S&P Global Ratings

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Summary:

Andover, Massachusetts; General Obligation

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Credit Profile		
US$15.631 mil GO mun purp loan ser 2017 due 11/15/2047		
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' rating to Andover, Mass.' series 2017 general obligation (GO) municipal-purpose loan bonds and affirmed its 'AAA' rating on the town's existing GO debt.

The town's full faith and credit pledge, subject to limitations of Proposition 2-1/2, secure the bonds. Despite limitations imposed by the commonwealth's levy limit law, we did not make a rating distinction for the limited-tax GO pledge due to the town's flexibility under the levy limit.

Officials plan to use series 2017 bond proceeds to fund various capital items highlighted in the town's capital improvement plan (CIP).

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 77% of general fund revenue from property taxes; and independent taxing authority and independent treasury management from the federal government.

The long-term rating reflects our view of Andover's:

- 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 break-even operating results at the total governmental fund level in fiscal 2016;
- Strong budgetary flexibility, with an available fund balance in fiscal 2016 of 8.8% of operating expenditures;
- Very strong liquidity, with total government available cash at 19.1% of total governmental fund expenditures and 3.2x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges at 6.0% of expenditures and net direct debt that is 47.9% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 74.6% of debt scheduled to be retired in 10 years, but significant

medium-term debt plans and 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 34,924, 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 175% of the national level and per capita market value of $219,485. Overall, market value grew by 1.6% over the past year to $7.7 billion in 2017. The county unemployment rate was 3.8% in 2016.

Andover is well situated at the crossroads of Interstates 93 and 495, providing residents with access to a broad range of employment opportunities across the deep and diverse MSA economy. 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. (3,300 employees), missile systems;
- The Internal Revenue Service (2,340), which operates a regional service center;
- Phillips Corp. (2,000), medical electronics;
- Wyeth BioPharma (1,835); and
- Phillips Academy (1,186), a private school.

Unemployment has historically remained below both commonwealth and national rates and has shown resiliency in past economic downturns.

The town's property tax base is roughly 80% residential and 18% commercial and industrial. New taxable levy growth has averaged about 2% annually over the past several years, and we believe this will continue over the near term, reflecting ongoing economic development, particularly downtown.

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 1.6% of expenditures, and balanced results across all governmental funds of 0.2% in fiscal 2016. General fund operating results of the town have been stable over the last three years, with results of 0.5% in 2015 and 2.0% in 2014.

For fiscal 2016, the town did report a negative $2.6 million general fund operating result on a GAAP basis. However, the deficit reflected a one-time $5.2 million transfer to purchase land ($2.2 million) and set-aside reserves for the Ledge Road Landfill fund ($3.0 million). Excluding those transfers and also making further adjustments to account for spending of bond proceeds, budgetary performance remained strong.

Management's continued focus on its budgeting practices is generating better-than-budgeted revenue performance and departmental expenditure savings. The town has invested in capital from available reserves, leading to declines in certain balances, but operations overall have been stable and continue to benefit from a strong economy.

For the fiscal 2017 year, management is reporting a budgetary surplus of $4.5 million, led by a $2.7 million revenue surplus and roughly $1.8 million in unspent appropriations. Management cited higher excise tax receipts, along with increases in licenses and permits. Additionally, the town's internal service funds, used to account for its health benefit accounts, also posted an operating surplus of $641,000, improving overall cash balances in that account.

Given these estimates, and the stable credit conditions in the region, we believe that general fund and total governmental fund performance should remain stable and strong. The 2018 municipal budget is balanced at $178 million, a 4.2% increase from its 2017 budget. Property taxes account for 77% of general fund revenues, and collections remain strong, exceeding 98%. State revenues account for only 13% of general fund revenues.

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 liabilities. 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 or business conditions worsen and actuary assumptions are not met or revised or they are found inadequate at current levels.

Strong budgetary flexibility

Andover's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2016 of 8.8% of operating expenditures, or $14.4 million.

The town's available reserves (unassigned and assigned general fund balances) have been stable for several years. Based on current estimates, available reserves should improve $19.1 million, or about 11% of expenditures.

Looking ahead, we anticipate reserves will remain stable and at current levels given the strong budgetary performance and stable credit environment. We have noted that the town has spent down some stabilization funds for capital in the past and acknowledge that that spending was planned and in line with its long-term capital improvement strategy and not at levels that would substantially deteriorate reserve position.

Very strong liquidity

In our opinion, Andover's liquidity is very strong, with total government available cash at 19.1% of total governmental fund expenditures and 3.2x governmental debt service in 2016. In our view, the town has strong access to external liquidity if necessary.

Our opinion is that liquidity will remain very strong as there is no significant deterioration of cash balances planned or anticipated. Further, 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.

Adequate debt and contingent liability profile

In our view, Andover's debt and contingent liability profile is adequate. Total governmental fund debt service is 6.0% of total governmental fund expenditures, and net direct debt is 47.9% of total governmental fund revenue. Overall net debt is low at 1.3% of market value, and approximately 74.6% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors. Negatively affecting our view of the town's debt profile is its significant medium-term debt plans.

Including the bond issue, Andover has roughly $113 million of total direct debt. Of that amount, we have excluded roughly $19.4 million of enterprise-related GO debt based on three years of evidence that user charges have provided partial coverage to support the obligations.

Over the next year, the town will begin issuing debt to fund a municipal services facility and also continue to fund improvements to its wastewater infrastructure, but given its aggressive amortization schedule, we do not anticipate any significant changes to its debt profile.

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 2016. Of that amount, 4.3% represented required contributions to pension obligations, and 3.3% represented OPEB payments. The town made its full annual required pension contribution in 2016. The funded ratio of the largest pension plan is 41.7%.

The town contributes to the Andover Contributory Retirement Board. The pension system, a defined-benefit pension plan, maintains a fiduciary net position as a percentage of the total pension liability of 41.8% and a net pension liability of $159.7 million. These figures are based on a 6.25% discount rate, which is conservative. While pension costs are currently manageable as percentage of expenditures, due to the retirement system's below-average funded ratio, we believe this will remain a growing cost over the next few years and likely challenge budgetary performance.

Additional long-term credit considerations include the town's long-term OPEB liabilities. As of June 30, 2015, the latest actuarial valuation date, the OPEB unfunded actuarial accrued liability was $188 million. Andover established an OPEB trust fund and contributed 41% of the actuarially required contribution in 2016. The current balance in the trust is $9.6 million, up from $7.6 million the previous year.

Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

Outlook

The stable outlook reflects our view of Andover's continued consistent financial performance with very strong management conditions contributing to strong 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 due to our expectation that the town will maintain strong budget flexibility and financial performance. Although unlikely, should budgetary performance and flexibility deteriorate significantly, we could lower the rating.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.