

Natick, Massachusetts

New Issue Report

Ratings

Long Term Issuer Default Rating AAA

New Issue

\$94,695,000^a General Obligation
Municipal Purpose Loan Bonds,
Series 2018

AAA

^aPreliminary, subject to change.

Rating Outlook

Stable

New Issue Summary

Sale Date: Nov. 29, via competitive sale

Series: Approximately \$94,695,000 General Obligation (GO) Municipal Purpose Loan Bonds, Series 2018

Purpose: To finance the town's local share of the construction costs associated with a new Kennedy Middle School and fire station as well as other town-related projects.

Security: GOs of Natick backed by its full faith and credit. Property taxes levied by the town are subject to limitation by the Proposition 2 1/2 Commonwealth of Massachusetts statute unless voters approve the exclusion of debt service on the bonds from the limitation. A large portion of the town's series 2018 bonds associated with the middle school and fire station projects were approved by voters and are exempt from the limitations of Proposition 2 1/2.

Analytical Conclusion

The 'AAA' GO bond rating and Issuer Default Rating (IDR) reflect Fitch Ratings' expectation for Natick to maintain healthy financial flexibility throughout economic cycles, consistent with its history of strong operating performance and sound reserves. The town's strong financial profile reflects a wealthy property tax base, manageable expenditure growth and a solid level of expenditure flexibility if needed during future economic downturns.

Fitch expects long-term liabilities associated with debt and retiree benefits to remain moderate based on manageable capital needs and expectations for continued growth in population and residents' personal income. Additionally, management has a practice of fully funding its actuarially determined pension contribution (ADC) and making contributions over and above pay-go for other post-employment benefits (OPEB).

Economic Resource Base: Natick is a wealthy suburb located in Middlesex County, approximately 18 miles west of Boston. It has an estimated 2017 census population of 36,246, which is up 10% since 2010. The town's quality school system, commutable location to Boston and relatively more affordable housing options outside of the city have led to continued population and tax base growth.

Key Rating Drivers

Revenue Framework: 'aaa'

Fitch expects Natick to realize continued strong revenue growth based on anticipated increases in the value of its tax base and management's historical practice of levying close to or the full allowable 2.5% annual increase in its tax levy. The town's independent legal ability to raise revenues is somewhat constrained by the state's Proposition 2 1/2 law; however, a healthy level of new construction, which is excluded from the cap, supports expectations for strong natural growth in revenues going forward.

Expenditure Framework: 'aa'

Fitch expects the natural pace of spending growth to be in line with that of revenues over time. Carrying costs for long-term liabilities claim a moderate proportion of governmental spending, and Fitch expects such costs to remain moderate. Fitch believes that management has the flexibility and willingness to cut spending as necessary during economic downturns.

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Rating History (IDR and GO Bonds)

Rating	Action	Outlook/ Watch	Date
AAA	Assigned	Stable	11/19/18

Long-Term Liability Burden: 'aaa'

Natick's long-term liability burden for debt and Fitch-adjusted net pension liabilities (NPL) is low, at 8.6% of personal income, after issuance of the series 2018 bonds. Fitch anticipates the burden remaining low based on manageable future debt needs, a strong practice of pay-go capital spending and an expected increase in personal income over time. Natick fully funds its ADC, and principal amortization rates are slightly above average.

Operating Performance: 'aaa'

The town's steady revenue growth, combined with prudent fiscal policies and conservative budgeting practices, has resulted in historically sound operating results and maintenance of strong reserve levels. Fitch considers the town's gap-closing capacity to be strong based on its high reserves combined with a solid level of expenditure flexibility and substantial legal revenue raising ability. Fitch expects management will maintain its financial flexibility to withstand future economic downturns in a manner consistent with the current rating level.

Rating Sensitivities

Change In Revenue Growth Prospects: Fitch expects tax base growth to continue helping support future expenditure growth. A notable adverse change in the town's growth prospects could pressure the rating.

Increase in Long-term Liability Burden: An increase in Natick's long-term liabilities beyond Fitch's current expectations could pressure the rating.

Credit Profile

The town's fiscal 2019 taxable assessed value (TAV) is \$8.8 billion, or a very high \$242,000 per capita, highlighting the desirable geographic location in the greater Boston metro area and above-average wealth levels for residents. The town's largest employer, outside of the town itself and the school district, is the software development company MathWorks, Inc., which employs roughly 2,600 people. MathWorks, a privately held corporation specializing in mathematical computing software, maintains its headquarters in Natick and is currently undergoing expansion of its operations with the construction of an additional campus expected to house approximately 2,000 new jobs. Other major employers include the U.S. Army Natick Research, Development and Engineering Center, the Natick Mall, and MetroWest Medical Center. Unemployment levels are low, reflective of recent strong job and labor force growth, and are consistently better than state and national rates.

Revenue Framework

Real and personal property taxes are the largest revenue source and made up roughly 80% of fiscal 2017 budgeted general fund revenues. Motor vehicle and other excise taxes account for another approximately 4% of revenues, and state aid, primarily for education, represents approximately 10%. State aid has seen moderate increases in the past several years, as student enrollment growth has been strong in Natick.

General fund revenues increased at a compound annual growth rate of 4.5% for the 10-year period of 2007 through 2017 exceeding national GDP and inflation. The growth is due to increases in the tax base from new development as well as management's practice of typically increasing its property tax levy by the full 2.5% permitted under state law. When Fitch adjusts the revenue growth to exclude policy actions, the trend in growth still exceeds inflation but is slightly below the rate of GDP.

Related Research

[Fitch Rates Natick, MA's \\$95MM Series 2018 GO Bonds 'AAA'; Outlook Stable \(November 2018\)](#)

Related Criteria

[U.S. Public Finance Tax-Supported Rating Criteria \(April 2018\)](#)

The town's TAV declined modestly through the recession, but has experienced notable growth since fiscal 2012 due to a combination of new development and appreciation in property values. TAV has grown by 41% from fiscal 2012 through fiscal 2019 and the current fiscal 2019 value of \$8.8 billion exceeds the town's peak TAV prior to the recession by 33%. Fitch expects this trend of robust growth to continue due to the strong regional economy, notable projects underway and rising housing values.

Pursuant to state law, Proposition 2 1/2 limits the town's ability to levy property taxes by a "levy ceiling," an absolute cap on the level of property taxation, set at 2.5% of overall market values, and a levy limit that restricts the annual growth in taxation to a 2.5% increase over the previous year's levy plus the value of new growth. Taxation in excess of the levy limit requires voter approval. Declines in market value lower the "levy ceiling" and vice versa. The town's fiscal 2018 levy ceiling (currently \$206 million) is very high compared to its fiscal 2018 tax levy (\$107 million) due to continued growth in value over the years.

Management has historically levied close to the full 2.5% levy increase each year. Any excess in levy capacity is carried forward and available for use at any time. Additionally, voted debt can be excluded from Proposition 2 1/2 limits, and the town has been successful in receiving exemption approval by voters for a large portion of this current bond issue and prior bond issuances for school-related debt as well as for certain town projects.

The town's top 10 taxpayers represent a moderate 10% of the total tax base, including Natick Mall (and its luxury condo complex), which accounts for 4%, followed by MathWorks, Inc., at 2%.

Expenditure Framework

The bulk of general fund spending is associated with education, which represents close to half of general fund spending. The next largest component is public safety, at approximately 11% of the budget. Spending for education has been a primary budget driver for the last several years as student enrollment has grown by roughly 15% since fiscal 2009. Natick has consistently provided funding for schools over and above the state minimum requirement.

Carrying costs for debt service, pension and OPEB contributions were moderate for fiscal 2017, representing 13% of total governmental spending. Debt service costs associated with the series 2018 bonds are projected by Fitch to increase the spending metric to a level closer to 17% of governmental spending, which Fitch still considers to be moderate.

The town received voter approval to exempt from Proposition 2 1/2 limitations the new middle school and the fire house component of the current financing, which account for approximately \$82 million of the principal amount of the current offering. Of the town's current outstanding bond governmental debt service, approximately 50% is exempt from Prop 2 1/2 limitations as a result of voter approval. The bulk of the exempted debt is associated with the town's new high school, completed in 2011.

The town's five-year capital improvement plan includes potential future borrowing that Fitch considers manageable and also assumes a continued funding of capital needs on a pay-go basis. Fitch would expect the carrying cost metric to remain close to or below the current level going forward based on a moderate level of future debt plans, expected annual increases in pension contributions, the town's principal amortization rate, and a general increase in future total governmental spending.

Natick is a full-service town, and Fitch believes management has flexibility to reduce services if necessary. Changes to labor contracts are subject to collective bargaining, and minimum manning provisions apply for fire personnel, which Fitch considers fairly restrictive. However, of

the 1,727 full-time school and town employees, only approximately 54% belong to unions or other collective bargaining groups. Additionally, management reports its annual appropriations for school spending are currently around 40% over the minimum required by the state. The legal capacity to reduce education spending is a key consideration in the assessment of the town's expenditure framework, if only temporary, and notwithstanding the strong commitment the town has demonstrated to the funding of its highly accredited school system.

Long-Term Liability Burden

Long-term liabilities for governmental debt, including the series 2018 bonds, and for Fitch-adjusted NPLs are low, at 8.6% of residents' estimated personal income. Fitch expects the long-term liability burden to remain low based on manageable future debt plans, principal amortization rates (56% within 10 years) and expected growth in personal income levels over time. Governmental debt represents roughly 60% of the metric.

The town is a member of the Natick Contributory Retirement System, a cost-sharing multiple-employer defined benefit pension plan, and essentially all non-teacher employees participate in the plan. In the town's most current audited financial statements for fiscal 2017, it reported an NPL of \$87 million based on a 7.375% investment rate of return (IRR). The reported assets to liabilities ratio was 60%. Using a Fitch-adjusted 6% IRR, the assets to liabilities ratio equated to a lower 51% with an estimated NPL of \$115 million (3.6% of personal income) for the town's governmental portion of the plan (excludes the town's enterprise funds and Natick Housing Authority). The town's pension funding schedule assumes full amortization of the outstanding unfunded actuarial liability through 2030, 10 years earlier than what is permitted by the Commonwealth of Massachusetts. Teachers participate in the state administered Teachers' Retirement System for which the town has no liability or contribution requirements.

The town's unfunded OPEB liability totaled \$169 million as of July 1, 2016, assuming a 4% investment rate of return, equal to 5% of personal income. OPEB contributions in fiscal 2017 totaled \$4.9 million (roughly 3% of governmental expenditures). Management has taken actions to control long-term growth by switching to lower-cost HSA eligible-health insurance policies with higher deductibles and co-pays, which Fitch expects should have a positive impact on controlling growth in the OPEB liability. Management established an OPEB trust in 2015, and the balance in the OPEB trust was \$3.3 million as of June 30, 2018.

Operating Performance

Fitch expects Natick will continue to maintain strong reserve levels for the current rating level throughout economic cycles given its historically stable revenue performance and high level of inherent budget flexibility in the form of substantial revenue and spending control. For details, see Scenario Analysis, page 6.

Fiscal practices governing maintenance of operating reserves as well as capital-related reserves help contribute to the town's strong financial profile. The town has averaged roughly \$4.5 million annually in cash spending for capital over the last five years. During the most recent downturn, management instituted spending controls, imposed a hiring freeze, and reduced positions to help manage reductions in revenues and reduce the reliance on reserves. Fitch expects management would take similar actions during a future downturn and take immediate action to rebuild reserves as it did subsequent to the 2007-2009 recession.

At fiscal year-end 2017, the general fund experienced a net operating surplus of approximately \$6 million (4% of spending), reflective of a combination of positive revenue variances, namely from building permits and local excise taxes, and lower-than-budgeted spending. The

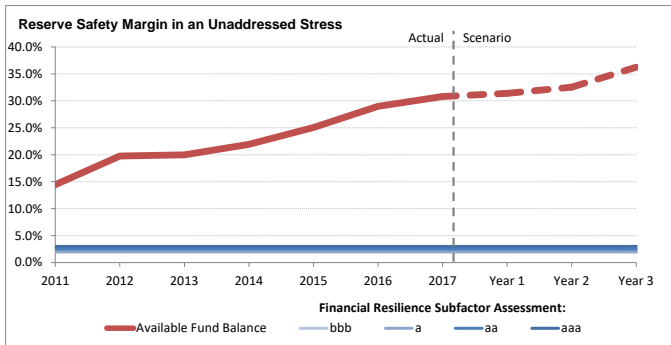
unrestricted general fund balance increased by approximately \$5 million to roughly \$45 million, or a solid 31% of spending. Fiscal 2017's financial results included an appropriation of \$1 million to the town's OPEB trust.

The fiscal 2018 final revised operating budget totaled \$151 million and was up 11% from the final revised 2017 budget. The primary drivers were school spending, debt service and employee benefits. Management reports preliminary results are positive.

The original fiscal 2019 budget is up slightly over the fiscal 2018 budget and reflects increases for education, debt service and pension costs. The budget includes appropriation for capital spending and continues its annual contribution to the capital stabilization fund and OPEB trust.

Natick (MA)

Scenario Analysis



Analyst Interpretation of Scenario Results:

Fitch expects Natick will continue to maintain strong reserve levels for the current rating level throughout economic cycles given its historically stable revenue performance and high level of inherent budget flexibility in the form of substantial revenue and spending control. The town has experienced surplus operations since fiscal 2011 and has historically maintained reserve levels well above the level Fitch deems adequate to maintain a 'aaa' operating performance assessment.

Scenario Parameters:	Year 1	Year 2	Year 3
GDP Assumption (% Change)	(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)	2.0%	2.0%	2.0%
Revenue Output (% Change)	(1.0%)	2.6%	4.6%
Inherent Budget Flexibility	High		

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2011	2012	2013	2014	2015	2016	2017	Year 1	Year 2	Year 3
Total Revenues	114,135	122,637	123,880	129,307	131,124	136,932	147,936	146,456	150,245	157,176
% Change in Revenues	-	7.4%	1.0%	4.4%	1.4%	4.4%	8.0%	(1.0%)	2.6%	4.6%
Total Expenditures	112,313	119,287	125,060	130,409	129,854	134,762	144,129	147,011	149,951	152,951
% Change in Expenditures	-	6.2%	4.8%	4.3%	(0.4%)	3.8%	7.0%	2.0%	2.0%	2.0%
Transfers In and Other Sources	4,132	4,398	3,433	5,184	3,590	7,738	3,558	3,523	3,614	3,780
Transfers Out and Other Uses	416	397	401	312	667	2,830	1,205	1,229	1,254	1,279
Net Transfers	3,716	4,001	3,032	4,872	2,923	4,908	2,353	2,293	2,360	2,501
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	5,538	7,350	1,852	3,771	4,194	7,078	6,160	1,738	2,653	6,727
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	4.9%	6.1%	1.5%	2.9%	3.2%	5.1%	4.2%	1.2%	1.8%	4.4%
Unrestricted/Unreserved Fund Balance (General Fund)	16,293	23,647	25,047	28,663	32,706	39,873	44,779	46,518	49,171	55,898
Other Available Funds (GF + Non-GF)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Other Available Funds)	16,293	23,647	25,047	28,663	32,706	39,873	44,779	46,518	49,171	55,898
Combined Available Fund Bal. (% of Expend. and Transfers Out)	14.5%	19.8%	20.0%	21.9%	25.1%	29.0%	30.8%	31.4%	32.5%	36.2%
Reserve Safety Margins	Inherent Budget Flexibility									
	Minimal		Limited		Midrange		High		Superior	
Reserve Safety Margin (aaa)	16.0%		8.0%		5.0%		3.0%		2.0%	
Reserve Safety Margin (aa)	12.0%		6.0%		4.0%		2.5%		2.0%	
Reserve Safety Margin (a)	8.0%		4.0%		2.5%		2.0%		2.0%	
Reserve Safety Margin (bbb)	3.0%		2.0%		2.0%		2.0%		2.0%	

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's downturn scenario assumes a -1.0% GDP decline in the first year, followed by 0.5% and 2.0% GDP growth in Years 2 and 3, respectively. Expenditures are assumed to grow at a 2.0% rate of inflation. Inherent budget flexibility is the analyst's assessment of the issuer's ability to deal with fiscal stress through tax and spending policy choices, and determines the multiples used to calculate the reserve safety margin. For further details, please see Fitch's US Tax-Supported Rating Criteria.

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