

RatingsDirect®

Summary:

Andover, Massachusetts; General Obligation; Note

Primary Credit Analyst:

Victor M Medeiros, Boston (1) 617-530-8305; victor.medeiros@spglobal.com

Secondary Contact:

Anthony Polanco, Boston 617-530-8234; anthony.polanco@spglobal.com

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Credit Profile

US\$6.155 mil GO muni purp loan ser 2016 due 09/15/2036

Long Term Rating AAA/Stable New

US\$2.004 mil GO BANs dtd 12/16/2016 due 06/15/2017

Short Term Rating SP-1+ New

Andover GO

Long Term Rating AAA/Stable Affirmed

Rationale

S&P Global Ratings assigned its 'AAA' rating to Andover, Mass.' series 2016 general obligation (GO) municipal-purpose loan bonds and affirmed its 'AAA' rating on the town's existing GO debt. At the same time, we assigned our 'SP-1+' short-term rating to the town's series 2016 GO bond anticipation notes (BANs), which mature on June 15, 2017.

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.

The 'SP-1+' BAN rating reflects our opinion that the town will maintain a very strong ability to pay principal and interest when the notes are due. In our opinion, Andover has a low market-risk profile because it maintains strong legal authority to issue long-term debt to take out the notes and it is a frequent issuer that regularly provides ongoing disclosure to market participants.

Officials plan to use series 2016 bond proceeds to fund various capital items highlighted in the town's capital improvement plan.

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 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 operating results that we expect could improve in the near term relative to fiscal 2015, which closed with a slight operating surplus in the general fund but an operating deficit at the total

governmental fund level in fiscal 2015;

- Strong budgetary flexibility, with an available fund balance in fiscal 2015 of 9.0% of operating expenditures;
- Very strong liquidity, with total government available cash at 19.7% of total governmental fund expenditures and 3.2x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability position, with debt service carrying charges at 6.1% of expenditures and net direct debt that is 50.3% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 75.4% 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 costs from escalating; and
- Strong institutional framework score.

Very strong economy

We consider Andover's economy very strong. The town, with an estimated population of 34,658, is in Essex County 22 miles north of Boston. It is in the Boston-Cambridge-Newton MSA, which we consider to be broad and diverse. It has a projected per capita effective buying income of 193% of the national level and per capita market value of \$217,626. Overall, market value grew by 4.3% over the past year to \$7.5 billion in 2016. The county unemployment rate was 5.2% in 2015.

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/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 in 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 capital 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. The town 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 slight surplus operating results in the general fund of 0.5% of expenditures, but a deficit result across all governmental funds of negative 1.7% in fiscal 2015. Our assessment accounts for the fact that we expect budgetary results could improve from 2015 results in the near term. General fund operating results of the town have been stable over the last three years, with results of 2.0% in 2014 and 0.3% in 2013.

Andover's budgetary performance has been strong. After adjusting for one-time capital outlay funded by bond and BAN proceeds in the capital and school projects funds, it has closed with positive operating results for several years in the general fund.

Management's continued focus on its budgeting practices has led to 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 have been stable overall.

For the fiscal 2016 year, management is reporting a budgetary surplus of \$3.6 million, led by a \$2.6 million revenue surplus and \$1 million in unspent appropriations. Management cited higher excise tax receipts, along with increases in licenses and permits. Given these projections, we believe that general fund and total governmental fund results will remain similar to years past, particularly given the stable credit conditions in the region. Property taxes account for 77% of general fund revenues, and collections have historically been strong. State revenues account for only 13% of general fund revenues.

The 2017 municipal budget is balanced at \$170 million, a 3.5% increase from its 2016 budget.

Strong budgetary flexibility

Andover's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2015 of 9.0% of operating expenditures, or \$14.0 million.

The town's available reserves (unassigned and assigned general fund balances) have been stable for several years. While it recently spent down some stabilization funds for capital, we acknowledge those were planned and in line with its long-term capital improvement strategy.

Looking ahead, we anticipate reserves to remain stable and at current levels given the strong budgetary performance and stable credit environment.

Very strong liquidity

In our opinion, Andover's liquidity is very strong, with total government available cash at 19.7% of total governmental fund expenditures and 3.2x governmental debt service in 2015. 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.

Strong debt and contingent liability profile

In our view, Andover's debt and contingent liability profile is strong. Total governmental fund debt service is 6.1% of total governmental fund expenditures, and net direct debt is 50.3% of total governmental fund revenue. Overall net debt is low at 1.2% of market value, and approximately 75.4% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

Including the bond and BAN issues, Andover has roughly \$107.8 million of total direct debt. Of that amount, we have excluded roughly \$23.1 million of enterprise-related GO debt based on three years of evidence that user charges have provided coverage to support the obligations.

Over the next year, the town may begin issuing debt to fund a municipal services facility, 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. The town has a plan to fund the liabilities, but we anticipate annual costs will continue to escalate. Its combined required pension and actual OPEB contributions totaled 8.1% of total governmental fund expenditures in 2015. Of that amount, 3.5% represented required contributions to pension obligations, and 4.6% represented OPEB payments. The town made its full annual required pension contribution in 2015. The funded ratio of the largest pension plan is 51.5%.

The town contributes to the Andover Contributory Retirement Board. The pension system, a defined-benefit pension plan, maintains a fiduciary net position as a percent of the total pension liability of 51.5% and a net pension liability of \$108.3 million. While pension costs are currently manageable, 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 pressure 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 town's OPEB unfunded actuarial accrued liability was \$184 million. Andover established an OPEB trust fund and contributed 64% of the ARC in 2015. The current balance in the trust is \$5.4 million.

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.

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

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.globalcreditportal.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.

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