agencies to evaluate the Town's debt, this study is intended to be as "un-technical" as possible so as to be useable to the widest possible audience.

I hope this analysis is helpful to you and would welcome the opportunity to provide any additional information that would be useful to you or the residents of our community.

Very truly yours,

Stephen P. Lisauskas,
Deputy Town Administrator

WHAT IS DEBT?

Municipal debt – usually bonds and notes – is a tool for financing investment in the infrastructure and capital equipment that permits government to provide services to the public. In its most basic form, debt occurs when a city or town borrows money from other people. The money that is borrowed is usually repaid over a number of years, and the lender usually charges interest to the borrower as compensation for allowing someone else to use their money. To begin to understand municipal borrowing, a few key terms are important:

- Bond:** A long-term financing tool that allows a community to borrow money to finance certain investments. Municipal bonds in Massachusetts are generally issued with a fixed interest rate and carry a term of between 10 and 30 years.
- Note:** A financing tool generally used for short-term needs, such as “bridge financing” during construction. In Massachusetts, notes are generally issued as one-year debt which can be “rolled” for a maximum of five years.
- Term:** The length of time a bond or note is outstanding. In other words, if a community borrows money for 20 years to finance the construction of Town Hall, the “term” of the debt is 20 years. In five years, the “remaining term” would be 15 years.

FOR WHAT PURPOSES CAN DEBT BE ISSUED?

With rare exception – exceptions which are authorized by the Commonwealth on a case-by-case basis through special legislation – municipal debt can only be incurred for investment in the capital needs of a community. State finance law permits communities to issue debt for the following purposes:

Public Works

- Construction and reconstruction of roads, bridges, sidewalks, public wharves, walls and dikes, and for the acquisition of land
- Construction and reconstruction of municipal buildings, including schools and hospitals
- Drainage and sewer system improvements
- Traffic signals, public lighting, fire alarm and police communication equipment
- Construction of off-street parking areas

Municipal Equipment

- Departmental equipment, including fire equipment and heavy equipment such as graders, street sweepers and sidewalk plows
- Costs for design, development and purchase of computer software and equipment

Energy

- Energy conservation, to pay for energy audits or to implement alternative energy technologies

Environmental

- Asbestos abatement in municipal buildings
- Preservation and restoration of lakes and ponds

Recreational

- Construction of parks and playgrounds
- Construction of artificial skating rinks, outdoor swimming pools, golf courses, tennis courts and other outdoor recreational facilities

The rare exception mentioned above – issuance of debt for a non-capital purpose – has generally been limited to communities in significant financial distress (those communities which need to issue deficit debt) and to communities which have issued debt to finance investment in the stock and bond markets (pension obligation bonds). Both of these types of debt must be approved by the Commonwealth on a case-by-case basis.

Deficit Debt: Debt issued to permanently finance a deficit that is generally too large to be eliminated in the budget of any one fiscal year.

Consistent with good financial management practices, the Town of Natick has only issued debt to finance capital investment. Appendix A of this report is a summary of all projects financed by debt that is currently outstanding. Each of these projects is a capital project, and each expenditure of funds is considered a capital investment.

Capital: The Town of Natick defines capital as buildings, facilities, land, infrastructure or major equipment with an estimated useful life of at least five years and a cost of at least \$5,000. Similarly, any improvements to capital which would extend the useful life of the capital being improved by at least five years may be considered capital if it costs at least \$5,000.

Capital Investment: The expenditure of money to improve existing infrastructure, extend its useful life or build or acquire new capital assets. This is considered an investment because the money expended is used to reduce costs and/or improve services over a multi-year timeframe.

Debt Service: The costs of repaying debt. Debt service includes principal and interest payments.

WHY SHOULD DEBT BE ISSUED?

Debt should be issued to finance capital improvements that will maintain or improve the rate of return on taxpayer dollars. Stated another way, debt should be issued to finance capital projects that prevent things from getting worse, make things better or improve operations, services or efficiency. While it makes sense to make capital investments based on these criteria, the question remains as to why bond financing is an appropriate means to finance these investments in the first place.

There are a number of reasons to issue debt to finance capital investment. First, certain projects – such as the renovation and expansion of Natick Public Library or the construction of the Wilson School – are far too expensive to finance through the annual budget. There are projects that can only be afforded by spreading their cost over many years, something that requires the issuance of debt.

The issuance of debt to finance projects with a long life is also considered “fair”. This equity concern is grounded in the argument that today’s taxpayers should not pay the entire cost of projects that will benefit future residents; rather, the people who benefit from the project should pay for its costs. As benefits from the investment will accrue over time, the costs should be paid over time as well. This requires the issuance of debt.

To simplify, assume the Town is building a new elementary school that would provide educational services for 50 years. It would not be “fair” to finance this project through direct cash appropriation because today’s taxpayers would pay for its entire cost. Those who moved into Natick in two years would receive 48 years of benefit without paying any of the cost, and those who moved out of Natick in five years would have paid 50 years of cost but received only five years of benefit.

WHAT IS DEBT MANAGEMENT AND WHY IS IT IMPORTANT?

Debt management is the application of financial knowledge to ensure that our debt is structured in the manner that saves as much money as possible for our residents and protects our taxpayers from the risks associated with debt. Proper debt management can help the Town take advantage of opportunities that suddenly arise and can help us predict and resolve problems before they occur.

Debt management also helps a community ensure the cost of its debt is fair and equitable. Part of this fairness is issuing debt whose term does not exceed the useful life of the asset it finances. This reduces overall costs by placing a limit on the term of the debt and ensures that taxpayers will not be required to pay for assets that no longer exist, and therefore are no longer providing a public benefit.

Proper debt management should incorporate communication with the public to ensure the people we serve are fully informed of the ways in which their government is financed. This analysis continues the Town’s efforts to improve communication about public finances.

ANALYSIS OF THE TOWN’S DEBT

The Town’s current outstanding debt portfolio is comprised of 33 different debt issuances¹. These issuances range from the small – \$85,000 to finance various capital purchases for Fiscal Year 2005 – to the large – \$13.2 million for the Bennett-Hemenway School. The Town also has 17 additional outstanding debt issuances for the Water and Sewer Enterprise Fund and two for the Golf Course Enterprise Fund.

There are many different ways to examine the Town’s debt. This document first examines the policy issues associated with our debt – for what purpose it was issued, in what structure or manner it was issued – and then examines what this debt tells us about the finances of our community. The latter analysis relies on benchmarks established by Moody’s Investors Service, Standard & Poor’s and Fitch Ratings, the three large companies that evaluate and rate municipal debt. These benchmarks will tell us how our debt relates to our community’s ability to repay it and will also highlight areas of further investigation and public discourse.

¹ The Town has 33 different debt issuances for Town and school-related purposes. Many other debt issuances occurred in the past and have been repaid. Debt that was issued and has already been repaid is not included in this analysis because it does not incur any cost to our taxpayers today.

This analysis examines the Town’s \$58,155,388 in tax-backed bonds only. Debt which is self funded – that is, debt which is funded by its own stream of revenue – is not included because it does not compete for tax dollars or impact the finances of Town government, except in the case of extreme emergency. As a result, this analysis excludes the Town’s \$14,296,881 in water and sewer debt and the \$3,064,925 in golf course debt. This section of the report examines the Town’s tax-backed debt in its two major components: the \$46,665,388 in “inside the tax rate” debt and the \$11,490,000 in voter-approved debt exclusion debt.

Debt Exclusion: A process under Proposition 2 ½ that allows taxpayers to approve a temporary increase in their property taxes to finance a specific project. The people of Natick have approved two debt exclusion projects, one for Kennedy Middle School and one for Wilson Middle School.

Enterprise Fund: A separate legal account operated by a city or town for provision of a specific revenue-generating service. Enterprise funds are commonly established for utilities (water, sewer, power), recreation (golf courses, skating rinks) and for other capital purposes (parking garages). The revenues of the enterprise fund are revenues of the fund, and the expenditures of the fund are its own expenditures. Any deficits of an enterprise fund must be repaid by the city or town that created the fund.

PURPOSE FOR ISSUANCE: TOWN AND SCHOOL DEBT

All Tax Supported Debt

Of the Town’s \$58,155,388 in tax-supported debt, \$32,193,000 was issued to finance school projects and \$25,962,388 was issued for all other municipal purposes. “All other municipal purposes” includes roads, sidewalks, police, fire, recreation, general government and senior and other social services. The following charts illustrate the breakdown of the Town’s tax-backed debt portfolio as well as the repayment schedule for this debt.

Chart One
All Tax Supported Debt by Purpose for Issuance
 Fiscal Year 2006

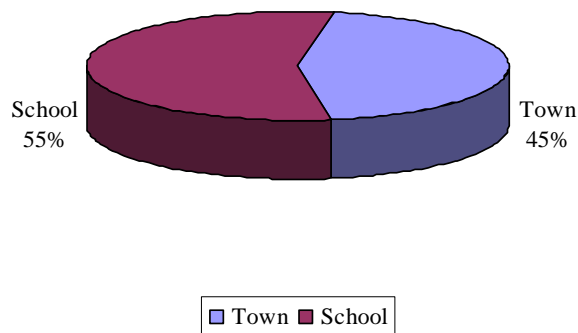


Chart Two
 All Tax-Supported Debt Service by Purpose for Issuance
 Fiscal Year 2006

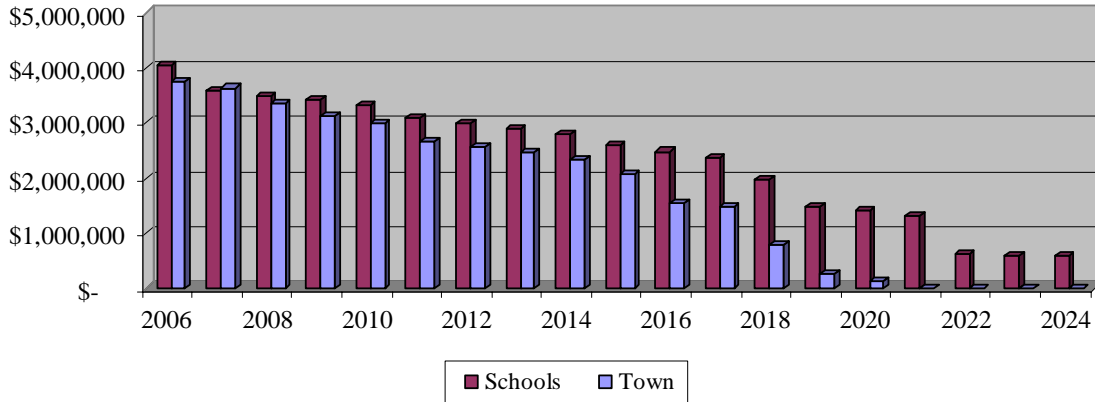


Chart One demonstrates that a majority of the Town’s outstanding tax-supported debt was issued to finance school construction and renovation projects. Approximately 45% of the Town’s remaining debt has been issued to finance all other government purposes. Said another way, the Town has issued the majority of its debt to finance the capital needs of the School Department, with all other departments receiving less debt support than our school system.

Chart Two indicates that debt issued for general government and school purposes have the same general characteristics. Both have declining costs over time – debt service for next year is less than the debt service for the current year. This demonstrates that back-loading of debt is not occurring. It is interesting to note, however, that Town debt appears to have a more aggressive repayment schedule than does the school debt.

Non-Debt Excluded, Tax Supported Debt

As discussed above, the Town currently has outstanding \$58,155,388 in debt supported by tax revenue. This debt is repaid through property taxation, though some is repaid through the Town’s general property tax revenue and some through the dedicated tax of voter-approved Proposition 2 ½ debt exclusions.

Of the Town’s \$58,155,388 in tax-supported debt, \$46,665,388 has been issued “inside the tax rate” and is supported by general tax revenue. \$11,490,000 was issued “outside of the tax rate”, through voter-approved debt exclusions. All debt for general government departments is being repaid through existing tax revenue and therefore is shown in this analysis. Approximately 36% of the School Department’s debt is excluded from this portion of the analysis because it is being repaid through a separate tax which is outside of the Town’s general revenue stream.

Chart Three
All Tax Supported Debt
Source of Funding
January 2005

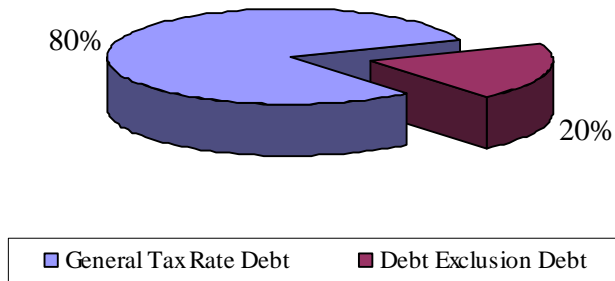
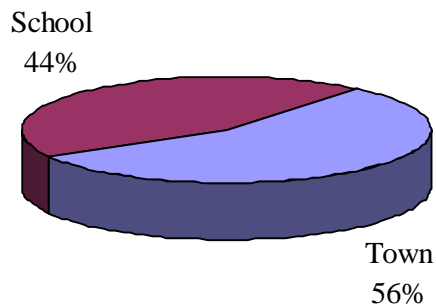


Chart Three demonstrates graphically that the vast majority of the Town's tax-supported debt is financed through the general tax rate. This means that the majority of the Town's tax-supported debt is repaid from the pool of money available to fund all Town services. Because debt payments are essentially mandatory, this results in a reduction in funding available to provide other services demanded by the public or to fund ongoing capital maintenance.

Of the Town's \$46,665,388 in non-debt excluded debt, \$20,703,000 was issued to finance school construction and renovation, with the remaining \$25,962,388 issued for all other municipal purposes. The following charts illustrate the breakdown of the Town's non debt-excluded tax-supported debt portfolio and its repayment schedule.

Chart Four
Tax Supported Debt by Purpose for Issuance
Non Debt-Excluded Debt
Fiscal Year 2006



As Chart Four demonstrates, a majority of the Town’s outstanding “inside the tax rate” debt was issued to finance Town capital expenditures. As mentioned, however, the voters have made significant capital improvements in school buildings which are “outside of the tax rate” because they are supported by the dedicated tax revenue of a debt exclusion.

Chart Five
Tax Supported Debt Service by Purpose for Issuance

Non Debt-Excluded Debt
Fiscal Year 2006

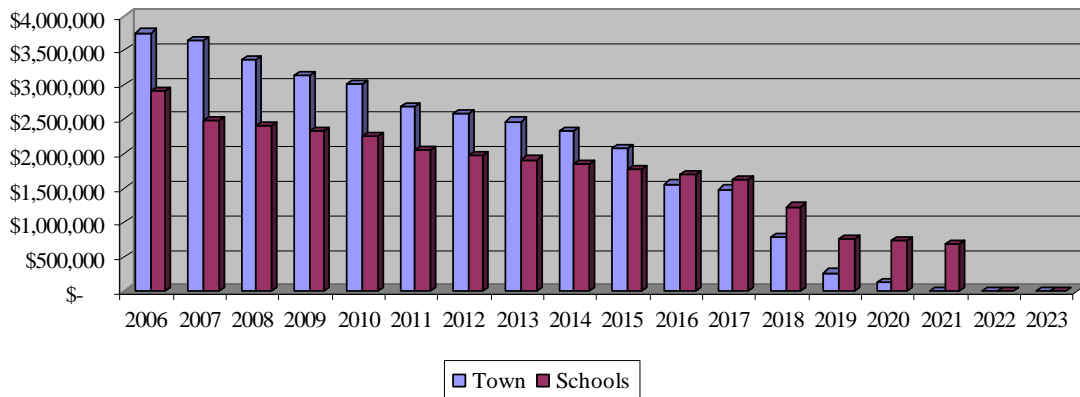
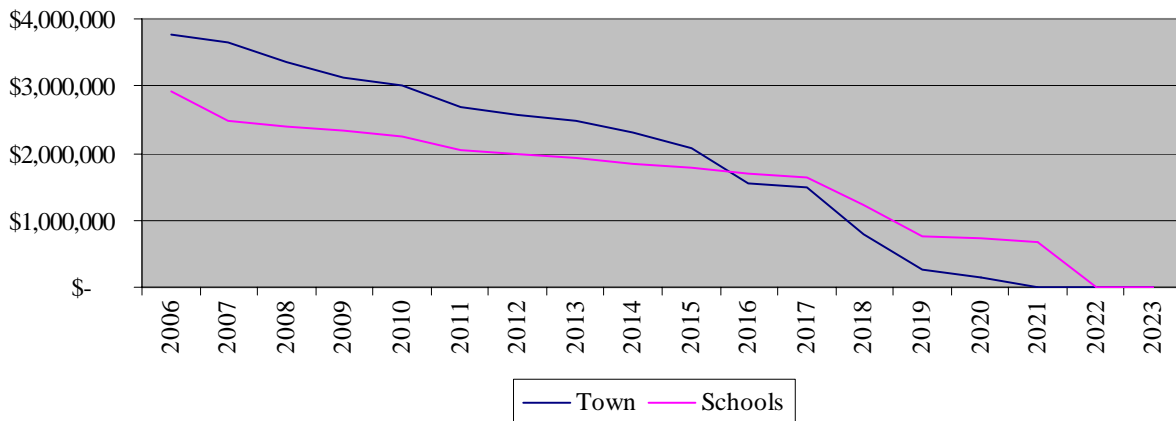


Chart Five indicates that “inside the rate” debt issued for general government and school purposes both have declining costs over time – debt service for next year is less than the debt service for the current year. It is interesting to note, however, that Town debt appears to have a more aggressive repayment schedule than does the school debt. Chart Six demonstrates this more clearly.

Chart Six
"Inside the Rate" Tax-Backed Debt Service by Purpose for Issuance
Fiscal Year 2006



COMPOSITION OF DEBT – FACILITY AND NON-FACILITY INFRASTRUCTURE

As discussed previously, debt can be issued for numerous purposes. Cities and towns deliver many services, from education and public safety to transportation, recreation and social services. Each different service has a different capital characteristic. Education, for example, requires the construction and maintenance of large buildings in which to educate children. Education debt should therefore be heavily skewed toward building and facility debt; debt would not be necessary for many other purposes in the delivery of educational services. Non-facility debt would not normally be a significant component of a community’s educational debt portfolio.

General government services should have a much more diverse mix of facility and non-facility debt. Transportation services provided in Natick – roads and buses – generally do not require the construction of buildings. Parks and recreational debt should include some building debt, though the amount will vary based on the quality and age of the recreational buildings that exist. Public safety debt would normally include a mix of facility and non-facility debt, with non-facility debt being comprised mainly of vehicle, apparatus and equipment debt.

Chart Seven
Facility and Non-Facility Debt for the School Department
January 2005

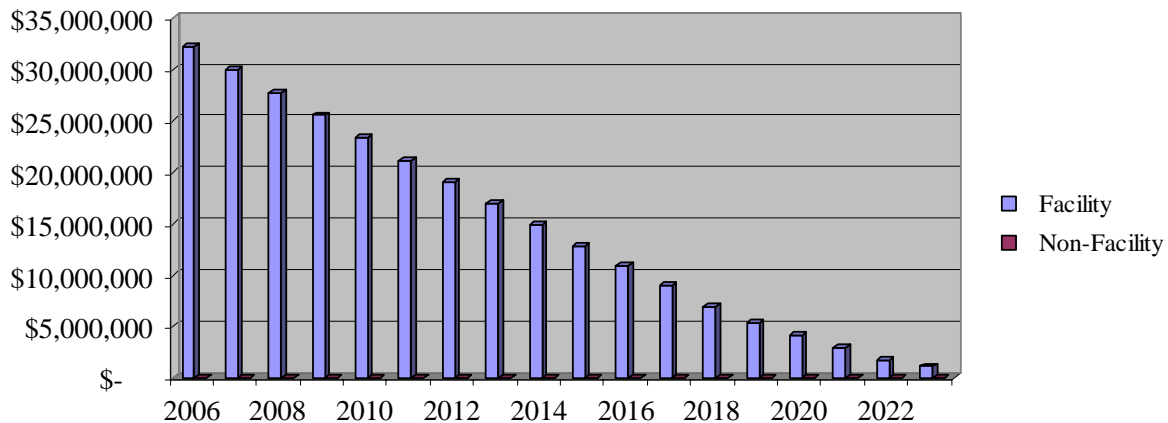


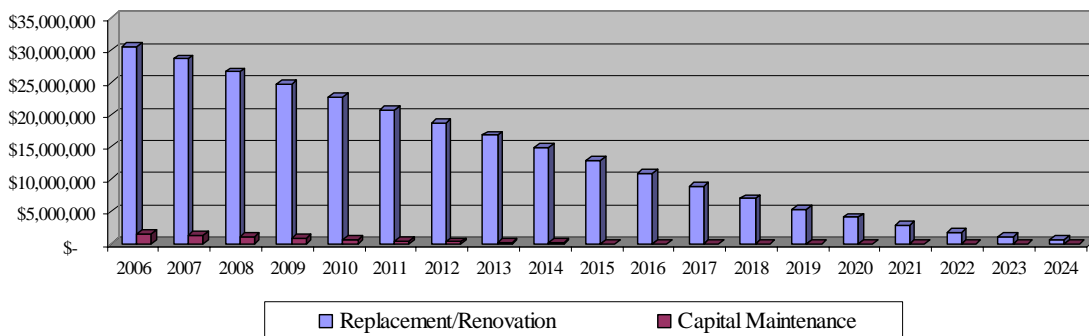
Chart Seven demonstrates School Department facility debt as compared to non-facility debt². As indicated above, this debt should be – and is – strongly skewed in favor of facility debt because the provision of educational services requires the construction of large buildings rather than the investment in large amounts of non-building infrastructure.

² This measure is intended to examine all capital investment by the School Department and therefore includes debt excluded projects. Failure to include all capital investment could be misleading if, for example, a large amount of non-facility debt has been authorized through debt exclusions.

Examining facility debt more closely, however, can provide insight into the nature of facility investment that has occurred in recent years. Facility debt can be issued to build or substantially renovate existing facilities or for capital maintenance purposes which are designed to increase the useful lives of existing facilities (replacement of an old roof, for example).

Chart Eight examines School Department facility debt more closely and indicates that the majority of School Department debt has been associated with the construction or substantial renovation of school facilities rather than for the capital maintenance of existing facilities.

Chart Eight
School Department Facility Debt
Replacement/Renovation Compared to Capital Maintenance
January 2005

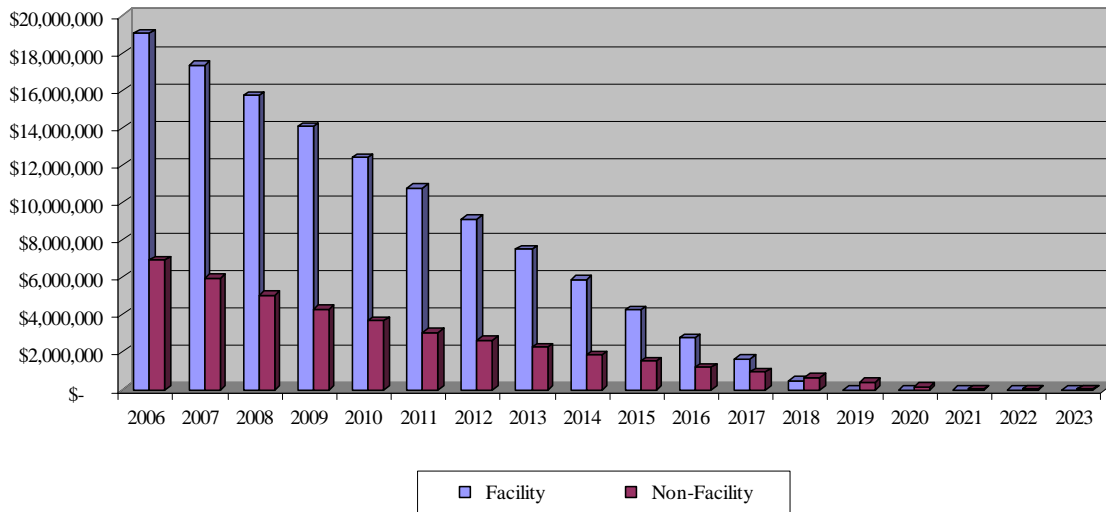


There are a number of possible explanations for this trend. First, capital maintenance projects are generally smaller than replacement and renovation projects. It is possible that sufficient capital maintenance can occur and the aggregate cost of these projects still be smaller than the cost of replacement/renovation projects. Debt incurred for capital maintenance projects is also generally incurred for a shorter term than debt for replacement and renovation projects. As such, a rapid drop-off should be expected in the debt curve for capital maintenance projects.

Chart Eight does demonstrate a heavy emphasis on the replacement and renovation of existing facilities as compared to capital maintenance. This is not a surprising outcome. From time to time capital investment will swing more heavily toward facility replacement than toward capital maintenance. The heavy emphasis toward capital replacement could be the result of a sustained shortage of facility investment in earlier years. In other words, the Department may have invested so heavily in new and renovated facilities because its prior facilities were in poor condition and needed to be replaced. It should be noted that every community has limited resources, and because of this it may not be possible to significantly increase capital maintenance when a significant emphasis has been placed on replacement of capital. This may result in an under-investment in capital maintenance, both because the Department has placed a priority on capital replacement and because limited resources prevent the increased investment in capital maintenance.

Chart Nine examines the debt issued on behalf of general government departments (those departments that are not the School Department or either of the Town’s enterprise funds).

Chart Nine
Facility and Non-Facility Debt for General Government Departments
January 2005



As expected, Town departments have issued a larger portion of their debt to finance non-facility capital investments than has the School Department. As discussed above, the reason for this is that Town services are generally more diverse in their capital requirements than the School Department. Many Town services are not facility-based but rather are associated with other investments, such as the purchase of fire apparatus, the removal of underground storage tanks that may leak oil into the environment, capping of the Town’s former landfill and others.

Further examination of general government debt shows similar trends to those occurring for School Department debt. Of the Town’s facility debt, only a small portion is dedicated to capital improvements; the majority of general government facility debt – and the majority of general government debt in total – is associated with the construction of the Police and Fire Headquarters complex, the renovation and expansion of the Morse Institute Library and the construction of Town Hall. The majority of the Town’s non-facility debt is associated with the mandatory capping of the Town’s landfill.

Several important conclusions can be drawn from the above analysis. First, the majority of the Town’s non-enterprise fund debt has been issued to finance the construction of buildings. A potential cause for this is a shortage of capital investment in prior years. Cities and towns should seek to establish and maintain capital replacement schedules that stagger large expenditures over time rather than permit them to occur all at once. The Town’s debt budget is heavily skewed toward facility replacement and major renovation which, with the Town’s limited resources, crowds out other important capital investment such as road and sidewalk improvements, roof and boiler replacements and investments in our recreational assets.

A review of the Town's debt budget relative to our overall budget – something that will be presented under separate cover – will show that the Town expends a significant portion of its budget on capital expenditures. This is wise and appropriate. The difficulty, however, is that so much of this expenditure is used to fund debt service for a small handful of facilities (a number of school facilities and a few major Town buildings), leaving little room to finance smaller ongoing capital investments that are important to preserving our quality of life and to extending the life of existing assets. This issue will require significant attention and public discourse in coming years as the Town continues its capital planning process and as we are confronted by major capital decisions, such as the future of Natick High School, the renovation of the Kennedy, Memorial and Johnson Schools and the construction of a senior center.

ANALYSIS OF THE TOWN'S DEBT BASED ON INDUSTRY BENCHMARKS

The municipal bond industry has established benchmarks that it uses to examine cities and towns across the nation. These benchmarks are intended to provide insight into a community's ability and willingness to repay the debt it issues and can be valuable tools for communities to evaluate their financial management. This analysis is intended to provide insight into our finances and our ability to support debt and public investment.

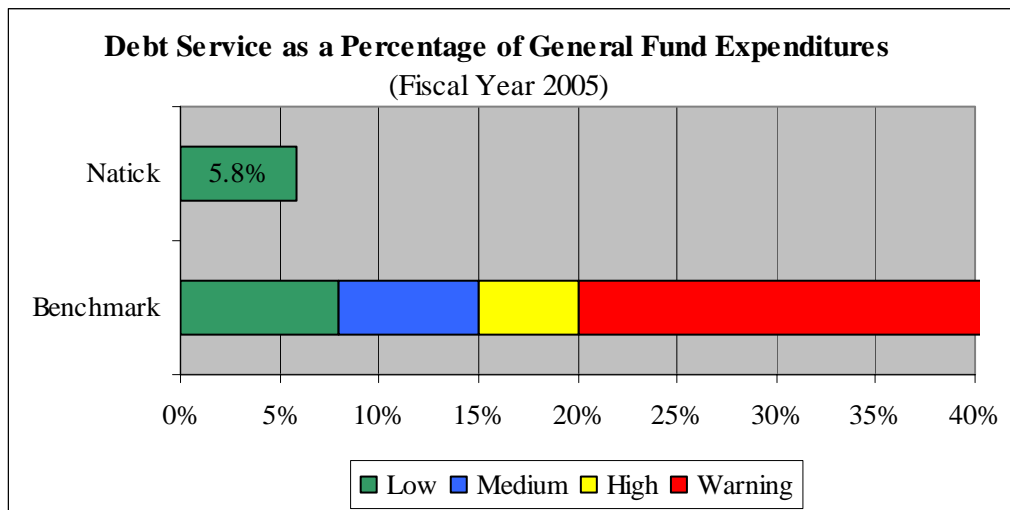
WHAT IS INCLUDED IN THIS REPORT AND WHAT IS NOT?

This ratio analysis looks at all debt that places a burden on our general government revenue stream. In doing so it excludes enterprise fund debt (debt that is repaid through water and sewer rates and through golf course revenue) and school debt which exists outside our normal taxing structure (voter-approved debt exclusion projects). For ratios that examine debt service, this analysis also nets from overall debt service the value of reimbursements we receive from the Commonwealth for school construction projects. This revenue is considered dedicated to the repayment of bonds and therefore reduces the overall cost of repaying our debt.

This report assumes normal operations for the Town of Natick. A "worst case scenario" analysis could be conducted that would assume that the Town's enterprise funds can not support their debt costs and that the Commonwealth stops making School Building Assistance payments. This measure is appropriate when the Town establishes its reserve funds, as reserve funds are established to address such emergencies. The Town's debt study, however, should examine debt under normal operating conditions.

Debt Service as a Percentage of General Fund Expenditures

This benchmark measures the Town's ability to finance debt within its current budget, similar to the measurement of household income dedicated to mortgage payments. This is the most immediate measure of ability to pay, but it only examines the ability to pay for debt within a community's existing budget. Cities and towns that have excess levy capacity – communities that do not tax to the maximum of their Proposition 2 ½ limitation – would have greater ability to pay for debt than this measure suggests because they have additional taxing capacity which they have not accessed.



The Town’s measure of debt service as a percentage of General Fund expenditures is strong, with 5.8% of the Fiscal Year 2005 budget dedicated to debt service. Many cities and towns – especially older industrial and formerly-industrial communities – have higher ratios of debt service to general fund expenditures.

The Town’s relatively low ratio of debt service to general fund expenditures provides our government with more budgetary flexibility to address financial problems that may arise. Debt payments are essentially mandatory and courts have ruled that these payments must be made even before salary payments for employees. Communities with high levels of debt service relative to operating expenditures have a larger portion of their budget dedicated to payments that must be made regardless of the community’s financial situation. Having a lower ratio means less money is dedicated to debt service, which means more flexibility exists within the operating budget.

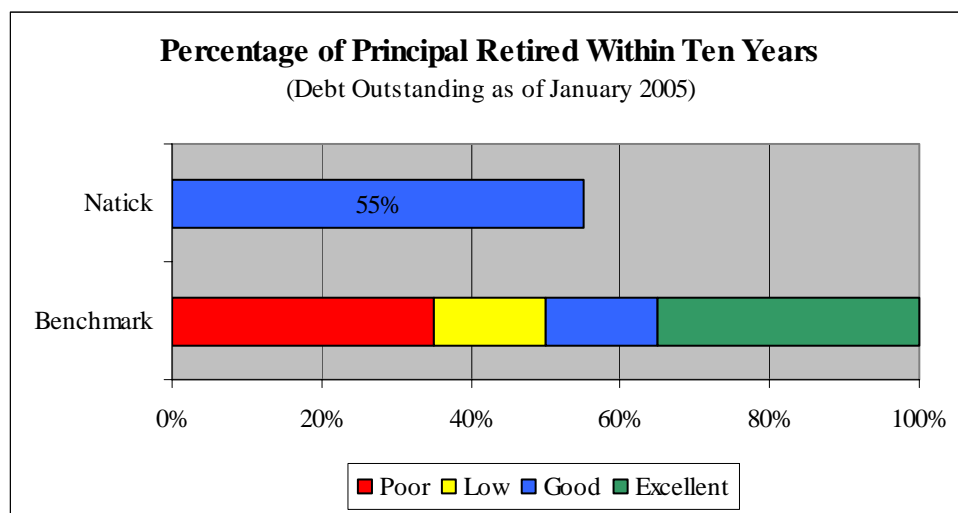
Debt Retirement: Percent Retired within Ten Years

The speed with which a community retires its debt indicates a number of important things. Included in these are:

- Willingness to repay debt: rapid repayment of principal indicates that a community is committed to repaying its debt. This “willingness to pay” is measured in a number of ways and is particularly important to those who lend money to others, as it provides them some proof of the borrower’s intention to repay the money it borrowed.
- Ability to repay debt: rapid repayment of principal indicates that a city or town has the financial resources necessary to repay debt quickly. This demonstrates a level of financial stability; communities that are experiencing financial difficulty are unlikely to repay their debt in an accelerated manner.
- Prevention of future problems: rapid debt retirement ensures that a community is not “back loading” its debt, locking itself into debt payments that are affordable now but that will grow as time passes. Back loading is a sign of poor financial management – either overspending is intentional or managers are unable to make the difficult immediate-term decisions to balance the budget using a more appropriate debt financing structure.

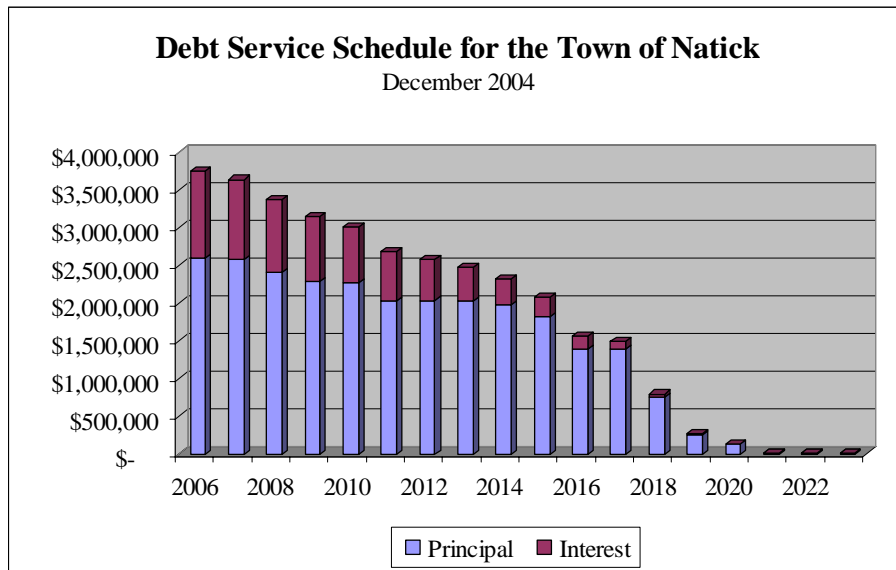
The percentage of debt retired within ten years is particularly important in determining the timing of debt repayment – the “back loading” issue described above. Back loading occurs when the cost of debt is pushed off into the future, reducing current year payments while increasing future ones. Back loading increases the cost of debt in the long term and can be a destabilizing financial factor when debt service requirements increase in future years.

Failure to invest in maintenance and capital investment can be considered a form of debt back loading because capital needs must be addressed at some point; delay in maintenance or investment only delays the financing of these improvements, increases the likelihood that capital will fail *en masse*, forcing unaffordable costs onto future taxpayers. Delaying capital investment also tends to make projects more expensive because costs tend to increase over time.



The Town’s debt retirement measure is strong. On average, 55% of the money borrowed by the Town is repaid within ten years. This places the Town well within the “good” ranking established by the rating agencies. It is interesting to note that 60% of general government debt is retired within 10 years while only 49% of School Department’s non-debt excluded debt is retired within this time period.

The Town’s overall ranking indicates a strong willingness to repay debt. Examining this ratio in conjunction with the Town’s overall debt schedule below indicates that the Town has not back-loaded debt; the Town’s overall debt structure is prudent and well within industry benchmarks.

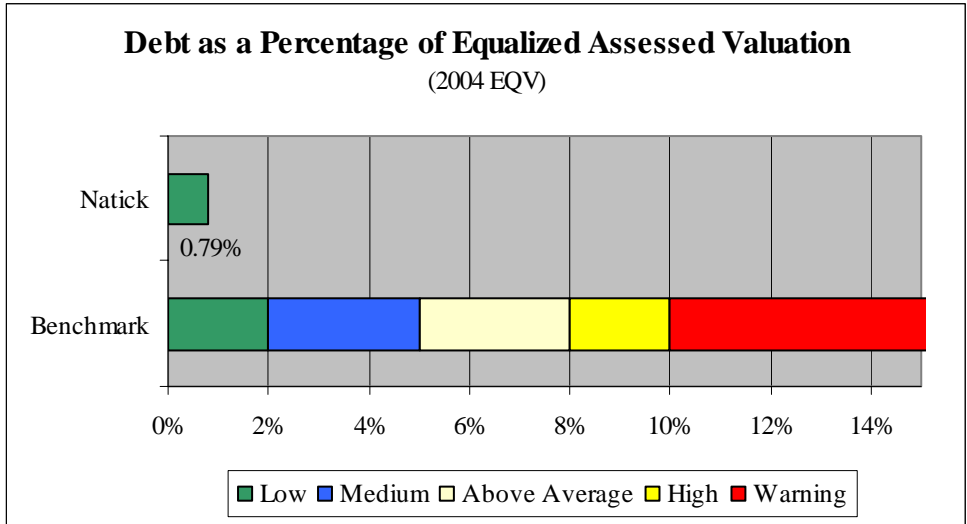


Debt as a Percentage of Full Property Value (EQV)

Debt as a percentage of full property value (known in government finance circles as “equalized value,” or EQV) measures the ability of a community’s property tax base to support borrowing. The majority of revenue in most communities comes from property taxation, so this ratio examines a community’s debt relative to its main revenue source. EQV or full property value measures the total value of property in a community. In essence, this ratio looks at a community’s primary source of revenue to determine if outstanding debt would place too large a burden on it.

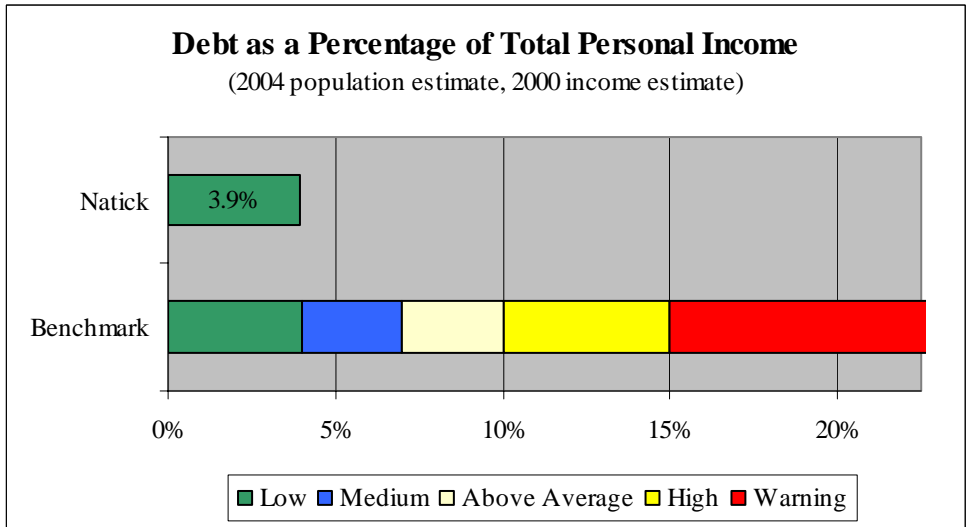
This measure is helpful but is not deeply informative because it looks at total outstanding debt, not debt service. Examining debt as a ratio of full property value does not say much about the affordability of that debt. A small amount of debt issued at a high rate of interest can be more expensive than a larger amount of debt issued at a lower interest rate. Further, in Massachusetts communities are limited in their ability to access their property tax base by Proposition 2 ½. This measure is a helpful benchmark to compare communities to one another but is not an absolute measure of debt affordability because of these issues.

The Town’s ratio of debt to property value is 0.79%. This is an extremely good ratio that reflects the Town’s reasonable debt burden and the significant value of property in Natick. As indicated above, however, this strong measure does not directly relate to the Town’s ability to pay for this debt; this ratio does not take into account debt structure (how much money is due at what point in time for each issuance) or the timing of payments, nor does it consider the Town’s limited ability to access property values due to Proposition 2 ½.



Debt as a Percentage of Total Personal Income

Like the ratio of debt to property value, the ratio of debt to personal income is a measure of affordability of the debt issued by a community. While property values provide the base that supports property taxation, it is personal income that allows people to buy goods and services, make investments and pay their taxes. Debt as a percentage of total personal income tells us how affordable our debt is based on the income characteristics of a city or town.



Natick’s ratio of debt to personal income is considered “low” by credit rating agencies. This means that the Town’s debt can be considered an affordable portion of ones tax bill; absent all other costs in the Town’s budget, the amount of debt issued by the Town is affordable based on the income characteristics of the community. Like the prior measure, however, this measure does not examine the cost of the debt but rather just the amount of debt issued.

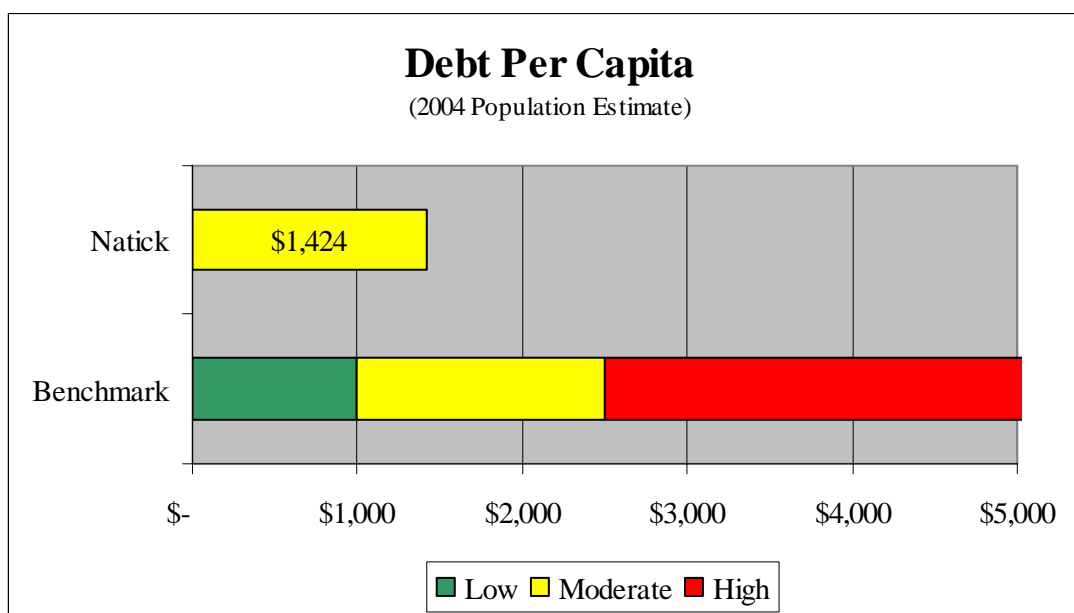
The measure also provides some ability to compare property values to incomes, and therefore to measure the magnitude of “house poverty” in Natick. Debt is the “common denominator” in the measure of debt-to-property-value and debt-to-total personal income and therefore can facilitate a comparison, though not a precise one.

The ratio of debt to personal income and debt to total property value are both in the “low” range as established by the rating agencies. The ratio of debt to personal income appears to be less favorable than that of debt to total property value (the former is on the borderline between “low” and “medium” and the latter is clearly “low”). This indicates that there may be some disparity between home values and income, but this measure is not pronounced, and is not nearly as severe as can be seen in other communities where debt represents only a small portion of total property value but a much more substantial portion of personal income.

Debt per Capita

Debt per capita examines the amount of debt the Town has issued per person in the community. This is not intended to be a literal measure – debt is not issued to benefit individuals but rather the community as a whole. This measure provides a sense of the cost of the capital investments in a community and, at its most extreme, how much money would be required from each resident to repay the community’s debt if for some reason immediate repayment was required.

Debt per capita can be a useful measure when examining similar communities – by and large, similar communities should issue similar amounts of debt for various capital purposes. Even similar communities have significant differences among them, however, so this measure should not be examined in absolute terms but rather in the context of the unique requirements and challenges facing each community. It should also be viewed in light of Proposition 2 ½ which limits a community’s ability to access its property tax base; Proposition 2 ½ can force communities to issue debt for smaller projects that communities in other states would pay for in cash.

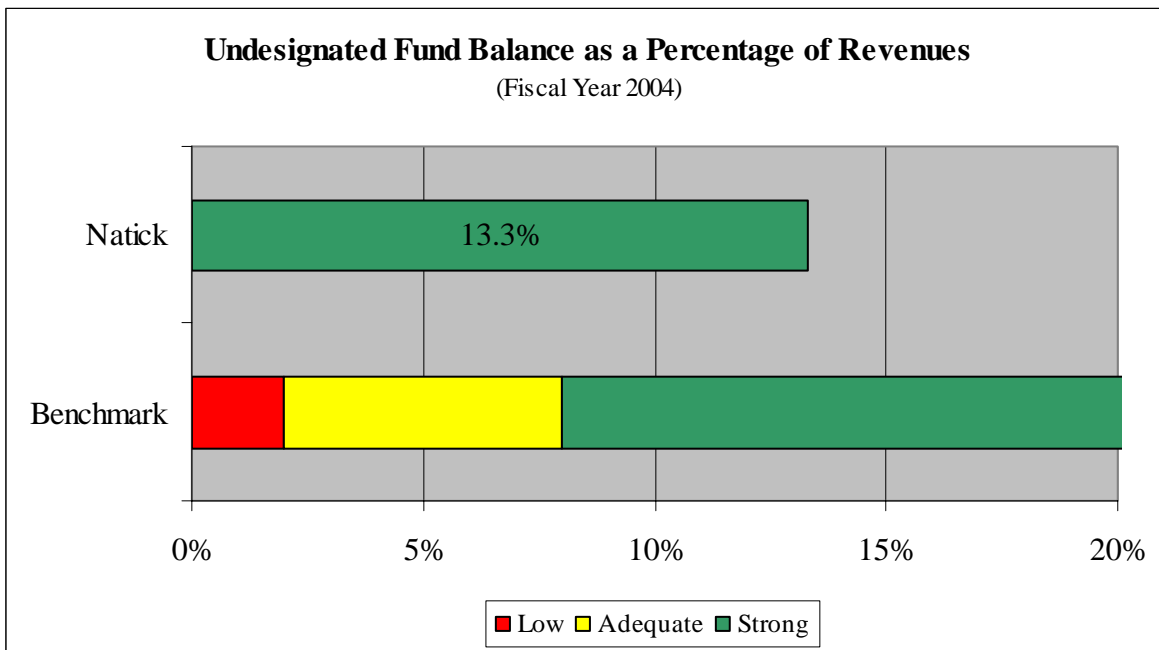


The Town’s level of debt per capita is considered moderate, closer to the low range (\$0 to \$1,000 per capita) than the high range (\$2,500 or higher per capita). This is not unexpected. Natick is an older community with an old infrastructure base. It is located in a high-cost region of the country, which increases the cost of construction projects and other capital investments. Land prices are high and land that is developable for public projects is extremely scarce. The Town is also required under State law to pay “prevailing wage” for construction projects. These factors combine to significantly increase the cost of capital projects in Natick and may help explain why the Town’s per capita debt burden is higher than the best measure established by rating agencies.

Undesignated Fund Balance as a Percentage of Revenue

Undesignated fund balance is a measure of available cash reserves. Cash balances for cities and towns fluctuate during the year depending on revenue and expenditure flows, growing upon receipt of quarterly tax payments and declining as time passes and money is spent.

This measure is an attempt to capture the cash position of a community at a single point in time and compare that to the total revenue required to support general government operations. This analysis uses the final Fiscal Year 2004 undesignated fund balance, the most recent figure available.



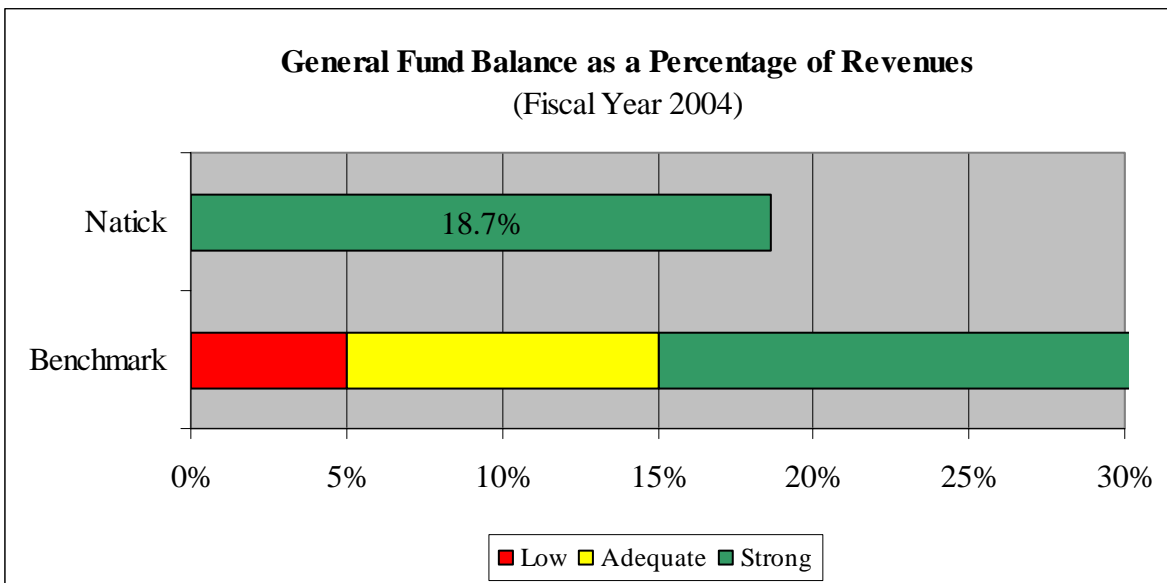
The Town’s ratio of undesignated fund balance to revenue is quite strong. The Town maintains sufficient cash on hand to finance governmental operations without borrowing for cash flow purposes. This helps reduce costs for taxpayers and also permits the Town to borrow from itself to temporarily finance certain projects.

“Borrowing from yourself” can help the Town avoid the issuance of Grant Anticipation Notes and State Aid Anticipation Notes. This allows the Town to initiate certain projects in anticipation of known revenue without needing to issue temporary debt or wait for actual payment. If reserve funds are established to facilitate it, this concept can be expanded to include sufficient reserves to avoid the issuance of Bond Anticipation Notes and could create significant financial savings for the Town.

It should be noted that the Town’s continued reliance on reserve funds to support the operating budget will reduce the Town’s undesignated fund balance, leaving less cash on hand to finance needs at any given point in time. Reserve fund balances are limited, and the continued appropriation of Free Cash, stabilization reserve and overlay surplus to fund the operating budget may deplete our reserves in the near future. This may cause a revenue shortfall that will need to be addressed, as well as possible cash flow issues in more extreme situations.

General Fund Balance as a Percentage of Revenue

General Fund balance as a percentage of revenues is a measure of the Town’s financial health and position, including reserves and encumbrances. The larger this percentage, the more resources are available to the Town that can be used to finance public expenditures, including unforeseen difficulties, or to take advantage of unanticipated opportunities.



The Town’s ratio of General Fund balance to revenues is quite strong, a reflection of the Town’s strong undesignated fund balance (available cash on hand) as well as reserve fund balances. This figure also represents encumbrances which have been made between Fiscal Year 2004 and Fiscal Year 2005³.

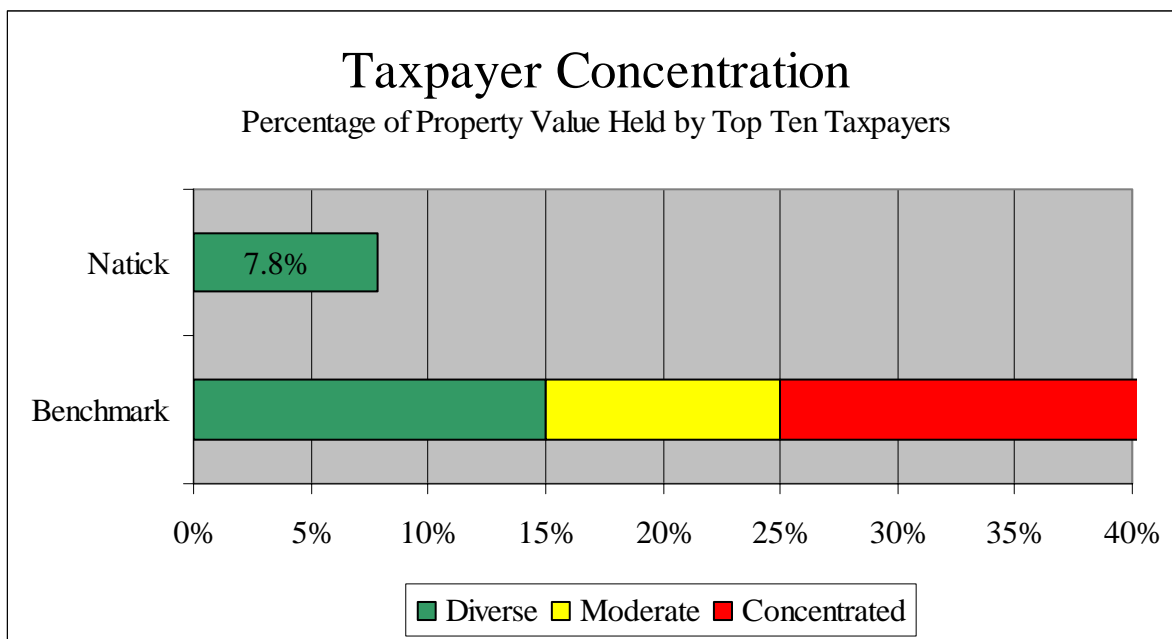
³ An encumbrance is the carry forward of money from one fiscal year to another, generally to pay for a service that was provided prior to June 30th (the end of one fiscal year) but for which the bill was not received until after the beginning of the next fiscal year (July 1st). Encumbrances also occur for certain projects, such as construction projects, where it is not possible to finish the project in a single fiscal year.

Taxpayer Concentration: Amount of Property Value Held by the Ten Largest Taxpayers

Taxpayer concentration is a measure of revenue risk for a community. Communities that have low taxpayer concentrations have a diverse base of taxpayers and are better able to handle the revenue loss associated with loss of any one taxpayer. Communities with high levels of taxpayer concentration – those lacking a diverse property tax base – are at much greater risk if a single large taxpayer leaves the community.

The problems associated with taxpayer concentration can be seen in the impact of Lucent’s downsizing in North Andover or, more starkly, in the impact that downsizing at General Electric had in Pittsfield and Schenectady, New York. General Electric laid off 9,000 people in Pittsfield – a community of 45,000 residents – and 11,000 people in Schenectady, a community of 61,000 residents. The high levels of property value associated with a single or small group of taxpayers can present a real and significant risk to the revenue flow of communities.

The Town’s taxpayer concentration measure is quite strong, with only 7.8% of market value held by the top ten property owners in Natick. There is also diversity among the top ten property owners. Large property owners include those in retail, high technology office space, residential (both condominium and rental) and leisure services.



The diversity of the Town’s property tax base helps protect our overall revenue stream. If one sector of the economy enters recession than another may be strong, helping to protect the Town’s overall financial position. This permits the Town to provide a more stable level of services to our residents because the Town’s revenue position – and therefore its expenditure pattern – is not continually being adjusted because revenues are changing with economic conditions.

The Natick Mall is the highest value property in Natick. This in and of itself is not a bad thing, but it should be noted that the ninth and tenth highest value properties are also Natick Mall-related properties (Macy’s and Filenes). The potential expansion of the Natick Mall will make the Mall and Mall-related properties an even larger percentage of the Town’s property valuation.

The proposed expansion of the Natick Mall would provide additional tax revenue to the Town, and this revenue would help the Town serve its residents. The Town may wish to consider the relatively substantial presence the expanded Mall would have in its property valuation, however. This in turn may point to a need to further diversify our tax base or to establish permanent reserve funds in case a recession impacts one or more of the Town's largest property tax payers.

Conclusion

The Town of Natick appears to have structured and managed its debt in an appropriate manner, well in line with best practices and industry benchmarks established by the bond rating agencies that evaluate the financial management of cities and towns across the country. The Town's ranking in each area of analysis – summarized below – is strong, with the only exception being debt per capita. This measure exists in a context, however – it is significantly more expensive than average to conduct capital projects in the Northeast, and specifically in Massachusetts. The measure is not consistent with the Town's strong performance in all other areas but is considered reasonable given the context in which it exists.

It should be noted that debt management is a dynamic process – continued hard work and vigilance will be required to ensure future debt issuances are made in line with prudent financial management practices. The Town's success in debt management is even more important given the recent financial difficulties it has faced and the anticipated need to significantly increase ongoing capital investments as well as address large individual projects such as the construction of a senior center, the Natick High School and the renovations of the Kennedy, Memorial and Johnson Schools.

Debt Service as a Percentage of General Fund Expenditures

Best Rating: Low
Town Rating: Low (borderline to medium)

Undesignated Fund Balance as a Percentage of Revenue

Best Rating: Strong
Town Rating: Strong

Debt Retirement: Percent Retired within Ten Years

Best Rating: Excellent
Town Rating: Good

General Fund Balance as a Percentage of Revenue

Best Rating: Strong
Town Rating: Strong

Debt as a Percentage of Full Property Value

Best Rating: Low
Town Rating: Low

Taxpayer Concentration

Best Rating: Diverse
Town Rating: Diverse

Debt as a Percentage of Total Personal Income

Best Rating: Low
Town Rating: Low

Debt Per Capita

Best Rating: Low
Town Rating: Moderate