

RatingsDirect®

Summary:

Andover, Massachusetts; General Obligation

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Credit Profile

US\$165.0 mil GO pension bnds due 11/01/2039		
<i>Long Term Rating</i>	AAA/Stable	New
US\$28.045 mil GO mun purp loan of 2021 bonds due 09/15/2051		
<i>Long Term Rating</i>	AAA/Stable	New
Andover GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Andover GO mun purp ln		
<i>Long Term Rating</i>	AAA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' rating to Andover, Mass.' series 2021 general obligation (GO) municipal-purpose loan bonds (\$28.045 million) and its series 2021 general obligation pension bonds (\$165 million) and affirmed its 'AAA' rating on the town's existing GO debt. The outlook on all ratings is stable.

The town's full-faith-and credit pledge, subject to Proposition 2 1/2 limitations, secures the bonds and outstanding GO debt. We rate this issuance based on the application of our criteria "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness," published Nov. 20, 2019. Despite limitations imposed by the commonwealth's levy limit law, we did not make a rating distinction between the town's limited- and unlimited-tax GO pledges.

Andover's GO bonds are eligible for a rating above the sovereign because we think 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, the town has a predominately locally derived revenue source with property taxes generating 75% of general fund revenue. The town also has independent taxing authority and treasury management from the federal government.

Officials plan to use series 2021 municipal purpose loan bond proceeds to fund various capital items and to permanently finance existing short-term debt. Proceeds of the 2021 pension obligation bonds (POB) will be paid to the Andover Retirement System and will be applied to the unfunded pension liability of the town.

Credit overview

The rating reflects Andover's local economy, which is characterized by very high wealth levels, with a large residential base and a strong commercial presence. The town has historically maintained its reserve levels at about 10% while also adhering to a comprehensive capital improvement plan, funded largely on a pay-go basis. We expect management, with well-embedded financial management policies and practices, will likely continue to produce at least break-even results. Town voters recently approved the issuance of \$175 million in POBs to fund the town's

outstanding pension liability; town voters additionally approved the exemption of \$87.5 million of the bonds from the limitations of Proposition 2 1/2, which provides the town with levying capacity should it be needed. In 2019, town employees also agreed to either a 1% deduction in pay to contribute to the unfunded liability or forego a cost of living adjustment, which is expected to yield \$250,000 to be allocated to the pension reserve. While the current issuance is expected to significantly increase in debt service payments, we expect the POBs will provide fixed-cost savings over the life of the bond and maintain the town's long-term liabilities.

The rating also reflects our opinion of the town's:

- Extremely wealthy, residential economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Formalized and comprehensive financial management policies support consistent operational results;
- Financial performance and fund balance levels diligently managed to balance operating needs; and
- Issuance of POBs, which weakens the debt profile, though a low discount rate (5.75%) and increased taxing capacity somewhat mitigates risk.

Environmental, social, and governance

We analyzed Andover's social, environmental, and governance risks relative to its economy, management, financial measures, and debt and liability profile and determined that all are in line with our view of the sector standard.

Stable Outlook

Downside scenario

Should the town's budgetary performance and flexibility experience sustained and significant deterioration, we could lower the rating.

Credit Opinion

Deep tax base with a largely residential economy anchored by robust commercial presence

Andover's has an estimated population of 36,182 and is located in Essex County in the Boston-Cambridge-Newton, Mass.-N.H. MSA, which we consider to be broad and diverse. While the town is primarily residential, accounting for approximately 82% of total assessed value (AV), the town's commercial base is robust. Top taxpayers include Columbia Gas of Massachusetts, Genetics Institute Inc (Pzifer), and Raytheon Co.; top 10 taxpayers total to 11.7% of the tax base. 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, with commuter rail stations facilitating travel to Boston and the region.

License and permitting has remained strong, with investment in commercial and residential development demonstrating stability, with new growth equal to about \$2 million, which is in line with its 10-year average.

Detailed and forward-looking management strategies and formalized policies

The town uses 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 monthly. The town is permitted to make midyear budget adjustments, if needed, during special town meetings. It also has a five-year capital improvement plan 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. The town is taking steps to mitigate cyber security risk.

Conservative budgeting and reliable revenue sources facilitate stable operations

The town's fiscal year end is June 30. Its primary revenue source is property tax (74%), followed by intergovernmental revenues (7.1%), and local tax and fee revenues (6.4%).

The town's operational results for fiscal 2020 (\$194 million) were positive at about 2% of budget, resulting in adding approximately \$4.4 million to reserves; this is attributed to conservative budgeting and a spending freeze implemented as a result of the pandemic. The town's fiscal 2021 budget totaled \$202.5 million. The budget included adjusted revenues assumptions (reduced by about 30%) for hotel, motel and meals tax revenues, and motor vehicle excise tax revenues (reduced by about 15%). The town's revenues outperformed the budget by about \$1.2 million in building permits and program revenues, in particular, while the town's property tax revenue collections were strong (99.6%). The fiscal 2021 results will also include a transfer to the capital projects fund and a one-time use of free cash for a land purchase. Andover's fiscal 2022 budget totals \$208 million, a 2.9% increase over the previous year's budget. Currently, revenues and expenditures are tracking with budget; while assumptions for hotel/motel/meals tax revenues are still lower than pre-pandemic levels, they are slowly increasing. The fiscal 2022 budget also includes a \$3 million transfer to the capital project fund.

The town is allotted to receive \$10.8 million in American Rescue Plan Act funds. These monies are expected to fund a variety of operational needs such as economic development, infrastructure projects to expand capacity, and social services/mental health.

As of fiscal 2020, the town's fund balance totaled 12% of general fund expenditures. The town's unaudited fiscal 2021 results show available reserves at about \$21 million, or 10.3% of expenditures. We anticipate Andover's available reserves will remain stable and at levels we consider strong. Our view of the town's financial profile could change should reserve levels fall below 8% of general fund expenditures.

Andover has maintained very strong cash balances over the past three fiscal years. 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.

Weak debt and contingent liability profile

Following this issuance, Andover has approximately \$306.3 million in total direct debt. The \$165 million pension obligation bond issuance, combined with the \$28 million issuance, more than doubles the town's previous debt burden. Of the total direct debt, we consider roughly \$16.9 million of enterprise-related GO debt self-supporting, based on several years of evidence that user charges have provided partial coverage to support the obligations. The town expects to issue about \$5.2 million over the next two to three years for various school renovation projects. We do not anticipate this issuance will impact our view of the town's debt score.

Pension and other postemployment benefits (OPEB)

In fiscal 2020 (prior to the issuance of the series 2021 POBs), Andover's combined required pension and actual OPEB contributions totaled 8.0% of total governmental fund expenditures. Of that amount, 5.0% represented required contributions to pension obligations, and 2.9% represented OPEB payments. The town made its full annual required pension contribution in 2020.

After the issuance of the series 2021 POBs, we calculate that the town's total governmental debt service is expected to increase to about 8% of total governmental fund expenditures from 4.7% and net direct debt will rise to 130% of total governmental fund revenue from 46.9%. This issuance will fully fund the town's outstanding pension liability. For more on our view of POBs, see our report "Pension Obligation Bonds' Credit Impact On U.S. State And Local Government Issuers," published Dec. 6, 2017, on RatingsDirect.

The pension contributions and funded ratios used in our analysis reflect pro forma figures following the issuance of the POBs. We do not view pension and OPEB liabilities as an immediate source of credit pressure for Andover given that the POB will refinance the town's pension liability into a fixed-debt obligation. However, if poor investment performance or other experience changes generate new liability--particularly if such liability occurs earlier in the amortization period--then the town risks having to pay both the debt service costs on the bonds and higher pension contributions, eliminating potential payment savings from the transaction.

Andover participated in the following plans as of June 30, 2020:

- Andover Contributory Retirement System: 49.7% funded, \$162.9 million net pension liability.

The town's net OPEB liability was \$117.1 million at the end of fiscal 2020. In 2017, the town began funding an OPEB trust, which had a net position of \$14.9 million at the end of fiscal 2020, or about 12.7% of the liability.

Institutional framework score

The institutional framework score for Massachusetts municipalities is strong.

Andover, Massachusetts Key Credit Metrics				
	Most recent	Historical information		
		2020	2019	2018
Very strong economy				
Projected per capita EBI % of U.S.	186			
Market value per capita (\$)	249,507			
Population		36,182	35,782	35,392

	Most recent	Historical information		
		2020	2019	2018
County unemployment rate(%)		9.8		
Market value (\$000)	9,027,671	8,799,009	8,321,337	
Ten largest taxpayers % of taxable value	7.3			
Strong budgetary performance				
Operating fund result % of expenditures		2.2	(0.2)	(0.1)
Total governmental fund result % of expenditures		0.9	1.1	2.5
Strong budgetary flexibility				
Available reserves % of operating expenditures		12.0	10.2	10.4
Total available reserves (\$000)		24,213	19,690	19,227
Very strong liquidity				
Total government cash % of governmental fund expenditures		31	30	23
Total government cash % of governmental fund debt service		656	643	502
Very strong management				
Financial Management Assessment	Strong			
Weak debt & long-term liabilities				
Debt service % of governmental fund expenditures		4.7	4.7	4.6
Net direct debt % of governmental fund revenue	130			
Overall net debt % of market value	3.2			
Direct debt 10-year amortization (%)	52			
Required pension contribution % of governmental fund expenditures		5.0		
OPEB actual contribution % of governmental fund expenditures		2.9		
Strong institutional framework				

EBI--Effective buying income. OPEB--Other postemployment benefits. Data points and ratios may reflect analytical adjustments.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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