Rationale

S&P Global Ratings assigned its 'AA+' rating to Avon, Mass.' series 2019 general obligation (GO) municipal-purpose loan bonds. The outlook is stable.

Security and use of proceeds

The town's full-faith-and-credit pledge, subject to Proposition 2-1/2 limitations, secures the GO debt. Despite commonwealth levy-limit laws, we did not make a rating distinction between Avon's limited-tax GO pledge and its general creditworthiness because our analysis of its financial and economic conditions already includes the tax limitation imposed on its revenue-raising ability.

Officials intend to use series 2019 bond proceeds in part to refund outstanding bond anticipation notes (BANs), and provide additional funds toward a police facility design and construction, along with other infrastructure improvements.

C**redit overview**

In our view, Avon has maintained very strong budgetary flexibility through historically balanced financial operations, with available reserves currently at an extraordinary high level as a percentage of general fund expenditures. We believe Avon's economic base, while small, benefits by its connection to regional economic centers in the Boston metropolitan statistical area (MSA), contributing to growth in total assessed value (AV) in both residential and commercial properties. Also underpinning the rating are steady management conditions, with formal policies and plans that the town adheres to and updates accordingly. Therefore, absent a substantial reversal of budgetary performance and flexibility or a deterioration in its wealth and income conditions, we believe Avon's credit quality will remain stable.

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

- Very strong economy, with access to a broad and diverse 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 2018;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 62% of operating expenditures;
- Very strong liquidity, with total government available cash at 43.8% of total governmental fund expenditures and 7.5x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges at 5.8% of expenditures and net direct debt that is 78.4% of total governmental fund

revenue, as well as low overall net debt at less than 3% of market value, but a large pension and other postemployment benefit (OPEB) obligation; and
- Strong institutional framework score.

Very strong economy

We consider Avon's economy very strong. The town, with an estimated 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 116% of the national level and per capita market value of $185,881. Overall, market value grew by 0.9% over the past year to $816.6 million in 2019. The county unemployment rate was 3.0% in 2018.

Generating the town's strong market value per capita is the significant commercial and industrial presence within the community. Residential property accounts for approximately 56% of the tax base, while industrial and commercial property accounts for 36%. Growth in the tax base has been steady since the recession and officials report several initiatives underway that should cater to additional expansion. The value associated with building permit activity was at its highest point in more than five years, totaling $5.3 million in 2018, and virtually double the five-year average. For fiscal 2019, at the midpoint of the calendar year the town is reporting $1.9 million in building permit value, again likely meeting or exceeding the five-year average. In our view, this is suggestive that new tax levy growth will be in line, if not modestly improve, in the next few years.

The tax base is slightly concentrated with the 10 leading taxpayers accounting for 21% of AV and net tax levy. They are mainly retail-oriented, which adds a bit of risk. However, officials report no significant appeals or vacancies that would weaken town operations.

Ultimately, the town economy benefits from its participation in the Boston MSA. Growth in the region has been robust over the years, and unemployment in Avon has generally tracked at or near the state average.

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's finance department monitors budget performance regularly, and reports budget-to-actuals monthly. Budgetary amendments or changing spending patterns are done at town meetings, as necessary, with the approval of the selectmen.

Regarding the budget process, officials perform historical trend analysis when drafting the budget and submitting it to department heads. The town has proven to be prudent on its estimating, as revenue and expenditure estimates are conservative and have outperformed the budget regularly.

The town does not do any formal long-term revenue and expenditure forecasting but it is working on establishing a more formal plan. In addition, Avon engaged a third party to produce a more comprehensive rolling five-year capital plan. There is no formal debt management policy, but management has demonstrated the practice of being aggressive in its debt amortization, and maintaining a level principal debt service schedule.

Statutory provisions in state law guide the town's investments and holdings with reporting submitted regularly to selectmen by the town treasurer for review.

Finally, Avon does not have a formal general fund reserve policy, but maintains a minimum reserve target for its general stabilization account of 10% of expenditures. The town has a practice of setting up several reserve accounts for unique purposes, providing additional flexibility in resource management.

Management will look to adopt more formal policies in the future, particularly in the areas of capital planning and reserves and liquidity.

Very strong budgetary performance

Avon's budgetary performance is strong, in our opinion. The town had operating surpluses of 7.7% of expenditures in the general fund and 6.1% across all governmental funds in fiscal 2018. Notably, general fund operating results have been stable over the last three years, with results of 6.5% in 2017 and 8.6% in 2016.

The town has produced an operating surplus in each of the last six years, bolstering its financial position significantly. According to officials, the town ended fiscal 2018 with positive operations due to its maintaining good controls on expenditures and being conservative with revenues.

Estimated results show a similar outcome for fiscal 2019. The town expects to end the year with a $1.2 million general fund surplus due to higher-than-budgeted taxes and miscellaneous fees and other local revenues, as well as savings in expenditures.

The fiscal 2020 budget totals $25.7 million, which is virtually flat over the previous year. Property taxes generate 80% of general fund revenue, with intergovernmental aid contributing 9%. We consider tax collections strong and stable, averaging 98% for the past five audited fiscal years.

Overall, management expects finances to remain stable. We anticipate the town may draw on certain stabilization funds in the next few years, although it will be for specific uses that were previously planned for. In our opinion, the town has no immediate costs challenging its budget outside of its increasing pension and OPEB costs. Nevertheless, given its recent results, we expect budgetary performance to remain strong as it has been proactive and prudent in budgetary matters.

Very strong budgetary flexibility

Avon's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 62% of operating expenditures, or $15.6 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 consistently maintained extraordinarily high reserve levels for the past several years, with current estimates showing that reserves improved again in 2019 by roughly $1.6 million.

Avon maintains 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 $2.6 million in 2019 (approximately 10% of general fund expenditures). This account is the town's main rainy day reserve and it will likely not draw on it except for emergency purposes. Management is developing a policy that would replenish this account any time it falls below 10% of general fund expenditures.

The town 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 $4.1 million (about 16%). The town has no plans to use any of these funds, but on occasion management transfers investment income to the general fund.

The fiscal 2020 budget is stable and we do not envision any drawdown in the town's two main accounts. There could be some use of reserves related to the special police stabilization account (current balance $1.3 million) and the special Butler Parking stabilization account ($358,000). Overall, however, we anticipate the town's financial reserves and budgetary flexibility will remain very high.

Very strong liquidity

In our opinion, Avon's liquidity is very strong, with total government available cash at 43.8% of total governmental fund expenditures and 7.5x governmental debt service in 2018. In our view, the town has strong access to external liquidity if necessary.

Avon is a regular market participant that has issued debt frequently for the past several years. 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. We expect Avon's liquidity to remain very strong over the next two years.

Adequate debt and contingent liability profile

In our view, Avon's debt and contingent liability profile is adequate. Total governmental fund debt service is 5.8% of total governmental fund expenditures, and net direct debt is 78.4% of total governmental fund revenue. Overall net debt is low at 2.8% of market value, which is, in our view, a positive credit factor.

Following this issuance, the town will have approximately $23 million in direct debt. It currently does not anticipate issuing any new debt over the next several years. Notably, based on current bonding plans, our calculations for debt amortization could improve the debt factor assessment to strong as the principal amortization reaches 65% in ten years. We currently calculate the ten-year principal debt amortization at 60%.

In our opinion, a credit challenge is Avon's large pension and OPEB obligation, but costs are currently manageable, in our view, although they will be increasing and might pose potential budgetary risks in the future, particularly if market conditions change. Avon's combined required pension and actual OPEB contributions totaled 7.1% of total governmental fund expenditures in 2018. Of that amount, 4.2% represented required contributions to pension obligations, and 3.0% represented OPEB payments. The town made its full annual required pension contribution in 2018. The funded ratio of the largest pension plan is 63.5%.

The town is a member of the Norfolk County Retirement System, a multiple-employer, cost-sharing, contributory defined-benefit pension plan. Its proportionate share of the net pension liability was $10.2 million. We consider the discount rate a bit optimistic, however, at 7.75%. OPEBs are generally provided on a pay-as-you-go basis, but the town has established a trust fund and has begun prefunding the liability. The unfunded accrued liability was roughly $13.9 million in 2018, with a plan fiduciary net position of $1.0 million. The plan fiduciary net position as a percentage of the total OPEB liability is 6.8%.

Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

OUTLOOK

The stable outlook reflects S&P Global Ratings' opinion of Avon's very strong economy that benefits from access to Boston area employment opportunities. The outlook also reflects the town's consistent operating performance, with a healthy reserve position and very strong liquidity. We do not expect to change the rating over our two-year outlook horizon.

Upside scenario

Positive rating potential is possible if Avon’s economy diversifies and expands to levels commensurate with those of a higher rating. In addition, if the town introduces stronger financial policies and planning documents, and fully integrates them into the budgeting process a higher rating is possible.

Downside scenario

If operating performance deteriorates, resulting in a draw on reserves, we could lower the rating.