S&P Global Ratings

RatingsDirect®

Summary:

Andover, Massachusetts; General Obligation

Primary Credit Analyst:
Christian Richards, Boston (1) 617-530-8325; christian.richards@spglobal.com

Secondary Contact:
Anthony Polanco, Boston + 1 (617) 530 8234; anthony.polanco@spglobal.com

Table Of Contents

Summary:

Andover, Massachusetts; General Obligation

Credit Profile		
US$16.325 mil GO mun purp loan of 2018 bnds due 11/15/2048		
Long Term Rating	AAA/Stable	New
Andover GO		
Long Term Rating	AAA/Stable	Affirmed
Andover GO mun purp ln		
Long Term Rating	AAA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AAA' long-term rating to Andover, Mass.' series 2018 general obligation (GO) municipal-purpose loan bonds and affirmed its 'AAA' rating on the town's existing GO debt. The outlook is stable.

Andover's full-faith-and-credit pledge, subject to the limitations of Proposition 2-1/2, secures the bonds. However, due to the town's revenue-raising ability and fungibility of those resources, we rate the limited obligation at the same level with our view of Andover's general creditworthiness. We rate the limited-tax GO debt based on the application of our "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" criteria (published Jan. 22, 2018, on RatingsDirect).

Andover's GO bonds are eligible for a rating above the sovereign because we believe the town can maintain better credit characteristics than the nation in a stress scenario. Under our criteria, titled "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions" (published Nov. 19, 2013, on RatingsDirect), the town has a predominately locally derived revenue source, with 75% of general fund revenue from property taxes; and independent taxing authority and independent treasury management from the federal government.

Officials plan to use series 2018 bond proceeds to fund various capital items highlighted in the town's capital improvement plan (CIP).

The long-term rating reflects our expectation that Andover will continue to experience economic growth. We further expect management, with well-embedded financial policies and practices, to continue producing positive financial results over the next several years.

The long-term rating further reflects our view of the following factors for the town, including its:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with an operating surplus in the general fund and a slight operating surplus at the

total governmental fund level in fiscal 2017;

- Strong budgetary flexibility, with an available fund balance in fiscal 2017 of 10.9% of operating expenditures;
- Very strong liquidity, with total government available cash at 20.1% of total governmental fund expenditures and 4.0x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability position, with debt service carrying charges at 5.0% of expenditures and net direct debt that is 51.0% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 71.6% of debt scheduled to be retired in 10 years, but a large pension and other postemployment benefit (OPEB) obligation and the lack of a plan to sufficiently address it; and
- Strong institutional framework score.

Very strong economy

We consider Andover's economy very strong. The town, with an estimated population of 35,119, is in Essex County in the Boston-Cambridge-Newton MSA, which we consider to be broad and diverse. It has a projected per capita effective buying income of 196% of the national level and per capita market value of $222,080. Overall, market value grew by 1.7% over the past year to $7.8 billion in 2018. The county unemployment rate was 3.8% in 2017.

Andover is a primarily residential town, accounting for approximately 81% of total assessed value (AV). The town's location, approximately 25 miles north of Boston, on Interstates 93 and 495, provides residents with access to a broad range of employment opportunities across the deep and diverse MSA economy. Additionally, area commuter rail stations enable easy travel to downtown Boston.

We believe the town's favorable location is a contributing factor to its strong economic profile. Locally, it maintains a sizable and diverse high-end economic base; large employers include Raytheon Co. (4,750 employees); the Internal Revenue Service (3,500), which operates a regional service center; Phillips Medical (2,000); Pfizer (1,200); and Putnam Investments (900). We note that Philips, along with Eisai, two of the town's top ten taxpayers, are relocating out of Andover. Management reports that the properties are being marketed and the town does not anticipate any material loss of revenue. Furthermore, management reports that the past two years were among the largest for new AV growth, with approximately $2.4 million-$2.6 million added to the tax levy each year.

Unemployment has historically remained below both commonwealth and national rates and has shown resilience in past economic downturns. We expect that Andover will continue to benefit from its physical location and that management will continue to seek out opportunities to further develop the tax base, as it is currently doing through rezoning and redevelopment opportunities both downtown and near the commuter rail station. Consequently, we expect that the town will maintain a very strong economy.

Very strong management

We view the town's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

The town uses identified trends and commonwealth estimates to develop annual revenue and expenditure assumptions, which it then uses to update its five-year budget forecast for complementing capital and budgetary planning. Management regularly monitors its budget, tracks revenue and expenditures, and reports budget-to-actual results to the finance committee at a minimum on a monthly basis. The town performs midyear budget adjustments, if needed, during special town meetings. It also has a five-year CIP and a capital budget that management approves and reprioritizes annually. The town adheres to a formal debt management policy when planning and addressing capital needs, including a policy that limits debt service in any one year to 10% of budgeted general expenditures, and targets principal amortization at 20 years. It has a formal reserve policy of maintaining reserves between 3% and 7% of expenditures, which it has exceeded recently.

Strong budgetary performance

Andover's budgetary performance is strong, in our opinion. The town had surplus operating results in the general fund of 2.6% of expenditures, and slight surplus results across all governmental funds of 1.2% in fiscal 2017.

We adjusted fiscal 2017 budgetary performance to account for recurring transfers and the expenditure of bond proceeds. Management's continued focus on its budgeting practices has consistently generated better-than-budgeted revenue performance and departmental expenditure savings over the past several years, which in fiscal 2017 again led to strong budgetary performance. Management is predicting fiscal 2018 to end similarly to fiscal 2017, with positive operating results and an addition to fund balance.

The 2019 budget is an approximately 4.1% increase from fiscal 2018, to $185.7 million. Property taxes accounted for 75% of fiscal 2017 audited general fund revenues, and state revenues account for only 17% of general fund revenues. Local collections remain strong, exceeding 99%.

Given 2018 estimates and management's track record of producing at least balanced results, along with generally stable credit conditions in the region, we believe that general fund and total governmental fund performance should remain stable and strong. However, while we expect our evaluation of Andover's budgetary performance to remain strong given the town's history of conservative budgeting and pending revenues from new growth; we believe future pension and OPEB costs could become a budgetary pressure due to the respective funding ratios and closed amortization schedule. We note management is actively making budgetary adjustments when needed for these costs, and is actively working to reduce the unfunded liability. The town is funding the actuarially determined contribution for pensions and has begun to prefund OPEBs. Nevertheless, we believe these liabilities could strain future operations, particularly if economic conditions worsen and actuary assumptions are not met.

Strong budgetary flexibility

Andover's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2017 of 10.9% of operating expenditures, or $19.2 million.

We anticipate Andover's available reserves will remain stable and at levels we consider strong, given the expectation for continued strong budgetary performance and the stable credit environment.

Very strong liquidity

In our opinion, Andover's liquidity is very strong, with total government available cash at 20.1% of total governmental fund expenditures and 4.0x governmental debt service in 2017. In our view, the town has strong access to external liquidity if necessary.

Andover has maintained very strong cash balances over the past three fiscal years. We note the town does not have any contingent liquidity risk from financial instruments with payment provisions that change on the occurrence of certain events. We do not consider any of the town's investments risky. Additionally, we believe it demonstrated its strong access to external liquidity, through its issuance of GO bonds over the past 20 years. We expect Andover's liquidity profile to remain very strong throughout the outlook period.

Strong debt and contingent liability profile

In our view, Andover's debt and contingent liability profile is strong. Total governmental fund debt service is 5.0% of total governmental fund expenditures, and net direct debt is 51.0% of total governmental fund revenue. Overall net debt is low at 1.3% of market value, and approximately 71.6% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

Following this issuance, Andover has approximately $119.6 million of total direct debt. Of that amount, we consider roughly $19.4 million of enterprise-related GO debt self-supporting, based on three years of evidence that user charges have provided partial coverage to support the obligations. We expect that the town will continue to issue new-money debt in accordance with its CIP. We do not expect this to alter our view of its debt profile, particularly given its rapid principal amortization schedule.

In our opinion, a credit weakness is Andover's large pension and OPEB obligation, without a plan in place that we think will sufficiently address it. Andover's combined required pension and actual OPEB contributions totaled 7.6% of total governmental fund expenditures in 2017. Of that amount, 4.4% represented required contributions to pension obligations, and 3.2% represented OPEB payments. The town made its full annual required pension contribution in 2017. The funded ratio of the largest pension plan is 42.8%.

The town contributes to the Andover Contributory Retirement System, a defined-benefit pension plan. As of June 30, 2017, the system has a funded ratio of 42.83%, which we view as very poorly funded. The system's net pension liability is approximately $165 million, of which the town's proportionate share is about $164 million. The system uses a 6.25% discount rate to calculate the pension liability, which we believe is conservative.

The town also provides OPEBs in the form of a health insurance, through a single-employer defined-benefit health care plan. As of June 30, 2017, the town's OPEB trust fund contained approximately $7.7 million in assets, resulting in a new OPEB liability of about $129 million. Management reports that the value of the trust has grown to $9.9 million, as of June 30, 2018. Andover has adopted a plan to fully fund its OPEB liability over the next 36 years. Notably, management has also made adjustments to benefits within the collective bargaining negotiations. Any cost savings from benefit changes are directed into the trust.

While pension and OPEB costs are currently manageable as percentage of expenditures, due to the retirement system's below-average funded ratio, we believe this will be a growing cost and could weaken Andover's budgetary performance over the longer term. If, over time, management continues with its funding plan, with clear reductions in unfunded liabilities, we could revise our view of the town's pension and OPEB profile.

Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

Outlook

The stable outlook reflects our view that Andover's management will continue producing consistent financial performance, leading to maintenance of strong budgetary flexibility. The town's very strong underlying economy and liquidity, in addition to its strong debt profile, provide rating stability. We do not expect to lower the rating in our two-year outlook horizon. Although unlikely, should budgetary performance and flexibility see sustained and significant deterioration, we could lower the rating.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- Local Government Pension And Other Postemployment Benefits Analysis: A Closer Look, Nov.8, 2017