

Rating Update: Moody's downgrades Brockton MA's GO to A1; outlook negative

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Downgrade affects \$106M in GO debt

BROCKTON (CITY OF) MA
Cities (including Towns, Villages and Townships)
MA

NEW YORK, August 25, 2015 --Moody's Investors Service has downgraded to A1 from Aa3 the rating on the City of Brockton's (MA) \$106 million of general obligation bonds. A negative outlook has been assigned. Concurrently, we have affirmed the Aa2 enhanced rating on the city's General Obligation State Qualified Municipal Purpose Loan of 2011 Bonds.

SUMMARY RATING RATIONALE

The downgrade to A1 reflects the city's increasing financial pressures and reliance on reserves to balance operations. The rating also incorporates the sizeable tax base, below average socioeconomic indicators, manageable debt burden and large pension liability.

The Aa2 enhanced rating on the city's General Obligation State Qualified Municipal Purpose Loan of 2011 Bonds reflects the inherent strength of the Massachusetts Qualified Bond Program (QBP) and its direct-pay arrangement authorized by state statute in which the State Treasurer makes debt service payments on qualified bonds directly to the paying agent. The rating also incorporates the city's sound state aid coverage of annual debt service.

OUTLOOK

The negative outlook reflects our expectation that the city's financial position will continue to be pressured over the near term. The city is projecting moderate budget gaps over the next three years and it will be difficult to balance the operations without strong taxpayer support.

WHAT COULD MAKE THE RATING GO UP (REMOVE NEGATIVE OUTLOOK)

- Trend of balanced financial operations that contribute to increased reserves
- Significant decline in the debt and pension liability
- Material increase in the demographic profile

WHAT COULD MAKE THE RATING GO DOWN

- Continued trend of operating imbalance causing further decline in reserves
- Material decline in the tax base
- Substantial increase in the debt or pension liability

STRENGTHS

- Sizeable and diverse tax base

CHALLENGES

- Reliance on state aid as a primary revenue source
- Revenue constraints of Proposition 2 ½
- Below average socioeconomic indicators

RECENT DEVELOPMENTS

Over the last five years the city has maintained financial operations through the use of reserves to close budget gaps. The operating imbalance has led to a financial position that remains pressured over the near term and uncharacteristic of the Aa rating category. See the Detailed Rating Rationale for further information.

DETAILED RATING RATIONALE

ECONOMY AND TAX BASE: SIZEABLE AND DIVERSE TAX BASE

Located 20 miles south of Boston (Aaa stable), the city has experienced a five-year average annual decline in equalized valuation (2010-2015) of 6.5%. Brockton's tax base declined from a peak of \$8.2 billion in fiscal 2007 to \$5.6 billion in 2015 due to a large number of foreclosures in 2009 and 2010 followed by a weakened housing market. Positively, the 2015 assessed value increased 1.9% which indicates a leveling off in valuation with limited growth over the medium term. The city's downtown area retains long-term redevelopment potential with proposals to rehabilitate older factory buildings into condominiums, serving residents who commute to Boston by commuter rail. Resident income levels are well below state and national averages, and equalized value per capita is \$61,003. While Brockton remains an important regional employment base, with a significant concentration in health facilities, the city's unemployment rate consistently exceeds those of the Commonwealth and the nation and remains elevated at 6% in May 2015.

Of note, the city is the only site remaining for the state's southeastern casino location. Final approval and construction progression could lead to future tax base and revenue growth for the city. Additionally, the city has an outstanding \$68 million lawsuit brought by developers of a gas-fired power plant. We feel the financial liability could be material given the limited financial flexibility of the city. Although, a settlement of the lawsuit could eventually lead to tax and revenue increases through a PILOT agreement if the power plant proceeds to be built.

FINANCIAL OPERATIONS AND RESERVES: PRESSURED FINANCIAL POSITION IS EXPECTED TO CONTINUE

Brockton's financial position is expected to remain pressured over the near term due to its dependence on state aid, portions of which have declined substantially over the last five years. Compounded by limited tax increases, in some years below the 2.5% limit, the reductions in state aid have contributed to a growing operating imbalance. The imbalance has been reduced by the use of reserves to limit operating deficits which have caused reserves to decline to \$37.6 million (11.4% of revenues) in 2014 compared to \$47.9 million (16.4%) in 2011.

The fiscal 2015 year-end projections reflect another operating deficit of around \$4.3 million due to continued draw down of reserves. The decline is estimated to reduce available general fund balance to \$33.3 million or around 10% of revenues.

The fiscal 2016 budget increased by 3% from the prior year and is balanced with \$2.5 million of prior year unused levy capacity under the lower levy limit and \$13.1 million free cash appropriation towards operations and capital needs. The city expects to have \$3 million in unused levy capacity at the end of fiscal 2016. The city's budget forecast reflects continued budget gaps averaging \$5-8 million through 2021. The gaps represent a limited 1.5% to 2.6% of the total budget but are projected to annually increase over this time period.

Liquidity

The city's cash and investments at the end of fiscal 2014 was \$79.3 million or 24.1% of revenues. Brockton's cash position has remained stable and is expected to maintain this adequate position going forward.

DEBT AND OTHER LIABILITIES: MANAGEABLE DEBT BURDEN WITH LARGE PENSION OBLIGATION

The city's direct debt burden of 2.2% of equalized value is expected to remain slightly elevated but manageable over the medium term given adequate amortization of principal. The city's capital plan has been deferred to some degree given the financial condition although \$13 million in projects have been approved by city council recently and awaiting final approval in September. The city's ability to manage operating and capital needs with taxpayer support will be a key factor in future rating reviews.

Debt Structure

All of the city's debt is fixed rate with 72% of principal retired within ten years. Fiscal 2014 debt service represented 3.6% of expenditures.

Debt-Related Derivatives

The city has no derivatives.

Pensions and OPEB

The city participates in the Brockton Contributory Retirement System, a cost sharing multiple-employer defined benefit pension plan. The city is required to contribute its full ARC payment each year which totaled \$16.1 million or 4.8% of 2014 expenditures. The 2013 Moody's 3-year average adjusted net pension liability equaled \$348.8 million or a moderate 1.12 times general fund revenues. Moody's uses the adjusted net pension liability to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities.

The city currently contributes to its OPEB liability on a pay-as-you-go basis, contributing 42% of its annual OPEB cost in fiscal 2014, representing \$15 million. The total Unfunded Actuarially Accrued Liability (UAAL) for OPEB is \$416.9 million, as of June 30, 2014. The city's total fixed costs for 2014, including debt service, required pension contributions and retiree healthcare payments, represented \$43.1 million or 12.9% of expenditures.

MANAGEMENT AND GOVERNANCE

Massachusetts cities and towns have an institutional framework score of 'Aa' or strong. The primary revenue source for Massachusetts municipalities is property taxes which are highly predictable and can be increased annually as allowed under the Proposition 2 ½ levy limit. Expenditures are largely predictable and cities and towns have the ability to reduce expenditures.

The city implements a conservative budget practice and develops multi-year budget projections, however, Brockton's capital planning is limited for its size.

KEY STATISTICS

- 2015 Full Valuation: \$5.7 billion
- 2015 Full Value Per Capita: \$61,003
- Median Family Income as % of US Median: 88.77%
- Fiscal 2014 operating fund balance as a % of revenues: 11.52%
- 5-Year Dollar Change in Fund Balance as % of Revenues (2010-2014): -8.18%
- Fiscal 2014 Cash Balance as % of Revenues: 24.1%
- 5-Year Dollar Change in Cash Balance as % of Revenues (2010-2014): -0.75%
- Institutional Framework: "Aa"
- 5-Year Average Operating Revenues / Operating Expenditures (2010-2014): 0.99x
- Net Direct Debt as % of Full Value: 2.20%
- Net Direct Debt / Operating Revenues: 0.4x
- 3-Year Average of Moody's ANPL as % of Full Value: 6.08%
- 3-Year Average of Moody's ANPL / Operating Revenues: 1.1x

OBLIGOR PROFILE

The city is primarily residential with a large commercial and industrial sector. Brockton has a population of 93,810 and is located approximately 20 miles south of Boston and is the population center of a metropolitan statistical area.

LEGAL SECURITY

Outstanding general obligation bonds are secured by the city's general obligation limited tax pledge as debt

service has not been voted exempt from the levy limitations of Proposition 2 ½.

USE OF PROCEEDS

Not applicable.

PRINCIPAL METHODOLOGY

The principal methodology used in the underlying rating was US Local Government General Obligation Debt published in January 2014. The principle methodology used in the enhanced rating was State Aid Intercept Programs and Financings: Pre and Post Default published in July 2013. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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