

# RatingsDirect®

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## Summary:

# Sudbury, Massachusetts; General Obligation

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## Summary:

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### Credit Profile

US\$10.89 mil go land acquis bnds unlted tax ser B dtd 01/26/2021 due 01/15/2041		
<i>Long Term Rating</i>	AAA/Stable	New
US\$7.9 mil go mun purpose loan of 2021 ser A dtd 01/26/2021 due 01/15/2041		
<i>Long Term Rating</i>	AAA/Stable	New
US\$2.175 mil go rfdg bnds ser C dtd 01/26/2021 due 08/15/2033		
<i>Long Term Rating</i>	AAA/Stable	New

### Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating to Sudbury, Mass.' general obligation (GO) municipal purpose loan of 2021 bonds (series A), taxable GO land acquisition bonds (series B), and taxable GO refunding bonds (series C). The outlook is stable.

The bonds are secured by the town's full faith and credit. We understand that voters exempted the entirety of the series B bonds from the limitations of Proposition 2-1/2, but that portions of the series A and C bonds are subject to these limitations. Despite limitations imposed by the commonwealth levy limit law, we do not make a rating distinction between the town's unlimited- and limited-tax GO pledges on its debt outstanding, as the ad valorem tax securing the limited-tax obligation is not derived from a measurably narrower property tax base and financial resources are fungible, supporting our view of the town's overall ability and willingness to pay debt service. Proceeds will be used primarily as follows:

- Series A: a new fuel system for the town's department of public works, dam repair, land acquisition, and refunding of debt outstanding to lower overall debt service costs;
- Series B: land acquisition costs; and
- Series C: refunding of GO bonds outstanding dated Aug. 15, 2013, to lower overall debt service costs estimated at almost 12% of the refunding principal.

### Credit overview

Despite S&P Global Ratings' view that the economic effects of COVID-19 and the recession could pressure credit quality, as discussed in our report "The COVID-19 Outbreak Weakens U.S. State And Local Government Credit Conditions," published April 2, 2020, on RatingsDirect, we believe Sudbury's stable financial position funded primarily with property taxes is mostly resilient against revenue loss. Furthermore, with its financial reserves equal to \$16.5 million, or 15% of expenditures, at fiscal year-end 2019 and a surplus expected in fiscal 2020, we believe the town has flexibility to absorb modest changes in its budgetary performance in fiscal 2021 stemming primarily from one-time expenditures associated with its COVID-19 response, should it not receive full reimbursement of these costs. Over the

longer term, the stable outlook reflects our view of the town's close proximity to Boston, strong financial management and planning practices that are instrumental in early identification of out-year budget gaps, and ongoing efforts to reduce long-term liabilities through annual appropriations into a dedicated trust fund for retiree postemployment benefits.

We rate the town's GO bonds above the sovereign because we believe it can maintain better credit characteristics than the U.S. in a stress scenario, based on the locally derived pledged revenue for bondholders and our view that pledged revenue supporting debt service on the bonds is at limited risk of negative sovereign intervention. The rating above the sovereign is based on our criteria "Ratings Above The Sovereign: Corporate And Government Ratings--Methodology And Assumptions," published Nov. 19, 2013.

The long-term rating reflects our opinion of Sudbury's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area;
- Strong management, with good financial policies and practices under our financial management assessment methodology;
- Strong budgetary performance, with operating results that we expect could improve in the near term relative to fiscal 2019, which closed with operating surpluses in the general fund and at the total governmental fund level;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 15% of operating expenditures;
- Very strong liquidity, with total government available cash at 25.5% of total governmental fund expenditures and 7x governmental debt service, and access to external liquidity we consider strong;
- Very strong debt and contingent liability position, with debt service carrying charges at 3.7% of expenditures and net direct debt that is about 32% of total governmental fund revenue (following the current transactions), as well as low overall net debt at less than 3.0% of market value and rapid amortization, with 67.8% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

### **Environmental, social, and governance factors**

We believe Sudbury benefits from social risks that are below those of the sector, given its wealth and income demographics that are above 225% of the nation, as this could translate to greater capacity for residents to afford revenue enhancements that might be required to maintain budgetary balance during a period of fiscal stress. Furthermore, we analyzed the town's environmental and governance risks relative to its economy, budgetary outcomes, and debt and liability profile and believe they are in line with those of the sector.

## **Stable Outlook**

### **Downside scenario**

While unlikely during the outlook period, should revenue loss stemming from recessionary pressure and expenditure growth from higher fixed costs lead to sustained budgetary imbalances and multiyear draws on reserves, we could revise the outlook to negative or lower the rating.

## Credit Opinion

### Very strong economy

We consider Sudbury's economy very strong. The town, with an estimated population of 19,627, is located in Middlesex County in the Boston-Cambridge-Newton metropolitan statistical area, which we consider broad and diverse. The town has a projected per capita effective buying income of 249% of the national level, which we view as extremely high and a positive credit factor, and per capita market value of \$242,018. Overall, the town's market value grew by 1% over the past year to \$4.8 billion in 2020.

Sudbury is a wealthy suburb of Boston located in Middlesex County and is bordered by the towns of Wayland to the east, Framingham to the south, and Marlborough to the west. The town's 24.4-square-mile area is nearly developed, although capacity remains for additional development as well as substantial preservation of open space and for recreational areas. Construction activity includes the recently complete mixed-use Meadow Walk development that includes a large residential component and various retail outlets, including Whole Foods. The residential portion represents the town's second-largest taxpayer at \$58.6 million, or 1.2%, of the town's total assessed valuation. Furthermore, the town is fulfilling its affordable housing requirement through a 275-unit apartment complex under construction.

Although Middlesex County's unemployment rate was 2.3% in 2019 and below that of the nation, it did reach nearly 7.0% in 2009 and 2010 during the prior economic downturn. We believe that the rapidly evolving economic conditions as a result of COVID-19, despite the positive developments with the vaccine, could continue affecting the labor market through mid-2021. However, we believe the employment diversity within Boston and the surrounding region could help mitigate the effects of social distancing and other decisions made to safeguard the community from COVID-19 on the unemployment rate. As a result, we will monitor the longer-term effects of the recession on the town's overall economic trends.

### Strong management

We view the town's management as strong, with good financial policies and practices under our financial management assessment methodology, indicating our view that financial practices exist in most areas but that governance officials might not formalize or monitor all of them on a regular basis.

The town has historically utilized a conservative, multiyear forecast to formulate its budget, and employs econometrics to make revenue projections and an outside consultant to assist with expenditure determinations. The town considers about five years of historical data when developing the budget, which it reviews monthly following adoption to ensure year-to-date trends are consistent with expectations. A five-year capital improvement plan identifies funding for all projects, and management updates the document annually. Management also prepares a three-year financial projection and provides quarterly reports to the town's board. Finally, the town aims to maintain a stabilization fund balance equal to no less than 5% of expenditures. (In fiscal 2019 the town maintained 3% of expenditures in the committed reserve.) There is no formal debt management policy other than maintaining a debt schedule with 50% of principal amortized during 10 years.

The town's multipronged approach to protecting its systems against cybersecurity threats includes annual employee

training, various software products to help prevent data breaches, and use of cloud-based data storage to ensure recovery should the town's technology become compromised. We believe this comprehensive methodology indicates the strength of the town's management team.

### **Strong budgetary performance**

Sudbury's budgetary performance is strong, in our opinion. We believe the town's stable revenue profile and conservative budget projections will continue to lead to strong budgetary results despite the budgetary challenges stemming from economic uncertainty in fiscal 2021. The town had operating surpluses of 2.0% of expenditures in the general fund and of 3.3% across all governmental funds in fiscal 2019. Fiscal 2019 results were consistent with the town's long history of conservative operations and stemmed primarily from health care benefit savings, reflecting 10 years of plan modifications to shift higher employee contributions to new employees when retirements occur.

For analytical consistency, we adjust the town's audited financial statements to reflect transfers into and from the general fund and remove one-time capital expenditures funded with bond proceeds.

The town's budget is primarily funded with property taxes (79%) while intergovernmental revenue accounts for the second-largest portion of revenue (about 15%), of which half is allocated to the town as a passthrough to support teacher retirement costs.

Preliminary results for fiscal 2020 show an operating surplus of about \$1.8 million (1.8% of expenditures), resulting from revenue collections' surpassing budgeted projections and cost savings from the closure of school facilities during the final months of the school year.

Furthermore, expenditures related to the town's initial COVID-19 response, equal to \$100,000, were reimbursed prior to year end either through its Coronavirus Aid, Relief, and Economic Security (CARES) Act allocation from the state or the Federal Emergency Management Agency. The fiscal 2021 budget is equal to about \$106.3 million, or a 3.74% increase over the prior year. Management anticipates no revenue pressure related to the recession, and anticipates receiving additional COVID-19-related reimbursements during the fiscal year. Furthermore, the state did not reduce local aid, resulting in the town receiving more than conservatively budgeted. As the town begins its budget planning process for fiscal 2022, management maintains a cautious approach and may appropriate more from its fund balance to cover capital investments or its other postemployment benefit (OPEB) trust fund contribution, which will remain \$600,000 to \$680,000 in fiscal 2022. We believe management has the tools in place to adjust its operations, if necessary, to maintain budgetary balance in the face of ongoing uncertainty.

### **Very strong budgetary flexibility**

Sudbury's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 15% of operating expenditures, or \$16.5 million.

We have adjusted available reserves to include the committed portion of the fund balance as this amount could be made available to support operations, if necessary, by a vote at a town meeting. With annual budgetary outcomes that have produced a surplus over the past several years, the town's nominal flexibility has gradually improved. Despite the challenges arising from the pandemic and recession, we believe management's conservative planning efforts will support this historical trend. Furthermore, management's formalized policy to maintain a stabilization fund of no less

than 5% of total projected general fund operating revenue for the next fiscal year helps ensure that its budget can absorb emergencies or unexpected interruptions in operations. Given the preliminary results for fiscal 2020, we believe the town's reserves will remain very strong despite the potential for a higher appropriation from fund balance in fiscal 2022.

### **Very strong liquidity**

In our opinion, Sudbury's liquidity is very strong, with total government available cash at 25.5% of total governmental fund expenditures and 7x governmental debt service in 2019. In our view, the town has strong access to external liquidity if necessary given the town's regular issuance of debt over the past 20 years. The town's maintenance of very strong liquidity as well as its conservative investment decisions insulates its operations from any near-term disruption in cash flow stemming from its decision to delay the fourth-quarter property tax due date to June 1 (from May 1). Furthermore, the town's lack of contingent liquidity risks, including privately placed loans that could contain provisions that accelerate debt service payments following certain events, supports our view that liquidity will remain very strong.

### **Very strong debt and contingent liability profile**

In our view, Sudbury's debt and contingent liability profile is very strong. Total governmental fund debt service is 3.7% of total governmental fund expenditures, and net direct debt is about 32% of total governmental fund revenue following the current transactions. Overall net debt is low at 0.9% of market value, and approximately 67.8% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

Following the current transactions, the town has about \$38 million of long-term debt outstanding. In November 2020, the town authorized the community center project at a cost of \$28.3 million. Long-term debt associated with this project will likely be issued outside of our two-year outlook timeframe, but we believe the town's conservative debt profile with rapid amortization and a substantial decline in annual debt service costs beginning in fiscal 2022 will allow the town to absorb this debt without deterioration in its credit profile.

### **Pension and OPEB liabilities**

- We believe pension and OPEB contributions are not an immediate source of credit pressure for Sudbury given the relatively modest combined contribution costs at 5.6% of total governmental expenditures in fiscal 2019.
- However, we believe the pension system's low pension funded ratio and permissive assumptions will likely lead to contribution volatility, particularly if assumptions are not met, but Sudbury has flexibility to absorb higher costs given the strength of its tax base and its demonstrated willingness to make budgetary adjustments to maintain balance.
- The town is required to fund OPEBs only on a pay-as-you-go basis and annually contributes an excess amount to a dedicated trust.

Sudbury participated in the following plans as of June 30, 2019:

- Middlesex County Retirement System (MCRS), a cost-sharing, multiple-employer, defined-benefit pension plan that covers eligible employees. The plan's funded ratio is 46.4% and the town's net pension liability is \$63.9 million.
- A defined benefit health care plan for retired employees with a net OPEB liability of about \$58.3 million.

The town made its full annual required pension contribution in 2019. MCRS uses a 7.5% discount rate. We believe this

discount rate is high for municipal systems and could lead to volatility in contributions should market performance not meet expectations. Although Massachusetts requires all pension systems to achieve full funding no later than 2040, the system is expected to be fully funded by fiscal 2035. We generally view closed, short amortization schedules as positive, but for MCRS to meet its adopted funding schedule and achieve full funding in 2035, higher contributions are required. Furthermore, the system did not meet our static funding metric in the most recent year or our minimum funding progress calculation, indicating that it is not addressing current costs or reducing the unfunded liability.

Sudbury maintains a dedicated trust to offset its OPEB liability, which at Dec. 31, 2019 contained \$8.4 million, resulting in a fiduciary net position of close to 12%. Officials anticipate the balance will reach at least \$9 million when information is available for Dec. 31, 2020, reflecting investment earnings and the fiscal 2020 contribution of \$600,000. While we consider Sudbury's prefunding of the OPEB liability a positive, its large and growing pension and OPEB liabilities could pressure the budget over the longer term.

### **Strong institutional framework**

The institutional framework score for Massachusetts municipalities is strong.

## **Related Research**

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 2020 Update Of Institutional Framework For U.S. Local Governments

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