Michael V. O'Brien
City Manager

CITY OF WORCESTER

To: Worcester City Council

From: City Manager Michael V. O'Brien

Date: October 27, 2010

Re: Bond Ratings

I am pleased to inform your Honorable Body that our commitment to fiscal discipline and our efforts of ongoing reforms have again been recognized by the three independent bond rating agencies. All three bond rating agencies—Moody's Investor Services, Fitch Ratings, and Standard and Poor's—have maintained the City's Bond Rating at A1, AA- and A-, respectively.

As you know, these ratings are an indicator of a community's long-term stability, vibrancy, and vitality. All three bond rating agencies cited our strong and progressive management, adherence to our Five Point Financial Plan and fiscal discipline (reserve-building efforts and reality-based budgeting), and strategic infrastructure investments in the community as key factors in their decisions.

We are very pleased by this news, especially in light of the economic challenges that persist globally and nationally. In this brave, new world, creditworthiness is subject to even stricter standards, and these agencies were looking at our City and our actions with a fine-toothed comb.

Our team spent countless hours preparing for these reviews and two full days with these analysts. We delivered a thorough and compelling presentation of our operational and financial management: from our continued efforts to restructure government; to the progress we've made to push our economic development agenda forward; and to our long-term solutions for sustainability. The agencies cited the transfer of the Worcester Regional Airport, the commencement of CitySquare demolition and construction, four PILOT agreements, the implementation of new software to improve services, and our ability to negotiate zero-wage increases and increased health insurance contributions through collective bargaining as significant accomplishments.

I've included a few comments from the attached reports for your information.

- *"Solid financial management has historically preserved limited reserve levels…" (Fitch)*
- *"Strong new development and expansion of business activity within the city should provide economic growth and offset declining taxable values…" (Fitch)*
- *"Demonstrated progress towards building reserve levels to city's 5% policy…"*
- *"Prudent management of city's ample tax levy capacity…" (Fitch)*

All in all, this is a strong and positive signal to investors who hold and purchase our bonds, to potential and prospective developers and businesses owners, and to the residents of our community. We are a solid, long term investment.

However, I must make note of concerns of the analysts: sizable pension liabilities and un-settled labor contracts.

"Worcester will also be challenged to address a large unfunded liability for post employment health benefits (OPEB). As of the most recent actuarial study, as of July 1, 2009, the city's liability dropped to $765 million, down significantly from the prior $1.2 billion liability. The drop captures significant changes in Worcester's health care benefits, including adoption of "Section 18" legislation, which requires participation in Medicare by eligible retirees." (Moody's Investments)

"In our view, these strengths are mitigated, in part, by the city's: large projected levels of fixed pension and other post employment benefits (OPEB) costs." (Standard and Poor's)

"WHAT COULD MAKE THE RATING GO-DOWN: "Unfavorable settlements in collective bargaining contracts" (Moody's Investments)

Both of these issues, pension liabilities and collective bargaining are intertwined and we have been, and remain, focused on the long term. We have made substantial progress addressing our OPEB liability through difficult reforms such as adoption of Section 18 and good-faith collective bargaining resulting in our employees increasing their contribution to their health care costs. These actions have saved tens and tens of millions of taxpayer dollars since re-directed to save jobs and to preserve core municipal services. Equally important, it has reduced our **REAL** liabilities by $435 million dollars.

We are projecting a return to double digit premium increases from our insurance providers for next FY (FY2012) and beyond. Millions of dollars will likely need to be taken away from direct services to sustain these unsustainable increases. Reforms such as joining the State's GIC for our employee health care and additional employee co-pay changes may very well be a necessity just to save jobs, preserve core services and continue to address these real long term liabilities (OPEB $765 Million).

We are deeply appreciative to those municipal employees and unions that have agreed to zeros percent wage increases for FY2010 and to take on more of their health care costs. It has allowed us to remain stable and to reaffirm our long-term footing. Our current budget for FY2011 was not able to build-in wage increases without layoffs. It is clear that our shared goal to weather this economic storm will require this same cooperative approach.

I am grateful to the work of our team: Assistant City Manager Julie Jacobson, Chief Financial Officer Thomas Zidelis, City Auditor James DelSignore, City Treasurer and Collector Mariann Hier Castelli, and Budget Director Jarrett Conner, and Lisa Dickinson and Kim Pare, of Unibank Fiscal Advisors, Inc. for their efforts. I'd like to thank the members of my Cabinet for rising to the challenge and pushing for progress in spite of adversity, and I am most grateful to the Worcester City Council for your support and stewardship.

FitchRatings

FITCH RATES WORCESTER, MA 2010A&B GOS 'AA-'; OUTLOOK STABLE

Fitch Ratings-New York-26 October 2010: Fitch Ratings has assigned an 'AA-' rating to the City of Worcester, MA's (the city) general obligation (GO) bonds as follows:

--$32,654,500 GO municipal purpose loan of 2010, series A;
--$5,050,000 GO DCU special improvement district loan of 2010 bonds, series B.

The bonds are scheduled to sell competitively on Oct. 28, 2010.

In addition, Fitch affirms the city's approximately $548 million outstanding GO bonds at 'AA-'.

The Rating Outlook is Stable.

RATING RATIONALE:
--Solid financial management has historically preserved limited reserve levels, but the city faces continued budget pressures from rising fixed costs and reductions in state aid.

--Ample tax levy capacity under Massachusetts Proposition 2 1/2 partially offsets thin reserve levels.

--Strong new development and expansion of business activity within the city should provide economic growth and offset declining taxable values.

--The stable presence of several higher education and health care institutions anchors the local economy and partially mitigates below-average economic indicators.

--Debt ratios are moderate and amortization is above-average, but the city has future debt needs.

KEY RATING DRIVER:
--Demonstrated progress towards building reserve levels to city's 5% policy in light of increasing wage, health and retirement costs;

--Prudent management of the city's ample tax levy capacity.

SECURITY:
The bonds are a general obligation of the city and payable from taxes levied on all taxable property in the city, subject to statutory levy limitations.

CREDIT SUMMARY:
Worcester is centrally located in the state, about 39 miles west of Boston, and reportedly has over $2 billion in developmental projects that are ongoing or in the proposal stage. Included in these plans is the $563 million mixed-use CitySquare project which, after some long delays, has secured new investors. The first phase of construction is underway for an office building to house Unum Group's new headquarters. In addition, a $100 million commuter rail expansion project is in the planning stages and is anticipated to provide a new rail terminal and 20 new commuter trains from Boston, increasing the attractiveness of Worcester as an alternative to Boston. According to city management, these are just a few of the ongoing and expansive development efforts taking place to help revitalize the city's core. This new development bodes well for the city as it potentially helps offset recent declines in taxable assessed values (TAV) as a result of the recession. The city's TAV declined 11% from fiscal 2009 levels to $10.9 billion as a result of the Jan. 1, 2009 revaluation.

Income levels within the city continue to be lower than state and national averages with median household income equivalent to 66% of state and 84% of national levels. Unemployment remains high at 10.8% as of August 2010 compared to 10.5% state and national rates of 8.3% and 9.5%, respectively. The presence of 10 higher education and several healthcare institutions provides stability to the local economy. The city has experienced growth in its population base which stands at approximately 182,596, up 5.85% from 2000.

The city's financial position improved slightly in 2010, with projections for a general fund surplus of $5.9 million which would increase general fund reserves to approximately $12 million or 2.25% of spending and transfers. The city's 5% general fund balance policy is given little weight in Fitch's rating, as the city has historically maintained much weaker balances of 1.5% to 2.5% of spending and transfers. The city's five-point program, implemented in fiscal 2007, restricts the use of free cash at year end to build up reserves. The city's finances have been pressured the last few years due primarily to state aid cuts, increases in employee benefits, and a weakness in economically sensitive revenues. These same pressures continue for FY2011 and 2012. The city was able to negotiate a 0% wage increase through fiscal 2010; the fiscal year 2011 budget assumes a 0% increase but is subject to continued union negotiations. Negotiations have netted increased contributions from employees for healthcare costs which has alleviated some budget pressure but lower expected revenues from the state and other local sources are expected to pressure operations in fiscal 2012.

On a positive note, the city successfully negotiated the sale of its airport to MassPort providing $14.4 million in cash which the city has prudently distributed to various departmental city operating funds to help offset certain liabilities, including $2 million to an escrow for future OPEB liabilities, $2 million in reserve for future potential state aid cuts and $2 million applied towards the city's fiscal 2011 budget as one-time revenues. Included in this year's budget is a 5% tax increase for general operations which includes the use of $2 million in unused levy capacity to be applied towards the improvements of streets and sidewalks. The city is subject to the state's Proposition 2 1/2 tax levy limits, but a $10 million margin in taxing capacity (5% of property tax revenue) under the levy limit provides some financial flexibility.

Debt ratios, excluding self-supporting debt, are moderate with debt per capita at $2,519, and debt to market value at 3%. The debt amortization rate is rapid with 70% paid off in 10 years. The city has a debt policy that imposes an inflation-adjusted limit on annual levy-supported debt service which was lowered to $15 million from $17.9 million during the difficult fiscal years of 2009 and 2010. The city has indicated it will stay within the inflation-adjusted limit, but Fitch expects debt levels will rise as the city continues to invest in its infrastructure.

The city's pension funded ratio was 69% as of Jan. 1, 2010, recouping some of the large decrease in asset values suffered during calendar 2008. Officials indicated that they extended the amortization schedule from 2030 to 2040 to provide funding relief as its contribution requirements are increasing. The city intends to continue funding 100% of the annual required contributions which equated to $29.8 million for fiscal 2010. Several changes to healthcare benefits, better than projected experience, and implementation of Chapter 32B Section 18 (which requires in part that retirees use Medicare at age 65), contributed to a significant actuarial drop of $432 million in the city's future OPEB liability. The city's OPEB liability was valued at a still high $793M as of June 30, 2010. Funding has been pay-as-you-go as the city has been focusing its efforts on pension funding.

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Additional information is available at 'www.fitchratings.com'.

In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, LoanPerformance, Inc., and IHS Global Insight.

Applicable Criteria and Related Research:
'Tax-Supported Rating Criteria', dated Aug. 16, 2010;
'U.S. Local Government Tax-Supported Rating Criteria', dated Oct. 8, 2010.

Applicable Criteria and Related Research:
Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=548605
U.S. Local Government Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=564566

MOODY'S
INVESTORS SERVICE

New Issue: MOODY'S ASSIGNS A1 TO CITY OF WORCESTER'S (MA) $37.7 MILLION GO BONDS

Global Credit Research - 26 Oct 2010

AFFIRMATION OF RATING AFFECTS $580 MILLION OF OUTSTANDING GO DEBT

Municipality
MA

Moody's Rating

ISSUE		RATING
General Obligation Municipal Purpose Loan of 2010 Bonds, Series A		A1
Sale Amount	$32,654,500	
Expected Sale Date	11/01/10	
Rating Description	General Obligation Limited Tax	
DCU Special Improvement District Loan of 2010 Bonds, Series B		A1
Sale Amount	$5,050,000	
Expected Sale Date	11/01/10	
Rating Description	General Obligation Limited Tax	

Opinion

NEW YORK, Oct 26, 2010 -- Moody's Investors Service has assigned an A1 rating to the City of Worcester's $32.6 million General Obligation Municipal Purpose Loan of 2010 Bonds, Series A and $5 million General Obligation DCU Special Improvement District Loan of 2010 Bonds, Series B. Concurrently, Moody's has affirmed the A1 rating on the city's $542.3 million of outstanding general obligation limited tax debt.

RATINGS RATIONALE

Both series of bonds are secured by the city's general obligation, limited tax pledge as debt service has not been excluded from the levy limitations of Proposition 2 ½. The Series A bonds are being issued to permanently finance a like amount of maturing BANs originally issued for fiscal 2010 capital needs, including approximately $17.6 million in self-supporting enterprise and other non-general fund capital projects. The Series B bonds, which are subject to Federal and Massachusetts Income Taxation, are issued to finance improvement at the city's convention center. The A1 rating incorporates the city's satisfactory overall credit profile, despite a narrow reserve position and limited financial flexibility after significant reductions in state aid. The rating also incorporates management's commitment to implementation of its five-point financial management plan to establish long-term operating stability and enhanced reserves, anticipated medium-term expansion in the city's substantial economic base, which is anchored by multiple health and higher education institutions, and the city's above-average debt position which is expected to remain elevated for the medium term.

FINANCIAL POSITION STRAINED BY STATE AID REDUCTIONS AND SLUGGISH LOCAL REVENUES

Due to significant reductions in state aid in fiscal 2009 and 2010, Moody's expects Worcester's financial position to remain relatively narrow in the near term, but stabilize over the medium term as expenditure controls and a more conservative budgeting approach bring the city's operating budget closer to structural balance. After a $5 million mid-year state aid cut and a $3 million snow removal overexpenditure, fiscal 2009 general fund balance dropped to $6.1 million. Significant expenditure reductions, including 130 layoffs, were imposed to mitigate the impact and to prepare for future budgets to include flat state aid projections. Available reserves, including unreserved general and stabilization fund balances, rose to roughly $10 million, a very slim 1.9% of revenues. The city's adopted budget is balanced with additional layoffs and vacancies which total over 200 since fiscal 2008, as well as 80 additional position reductions due to an early retirement incentive. Operations in fiscal 2010 were favorable, and a $5.9 million increase in fund balance is projected. Including over $6.5 million in combined stabilization funds, available reserves are projected to increase to $14.7 million, a still-narrow 2.78% of revenues.

Worcester has built a sizeable $12 million cushion of excess property tax levy capacity, and the city balanced the fiscal 2010 budget without tapping into this margin. The city does plan to use $2 million of tax levy capacity for the adopted fiscal 2011 budget, however, which includes a modest 2.1% overall expenditure increase. Most department budgets are level-funded, although the snow removal budget increased by 10% as part of a phased-in approach to increase it to more realistic levels. Notably, the budget does not include any subsidy for the Worcester Municipal Airport. Ownership was transferred to Massport (Revenue bonds rated Aa3/stable outlook), relieving the city of operating responsibility and netting roughly $14 million in compensation and reimbursement. After budgeting roughly $3 million for the fiscal 2011 operating budget, net proceeds are expected to be earmarked for future debt service and various capital needs as well as a $2 million reserve for potential mid-year state aid cuts in fiscal 2011.. The city remains in compliance with its five-point plan by appropriating roughly $14.9 million to various reserve funds in fiscal 2011. A contingency reserve of $300,000, reduced from $1 million in prior years, has been budgeted to absorb unanticipated needs. Moody's notes that state aid revenue is likely to remain flat, at best, for the medium term, and balancing future operating budgets while building reserve levels consistent with the city's adopted fiscal policies will remain a challenge for Worcester without additional sources of revenue. Furthermore, limited additional use of Worcester's excess levy capacity to build financial flexibility is not likely to put negative pressure on the city's credit strength.

The city's water and sewer enterprises are expected to remain fully self-supporting, and recently-enacted rate increases will offset increases in operating expenses and debt service. In the long term, Worcester will also be challenged to address a large unfunded liability for post-employment health benefits (OPEB). As of the most recent actuarial study, as of July 1, 2009, the city's liability dropped to $765 million, down significantly from the prior $1.2 billion liability. The drop captures significant changes in Worcester's health care benefits, including adoption of

"Section 18" legislation, which requires paritcpation in Medicare by eligible retirees. Fully funding the Annual Required Contribution (ARC) would have called for annual funding in fiscal 2010 of $49.5 million, a significant increase over the fiscal 2010 appropriation of $21 million. City management is evaluating strategies for managing the cost of post-employment health benefits and for funding the liability, which include reserving a portion of the airport proceeds. The city remains moderately dependent on state aid, with over 55% of fiscal 2009 General Fund revenues received from the commonwealth, while property taxes accounted for the second largest revenue source at 37% of revenues. Although bank foreclosures have risen recently, tax collections remain strong, averaging 98% over the past five years, and the city has initiated an aggressive delinquent tax collection program.

IMPLEMENTATION OF COMPREHENSIVE POLICIES TO BUILD RESERVE LEVELS AND PROMOTE FISCAL STABILITY

The city's management team has begun frequent financial reporting to the city council to improve projections and enable timely mid-year adjustments when necessary. Additionally, the city has initiated long-range planning designed to stabilize the city's financial position and to replenish reserves. The city's management expects to receive up to $28.5 million in reimbursements over a 10-year period from the commonwealth from school building construction costs, and has earmarked these additional payments entirely for reserves, including anticipated appropriations of $10 million to the capital campaign stabilization fund, with the balance to be used to construct a new high school, and to offset future general fund capital debt service expenses. The city anticipates a modest $1.14 million in free cash to be certified by the state later in fiscal 2011 and plans to transfer roughly $500,000 into its "bond rating stabilization" as required by the five-point plan. Worcester continues to pursue opportunities to optimize the design of its health insurance plans to keep current costs and long-term liabilities manageable. Adherence to the city's five point plan and other adopted policies will be critical to maintaining Worcester's long-term credit strength.

MODERATE DECLINES IN TAX BASE; CITY IS REGIONAL CENTER FOR UNIVERSITIES AND HEALTH CARE

Moody's anticipates that Worcester, now the second most populous city in New England, may experience additional contraction in its large $10.9 billion tax base. Despite aggressive economic revitalization efforts, which leverage the city's medical and higher education sectors, assessed values dipped 10% in fiscal 2010, primarily reflecting weak residential market conditions. Equalized value for fiscal 2011, reflecting market values on January 1, 2010, dropped 13.7%, reversing a period of solid growth averaging 11.2% annually from 2003 to 2009. City officials note that potential medium-term development could total up to $1.3 billion, including the $565 million redevelopment of the 20-acre CitySquare parcel, which recently broke ground and is expected to add 2.14 million square feet of mixed-use development. Restoration of Worcester Common, Union Station Bus Terminal improvements, redevelopment of the North Main Street District and expansion of the CSX freight terminal are expected to add $435 million to the tax base in the medium term. The additional development, along with improvements to the Union Station intermodal transportation center serving MBTA commuter rail trains, Amtrak and bus service, as well as several commercial tenants, are expected to further enhance the already favorable location of the city, roughly equidistant - approximately 44 miles -- to the cities of Boston (G.O. rated Aaa/stable outlook) and Providence, Rhode Island (G.O. rated A1).

The city continues to demonstrate below-average socioeconomic indices as noted in the income levels that are approximately 70% of statewide medians. This is partially reflects the large health care and educational components of the base, which also represent a number of the city's top employers, including the UMass Memorial Medical Center (Baa1/stable outlook), College of the Holy Cross (Aa3/stable outlook), Clark University (A2/stable outlook), Worcester Polytechnic Institute (A1/stable outlook), Worcester State College (A2/stable outlook), and Massachusetts College of Pharmacy and Allied Health Sciences (A3/stable outlook). Unemployment historically trends higher than state and national averages and increased to 10.8% in August 2010, ahead of the state and national jobless rates of 8.3% and 9.5%, respectively. College students account for roughly 17% of the city's total 175,011 population and moderately depress income levels, which are low at roughly 86% of the national median for personal and median family incomes. Preliminary projections for the 2010 U.S. Census indicate population growth of up to 6% in Worcester. Equalized value per capita is also relatively modest at $67,624 but increases to an average $84,200 when considering the value of tax-exempt property in the city, estimated at $2.9 billion.

ABOVE-AVERAGE DEBT BURDEN SUPPORTED BY ENTERPRISE REVENUE

Moody's believes that Worcester's above-average 4.7% overall debt burden will continue to make a large claim on general fund operations (8.5% of fiscal 2009 General Fund expenditures) given the sizeable level of outstanding debt, below-average amortization of principal (64.8% repaid within 10 years), and approximately $354 million in authorized but unissued debt. Significant state school construction reimbursement (90%) mitigates the overall debt burden to a more affordable 3.8%, while water and sewer enterprise revenues support approximately $116 million in utility debt, approximately 19% of the city's outstanding obligations. The city's debt burden, which includes short-term bond anticipation notes, loans from the state revolving fund and fixed-rate general obligation bonds, is unusually high due to the issuance of $221 million of pension obligation bonds in 1998, which now represents just under one-third (28%) of the city's total outstanding long-term debt. Although the city initially eliminated its unfunded liability, several cycles of weak investment returns resulted in the pension system's funded ratio to fall below 70% in fiscal 2009. Worcester's capital improvement plan is under review and is likely to be more modest than previous plans in response to weak economic forecasts. Moody's expects Worcester's debt burden to remain above-average, with pressure on the general fund reduced somewhat by self-supporting enterprise debt, roughly $4 million in stabilization funds earmarked for future capital and debt service, together with anticipated increasing annual five point plan appropriations dedicated to capital funding. To reduce pressure on future general fund budgets, fiscal 2010 general fund borrowing was scaled back to approximately $15 million, w below Worcester's general fund annual debt cap of approximately $17 million. Fiscal 2011 general fund borrowing is expected at roughly $15 million issued throughout the fiscal year, along with additional enterprise debt. Worcester has no exposure to variable or auction rate debt or swap agreements.

WHAT COULD MAKE THE RATING GO-UP:

"Sustained trend of operating surpluses and reserve replenishment

"Improved financial flexibility through conservative budgeting

WHAT COULD MAKE THE RATING GO-DOWN:

"Decline in available reserves

"Increase in debt burden

"Unfavorable settlements in collective bargaining contracts

"Erosion of tax base through valuation declines or instability of higher education or health care institutions

"Lack of progress in funding long-term liabilities

KEY STATISTICS

2008 Population (estimated, US Census): 175,011 (+1.4% since 2000)

2008 Estimated Student Population: 31,000 (17.8%)

2000 Per Capita Income: $18,614 (71.7% of commonwealth, 86.2% of nation)

2000 Median Family Income: $36,261 (69.7% of commonwealth, 85.9% of nation)

Unemployment (August 2010): 10.8% (MA 8.3%, US 9.5%)

2011 Equalized Value: $11.8 billion (-13.7% since 2009)

2011 Equalized Value per capita: $67,624

Average Annual Equalized Value Growth (2005-2011): 3.4%

FY 2009 General Fund Balance: $11.9 million (2.2% of General Fund revenues)

FY 2010 General Fund Balance (unaudited): $6.1 million (1.2% of General Fund revenues)

FY 2009 Combined Stabilization Fund balances: $5 million (0.9% of General Fund revenues)

FY2010 Combined Stabilization Fund balances (unaudited): $8.2 million (1.5% of General Fund revenues)

Overall debt burden (unadjusted, includes pension obligation bonds): 4.7%

Overall debt burden, adjusted for school construction reimbursement: 3.8%

Amortization of principal (10 years): 64.8%

Long-term general obligation debt outstanding: $580 million

The principal methodology used in rating Worcester (City of) MA was General Obligation Bonds Issued by U.S. Local Governments rating methodology published in October 2009. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found on Moody's website.

REGULATORY DISCLOSURES

Information sources used to prepare the credit rating are the following: parties involved in the ratings, parties not involved in the ratings, public information, confidential and proprietary Moody's Investors Service's information, confidential and proprietary Moody's Analytics' information.

Moody's Investors Service considers the quality of information available on the credit satisfactory for the purposes of assigning a credit rating.

MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

Please see ratings tab on the issuer/entity page on Moodys.com for the last rating action and the rating history.

The date on which some Credit Ratings were first released goes back to a time before Moody's Investors Service's Credit Ratings were fully digitized and accurate data may not be available. Consequently, Moody's Investors Service provides a date that it believes is the most reliable and accurate based on the information that is available to it. Please see the ratings disclosure page on our website www.moodys.com for further information.

Please see the Credit Policy page on Moodys.com for the methodologies used in determining ratings, further information on the meaning of each rating category and the definition of default and recovery.

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Credit Profile		
US$37.705 mil GO mun purp loan of 2010 bnds dtd 11/01/2010 due 11/01/2035		
Long Term Rating	A-/Stable	New
US$3.221 mil GO BANs dtd 11/05/2010 due 06/05/2012		
Short Term Rating	SP-1+	New

Rationale

Standard & Poor's Ratings Services assigned its 'SP-1+' rating to Worcester, Mass.' bond anticipation notes (BANs) and its 'A-' rating, with a stable outlook, to the city's general obligation bonds, series 2010 A and B. At the same time, we affirmed our 'A-' long-term rating and underlying rating (SPUR), with a stable outlook, on the city's existing long-term debt.

The ratings reflect our opinion of the city's general creditworthiness and demonstrated market access.

The ratings also reflect what we view as Worcester's:

- Diversifying local economy, which continues to shift to the service sector from manufacturing and benefits from the presence of 10 colleges and universities and a strong health care sector;
- Large and diverse property tax base that provides the city with, in our opinion, a large $12 million of levy space under commonwealth-wide levy limits, although there was a significant reduction in assessed value (AV) for fiscal 2010; and
- Good financial management policies.

In our view, these strengths are mitigated, in part, by the city's:

- Recent general fund deficits; and
- Large projected levels of fixed pension and other postemployment benefits (OPEB) costs.

The city's full faith and credit pledge secures the bonds and BANs, and the BANs are also secured by the city's legal authority to refinance the notes with long-term debt. The long-term debt to retire the BANs has been authorized. We understand that officials will use BAN and bond proceeds for a variety of projects.

Worcester, with an estimated population of 175,090, is the secondmost populous city in New England. The city is 40 miles west of Boston, and it serves as a commercial and industrial center in central Massachusetts. Good highway and rail access facilitates transportation throughout the region and into Boston. City income levels have historically been below commonwealth and national averages. In our opinion, median household effective buying income is an adequate 71% of the commonwealth's level and 83% of the nation's level; per capita effective buying income is similar. We consider, however, that the city's large student population somewhat deflates these income indicators.

The Worcester region has a large concentration of jobs in the biomedical industry, providing more than 7,500 jobs and $1 billion in economic activity. The city's Biotech Park contains more than 20 companies employing in excess of 2,000, but there is room for expansion. Despite the city's role as a regional economic center, unemployment remains above commonwealth and national rates; city unemployment in August 2010 was 10.8%.

Worcester's financial position declined in fiscal 2009, but city management estimates that it improved in fiscal 2010. Fiscal 2009 ended with a deficit of $5.8 million, although $3.1 million of this is for a snow removal deficit that is being raised on the fiscal 2010 tax levy. The deficit brought the unreserved general fund balance to $6.1 million. The stabilization fund increased to $6.6 million, in accordance with the city's "five point" financial plan—although officials intend to use $2.7 million of this fund for future capital projects—and the combined $12.7 million position was equal to 2.4% of expenditures, which we consider to be adequate. The city's state aid was cut midyear by approximately $5 million. The 2009 budget was reduced through 130 layoffs and the elimination of about 80 positions that had been held vacant from the beginning of the year; officials began planning for potential state cuts early in the fiscal year.

Management estimates that the unreserved fund balance increased to $10.6 million at the end of fiscal 2010, on an unaudited basis. Management also estimates the stabilization fund to add an additional reserve of about $5.7 million, for a combined financial position around 3% of expenditures. The fiscal 2011 budget projects an 8% decrease in local receipts. Worcester used $2.0 million of the available levy capacity for fiscal 2011, and balanced the budget without the use of reserves; the budget contains a $2.0 million contingency for potential additional state aid cuts. Most of the city's collective bargaining contracts are currently expired.

Worcester recently sold its airport to a state agency, and received $12.4 million of cash at closing, with another $2.0 million being held pending negotiations on OPEB expenditures for airport employees. Management has stated that $3.1 million will be reserved for future debt service, $2.0 million is for general 2011 expenditures, and $2.7 million for capital expenditures.

Standard & Poor's considers Worcester's financial management practices "good" under its Financial Management Assessment. This indicates financial practices exist in most areas but that governance officials might not formalize or regularly monitor all of them.

Worcester's debt burden remains moderate, in our opinion, with overall net debt at about $2,015 per capita, or 3.2% of market value. In our view, carrying charges were moderate at 9% in fiscal 2009, and amortization is above average at 65% over 10 years. The city is not engaged in any swaps or variable-rate debt.

Outlook

The stable outlook on the long-term rating and SPUR reflects Standard & Poor's view of management's demonstrated ability to make budget adjustments, along with Worcester's large amount of unused levy capacity, which provides revenue-raising flexibility. Although, in our opinion, the city's financial position is currently adequate, a significant decline could lead to a downgrade.

Economy

The city's large property tax base exhibits little taxpayer concentration. Worcester's AV declined by 10% from fiscal 2009 to fiscal 2010, to $10.91 billion, but despite the drop, the per capita market value of $62,300 remains strong, in our opinion. As of fiscal 2010, the city's excess levy capacity under the commonwealth's Proposition 2 1/2 levy limit is $12 million, which is among the commonwealth's highest. The city increased the tax rate sufficiently to produce a 4.8% increase in the levy. The residential sector was the main AV sector that declined. We view concentration as low, with the 10 leading taxpayers accounting for 8% of total AV. Property tax collections, which accounted for about 40% of fiscal 2009 general fund revenues, are sound in our opinion; current collections were nearly 99% in fiscal 2009, while total collections, including penalties, were about 100% in recent years.

The property tax base stands to get a substantial boost from numerous ongoing economic development projects planned or under construction. The largest is a $560 million mixed-use project known as CitySquare, which is in the preliminary phase. The Unum Group recently signed a 17-year lease for a to-be-constructed 214,000-square-foot building, which is projected to lead to the demolition of the existing structure on the site and construction of the building, scheduled to begin in fall 2010.

Finances

As of Jan. 1, 2010, the unfunded actuarial accrued liability in the city's pension fund increased to $308.2 million—a 67% funded level—up from a $130.5 million liability as of Jan. 1, 2008. Worcester has been making 100% of the annual required contribution for its pension fund. The commonwealth recently approved legislation allowing communities to extend the final amortization date for their pension fund from 2028 to 2040, which the city will adopt as a way to lessen the pension contribution increases arising from the investment losses.

The city recently received an updated actuarial valuation of its OPEB, dated as of July 1, 2009, which reduced the unfunded liability to $765.3 million from the prior valuation of $1.15 billion, with the difference due primarily to an improvement in experience levels and a reform of the city's retiree health care plan—enabled under Section 18 of Chapter 32B of commonwealth law—that reduced projected costs. The annual OPEB cost for fiscal 2010 was calculated to be $53.4 million. Worcester is funding its OPEB expenses on a current basis and has not yet included funding in its budget to amortize this liability.

Related Criteria And Research

- USPF Criteria: GO Debt, Oct. 12, 2006
- USPF Criteria: Short-Term Debt, June 15, 2007

Ratings Detail (As Of 27-Oct-2010)		
Worcester GO		
Long Term Rating	A-/Stable	Affirmed
Worcester GO (wrap of insured) (FGIC & AGM) (SEC MKT)		
Unenhanced Rating	A-(SPUR)/Stable	Affirmed
Worcester GO (ASSURED GTY)		
Unenhanced Rating	A-(SPUR)/Stable	Affirmed
Worcester GO		
Unenhanced Rating	A-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.