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Summary:

Avon, Massachusetts; General Obligation

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Summary:

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Credit Profile		
US$1.78 mil GO rfdg bnds due 10/01/2027		
Long Term Rating	AA+/Stable	New
Avon Twn GO mun purp loan of 2019 bnds		
Long Term Rating	AA+/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to the Avon, Mass.' series 2020 general obligation (GO) refunding bonds and affirmed its 'AA+' long-term rating on the town's existing GO debt. The outlook is stable.

Avon's full-faith-and-credit-GO pledge secures the bonds. We understand that the town voted to exclude a portion of the debt service from this issuance from the limitations of Proposition 2-1/2. Despite limitations imposed by the commonwealth levy limit law, we did not make a rating distinction between the limited-tax GO pledge and Avon's general creditworthiness because the tax limitation imposed on the town's ability to raise revenue is already embedded in our analysis of the town's financial and economic conditions.

Bond proceeds, along with approximately $1.3 million in pay-downs, will refund two series of outstanding GO debt for a present value savings.

Credit overview

Avon enters the national recession triggered by the outbreak of COVID-19 with very strong budgetary reserves and flexibility, and improved financial management policies. Supporting the long-term rating are the town's consistent economic growth and positive operating results over the past two years. Pension and other postemployment benefit (OPEB) costs are manageable, but could present a budgetary challenge over the next few years due to our expectation of rising costs.

While we note significant uncertainty around certain revenue shortfalls and potential state aid cuts that could weaken the town's performance as it heads into fiscal year 2021, we understand management has already taken measures to cushion the effects of potential revenue shortfalls and has additional measures at its disposal that it could implement should significant cuts happen. Lending further stability to the rating and the outlook is the town's very strong liquidity and stable revenue mix, with the predominant revenue stream of property taxes, which have historically been collected upward of 99% during the fiscal year payable. That said, given that there is still much uncertainty related to the potential effects of COVID-19 and the ensuing economic recession on the town's finances, we will continue to monitor for any material adverse effects throughout the outlook period. For more information on the coronavirus' effect in U.S. Public Finance, please see our reports titled "The COVID-19 Outbreak Weakens U.S. State And Local Government Credit Conditions" (published April 2, 2020 on RatingsDirect) and "The U.S. Faces A Longer And Slower Climb From

The Bottom" (published June 25, 2020).

The long-term rating further reflects our assessment of the town's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Adequate management, with standard financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 66% of operating expenditures;
- Very strong liquidity, with total government available cash at 46.2% of total governmental fund expenditures and 7.6x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges at 6.1% of expenditures and net direct debt that is 62.1% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value, but a large pension and OPEB obligation; and
- Strong institutional framework score.

Environmental, social, and governance factors

We evaluated the town's environmental, social, and governance (ESG) factors relative to its economy, financial measures, management, and debt and long-term liability profile. We acknowledge, absent the implications of COVID-19, we consider the town's social risks in line with those of the sector. We view environmental risks and their potential effect on taxable properties average relative to peers. Management, however, has been proactive in addressing risks by working to obtain grants through the state's Municipal Vulnerability Preparedness Program. We view its governance risks as in line with the sector.

Stable Outlook

Downside scenario

If operating performance deteriorates, due to COVID-19-related revenue or expenditure pressures or rising fixed costs, resulting in a draw on reserves, we could lower the rating.

Upside scenario

Continued diversification and growth of the town's tax base, in addition to demonstrated implementation of strengthened financial policies and planning documents, could result in upward rating movement over time.

Credit Opinion

Very strong economy

We consider Avon's economy very strong. The town, with a population of 4,393, is in Norfolk 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 114% of the national level and per capita market value of $197,616. Overall, market value grew by

6.3% over the past year to $868.1 million in 2020. The county unemployment rate was 2.5% in 2019.

Generating the town's strong market value per capita is the significant commercial and industrial presence in the community. Residential property accounts for approximately 58% of the tax base, while industrial and commercial property accounts for 37%. Growth in the tax base has been steady since the last recession and officials report that despite COVID-19-related health and economic pressures, officials continue to have significant conversations with commercial developers and there has been little slowdown in permitting activity over the past few months.

Over the long run, we expect Avon to continue to attract investment, resulting in growth in the tax base. However, rapidly evolving economic conditions due to the pandemic have significantly affected the labor market (see "U.S. Jobs Market Buckles Under The Coronavirus Pandemic," published April 2, 2020). While the regional economy showed resilience in the past recession, high unemployment, particularly if it exceeds 10%, is a risk we are monitoring. Additionally, if recessionary pressures persist, economic activity could slow, potentially limiting growth in the tax levy, or potentially pressuring the tax collection rate. At this time, we do not expect a change in our view of the town's economic profile, but will continue to monitor effects on its financial performance.

Adequate management

We view the town's management as adequate, with standard financial policies and practices under our FMA methodology, indicating the finance department maintains adequate policies in some, but not all, key areas.

The town recently completed an overhaul of its financial management policies, through a collaboration with the Collins Center at the University of Massachusetts. The Collins Center works with municipalities to improve their respective governance practices. Under this partnership, Avon adopted new financial and budget guidelines, as well as policies and planning tools. We will continue to monitor how the town implements and updates certain practices over time and revise our view of the management environment accordingly.

As part of the new policies, the town's capital improvement plan (CIP) is more robust, with guidelines for managing its capital investment strategy. It historically updates its CIP annually, and we expect the new, five-year CIP will also be updated annually as part of the budget process. For fiscal 2022, the town expects to implement a new long-term financial forecast tool, which we will evaluate on completion and implementation. While the new policies do not include a formal debt policy, we will evaluate how the town incorporates debt planning within its new budgetary frameworks.

The town also formally adopted state limitations on investments, and the new policy requires regular updates to the board and town administrator. The new reserve policy requires it to maintain 5% of budgeted revenues in its general stabilization fund. It also includes use and replenishment clauses, and is based on the GFOA's best practice recommendations.

As the town works to incorporate new policies and practices, its general practices remain similar to those of prior years. It has demonstrated that revenue and expenditure estimates are conservative, as they regularly outperform the budget. Officials perform historical trend analysis when drafting the budget and review with department heads. The finance department monitors budget performance regularly, and reports budget-to-actuals monthly to the board. Budgetary amendments or changing spending patterns are done at town meetings, as necessary, with the approval of the selectmen.

Strong budgetary performance

Avon's budgetary performance is strong, in our opinion. The town had operating surpluses of 7.0% of expenditures in the general fund and 6.8% across all governmental funds in fiscal 2019. General fund operating results of the town have been stable over the last three years, with results of 7.7% in 2018 and 6.5% in 2017.

Due to the sudden rapid economic deterioration, we have revised our budgetary performance assessment to adequate from strong. This assessment incorporates heightened near-term uncertainty that exists due to the recessionary pressures related to the COVID-19 pandemic and resulting financial pressures. Over the past three years, the town has consistently produced very strong budgetary performance, reflecting large surpluses in the general fund. It is expecting a relatively smaller surplus in fiscal 2020 of approximately $800,000, with revenues and expenditure both outperforming the budget. This will partially offset the expected use of $1.3 million from reserves that the town expects to expend as part of the current refunding.

For fiscal 2021, the town cut budgeted state aid 20%, relative to fiscal 2020. It also cut departmental budgets, eliminated vacant positions, reduced its contribution to the OPEB trust, and cut budgeted local receipts and lowered expected growth in the property tax levy. Management is working to ensure incurred COVID-19-related expenditures are reimbursable by FEMA or through the CARES Act. Providing stability is the town's high reliance on property taxes, which in fiscal 2019 accounted for about 74% of general fund audited revenues. Intergovernmental)including pass-through payments) was about 14% and the motor vehicle excise tax was about 4%. While the town's collection rate could drop somewhat from its roughly 99% average, we expect the predominance of the levy will be paid promptly. We believe management is taking proactive steps to insulate the town's finances from potential revenue and expenditure variances. However, we incorporated the uncertain environment into our forward-looking view of its budgetary performance.

Very strong budgetary flexibility

Avon's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 66% of operating expenditures, or $17.4 million. We expect the available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

The town has maintained high reserve levels for the past several years. It has several stabilization accounts for specific uses, the two largest being the general stabilization and the methyl tertiary butyl ether (MTBE) stabilization account. The town's general stabilization fund has a current balance of $2.7 million, as of June 30, 2019 (approximately 10.2% of general fund audited expenditures). This account is its main rainy day reserve. Avon established the MTBE fund following a water contamination settlement in 2009. The intent of the fund is to use proceeds for any remediation or potential clean-up. The current balance in this fund is $4.2 million. While the town expects to expend reserves for the current issuance, given the high reserve levels we do not expect a change in the overall flexibility profile.

Very strong liquidity

In our opinion, Avon's liquidity is very strong, with total government available cash at 46.2% of total governmental fund expenditures and 7.6x governmental debt service in 2019. In our view, the town has strong access to external liquidity if necessary.

Avon is a regular market participant that issues GO debt frequently. It does not have any variable-rate or direct-purchase debt, nor does it have any contingent liquidity risks from financial instruments with payment provisions that change on the occurrence of certain events. The town's investment policy mirrors state law, and it mostly invests in near-cash, short-term investments such as certificates of deposit and money market funds, which we consider relatively safe. While it could experience some variance in its cash on hand due to delayed collections in the current health and economic environment, we do not expect a material deterioration in its liquidity profile.

Adequate debt and contingent liability profile

In our view, Avon's debt and contingent liability profile is adequate. Total governmental fund debt service is 6.1% of total governmental fund expenditures, and net direct debt is 62.1% of total governmental fund revenue. Overall net debt is low at 2.2% of market value, which is, in our view, a positive credit factor.

Following this issuance, the town will have approximately $19.2 million in direct debt. It currently does not anticipate issuing any new debt over the next several years. The school department has begun examining its future needs, but it is too early in the process to determine if any school projects will move ahead or what effect they could have on the town's debt profile.

In our opinion, a credit weakness is Avon's large pension and OPEB obligation. Its combined required pension and actual OPEB contributions totaled 7.8% of total governmental fund expenditures in 2019. Of that amount, 4.5% represented required contributions to pension obligations, and 3.3% represented OPEB payments. The town made its full annual required pension contribution in 2019. The funded ratio of the largest pension plan is 58.4%.

Pension and other postemployment benefits

- In our opinion, a credit weakness is Avon's large pension and OPEB obligation. While annual costs remain manageable, we expect costs will rise given the size of the liability and low funded ratios.
- Additionally, while the pension plan uses an actuarially determined contribution (ADC), we believe some of the assumptions are likely to lead to cost escalation and volatility.
- The town is prefunding its OPEB liability in a trust, but we believe costs and the total liability are likely to grow.

The town participates in the following retirement plans:

- Norfolk County Retirement System: 58.4% funded, $12.0 million net pension liability
- Single-employer defined-benefit health care plan (OPEB): 7.9% funded, $15.2 million net OPEB liability

Avon's combined required pension and actual OPEB contributions totaled 7.8% of total governmental fund expenditures in 2019. Of that amount, 4.5% represented required contributions to pension obligations, and 3.3% represented OPEB payments. The town made its full annual required pension contribution in 2019, which it is required to do annually. While the pension plan exceeded our static and minimum funding progress metrics in the most recent year, indicating it is making progress in addressing current costs and the unfunded liability, we believe some of plan's assumptions may underestimate the liability and could lead to cost growth and volatility. While we generally view closed, short amortization periods positively, Avon's nine-year schedule is likely to lead to escalating costs due to the level-percent basis and low funded ratio. The plan's 7.75% discount rate is high, in our opinion, and could lead to contribution volatility. While we believe costs are currently manageable for Avon, we expect they will rise. The town is working to adopt a formal OPEB funding policy, which would require 2% of townwide salaries to be added to the trust annually, consistent with the town's practice over the past few years. In 2019, Avon contributed about 63% of the OPEB ADC. Given expected growth in health care costs, we believe growth in the liability is likely to outpace contributions and costs will continue to rise.

Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020