MOODY'S
INVESTORS SERVICE

CREDIT OPINION
20 January 2022

Rate this Research

**Contacts**

| | |
|---|---|
| Andrew T. Van Dyck Dobos | +1.312.706.9974 |
| *AVP-Analyst* | |
| andrew.vandyckdobos@moodys.com | |
| Thomas Jacobs | +1.212.553.0131 |
| *Senior Vice President/Manager* | |
| thomas.jacobs@moodys.com | |

**CLIENT SERVICES**

| | |
|---|---|
| Americas | 1-212-553-1653 |
| Asia Pacific | 852-3551-3077 |
| Japan | 81-3-5408-4100 |
| EMEA | 44-20-7772-5454 |


# Avon (City of), OH

## Update following upgrade to Aa1


## Summary

The credit profile of the City of Avon, OH (Aa1) has strengthened over the past several years as a result ongoing property tax and income tax base expansion that has contributed to growth in operating reserves and liquidity. The city's credit profile also benefits from its inclusion within the broader Cleveland (A1 stable) metropolitan region along with its above average resident income profile and positive population trends. Additionally, the city has a material amount of available land for future residential and commercial development. These positive credit factors help to balance the city's above average combined leverage comprised of outstanding debt and unfunded post-retirement benefit liabilities which will likely remain one of the city's main credit challenges .

On January 20, 2022 the city's issuer and general obligation limited tax (GOLT) ratings were upgraded to Aa1 from Aa2. The issuer rating represents Moody's assessment of hypothetical debt of the city supported by a general obligation unlimited tax (GOULT) pledge. The city does not currently have any outstanding debt supported by a GOULT pledge. The pledge supporting the city's GOLT bonds is considered limited tax based on the state's statutorily imposed limit of ten-mills on the ad valorem property taxes pledged.


## Credit strengths

» Affluent suburban tax base with available land for future development

» Strengthened financial position supported by growing income taxes

## Credit challenges

» Above average debt burden

» Elevated exposure to unfunded pension liabilities

## Rating outlook

Moody's does not typically assign outlooks to local governments with this amount of debt.

## Factors that could lead to an upgrade

» Material expansion of the city's property and income tax base

» Improvement to full value per capita wealth and resident incomes

» Significant moderation to the city's long term liability leverage

## Factors that could lead to a downgrade

- Material contraction of the city's property or income tax base
- Sustained narrowing of operating fund balance or liquidity
- Pronounced increases to the city's long term liability leverage

## Key indicators

Exhibit 1

*Sources: Moody's Investors Service, US Census Bureau, City of Avon audited financial statements*

## Profile

The City of Avon encompasses 21 square miles of Lorain County (Aa2) in northeast Ohio (Aa1 stable), approximately 22 miles west of the City of Cleveland. The city is governed by a mayor-council form of government and provides comprehensive municipal services to a population of roughly 25,000 residents.

## Detailed credit considerations

### Economy and tax base: affluent suburban tax base exhibiting valuation growth

The city's economy and tax base will remain resilient through the remainder of the coronavirus pandemic, aided by its educated labor force, increasing valuation trends and available land for future development opportunities. Situated in suburban Lorain County, city residents have good access to a variety of employment opportunities throughout the greater Cleveland metropolitan area. Locally, the city's economy is headlined by the presence of a major Cleveland Clinic (Aa2 stable) facility, which is the city's leading employer (904 employees) and largest income taxpayer. Other notable city employers include the Avon Local School District (Aa2; 728 employees), University Hospitals (A2 stable; 482 employees), and ShurTech Brands (387 employees), a manufacturer of adhesive products. While ongoing investment in the city's health care sector has been the largest driver of growth to the city's income tax base, Avon does benefit from a healthy retail sector located mainly around its I-90 corridor.

Avon's tax base is currently valued at a moderately sized $2.8 billion and has grown at an average annual rate of 3.9% over the past five years. Increases to the city's full value have boosted the city's full value per capita to a strong $123,000. Resident income levels are similarly strong as median family income is currently estimated at 164% of the national median. Residential real estate accounts for 79% of the city's 2021 assessed value, followed by commercial property at 14%. The city's tax base and demographic trends could benefit from further development of its available land, mostly located south of I-90, though the city may look to restrict its near term build out by purchasing land for park space. The city is considering asking residents to vote on a ten-year 0.15% income tax increase at a municipal election in 2022. If successful the collections realized from the increased rate would be used to acquire land. The passage or failure of the ballot initiative is not likely to have a material impact on the city's financial condition given the dedicated passive use of incremental tax revenue.

### Financial operations and reserves: positive operations have led to the steady bolstering of fund balance and liquidity

Avon's recent string of operating surpluses has resulted in the rebuilding of healthy reserves which provide the city with significant financial cushion against potential budgetary pressures. The positive operating trends have been supported by increasing collections of the city's permanent 1.75% income tax which is the city's main revenue stream accounting for nearly half of its annual governmental revenue. Over the past five audited years (fiscal 2016-2020) the city's income tax collections have increased at an average annual rate of 5.9%, and management reports an additional increase of nearly 15% in fiscal 2021. The recent strong growth in income taxes were achieved despite the economic challenges presented by the pandemic, and are largely a result of expansion of the city's healthcare sector.

The city has achieved six consecutive operating fund[1] surpluses including a $3.1 million surplus in fiscal 2020. The most recent surplus increased year-end operating reserves to $19.8 million representing a strong 55.3% of combined operating fund revenue. While audited results for fiscal 2021 will not be available for many months, city officials report a cash-basis general fund surplus of $1.4 million for the year. An additional general fund surplus of $532,000 is budgeted for fiscal 2022.

**Liquidity**

The city's liquidity position is strong and management has no plans to materially draw on its cash in coming years. At the close of fiscal 2020 the city maintained $19.4 million in operating cash, equal to a strong 54.3% of combined operating revenue. In addition to its governmental operating funds the city had $6.7 million in cash across its three business-type utility funds, equal to a healthy 398 combined operating days cash on hand.

### Debt, pensions, and OPEB: above average long term leverage

The city's above average combined long term leverage of outstanding debt and post-employment benefit liabilities will likely remain its most pressing credit challenge relative to similarly rated peers. The city is currently in the process of marketing $8.9 million in general obligation limited tax (GOLT) bonds to take out outstanding bond anticipation notes (BANs) before maturity. The outstanding notes were originally issued to finance street and utility infrastructure improvements, as well as the construction of a new municipal swimming pool. Once the new bonds are sold and the BANs are retired the city's outstanding GOLT debt will total $74.9 million. The GOLT debt is serviced through a combination of general operating revenue, special assessments on benefiting properties, tax increment revenue, and to a small degree net revenue of the city's utility funds. The city has no additional borrowing plans in 2022.

In addition to its debt the city carries long term liabilities associated with its participation in two underfunded cost-sharing pension and OPEB plans. As of fiscal 2020, Avon's three-year average Moody's adjusted net pension liability is $79.3 million, while its adjusted net OPEB liability is an additional $8.1 million. All in leverage of debt and unfunded retiree benefit liabilities totals an above average 5.7% of full value and 4.5x operating revenue. Total fixed costs, inclusive of debt service and retiree plan contributions, consumed roughly 20% of fiscal 2020 operating revenue.

**Legal security**

The city's GOLT bonds are unvoted obligations which carry the city's full faith and credit as well as its pledge to levy ad valorem property taxes within the state's statutory 10-mill limit.

**Debt structure**

Following the city's upcoming GOLT bond sale and take out of outstanding BANs, all of its debt will consist of fixed rate bonds that amortize over the long term. Principal amortizes at an average rate with approximately two-thirds of principal, including the current sale, scheduled to be retired over the next ten years.

**Debt-related derivatives**

The city is not party to any interest rate swaps or other debt related derivative agreements.

**Pensions and OPEB**

City employees are members of the Ohio Public Employees Retirement System (OPERS) and the Ohio Police & Fire Pension Fund (OP&F). There is broad legal flexibility in Ohio to amend pension benefits, and statute establishes a 30-year target for amortizing the unfunded liabilities of all cost-sharing plans. In 2012, the 30-year target was breached and the state legislature acted by reducing benefits and increasing employee contributions. The 2012 reforms did not increase employer contributions from participating governments. Despite the flexibility to contain the plan's liabilities, Avon's exposure to the two plans will likely be a long term credit drag relative to its highly rated peers who participate in either stronger funded defined benefit pension plans or offer only defined contribution plans.

## ESG considerations

### Environmental

Environmental considerations are not a material rating driver for the City of Avon. Located in northeast Ohio, the City of Avon has a continental climate with four distinct seasons. Situated near the shores of Lake Erie, the city has excellent access to an abundance of readily treatable fresh water. The city purchases its water supply in bulk from the City of Avon Lake (A1) and its sewage is treated at two wastewater facilities, one owned and operated by Avon Lake and the second by the City of North Ridgeville (Aa1) . The City of Avon maintains all of its water lines and also performs all maintenance and billing services. Neither environmental nor climate events are likely to interrupt general city operations or general credit profile for the foreseeable future.

### Social

Social considerations that factor into the city's credit profile include its socioeconomic and demographic characteristics and trends. Overall, the city has a solid socioeconomic profile as shown by its above average wealth and resident income profile. Additionally, the city has a relatively strong labor pool as the proportion of its working age residents with college degrees is significantly higher than that of the state and nation overall which should help to sustain its long term income tax trends. The city's population roughly tripled from 1990 to 2010 and grew by an additional 17% from 2010 to 2020. The city's upcoming income tax initiative may somewhat restrict residential growth, if successful, and is aimed at limiting traffic congestion and increasing park space. City residents have good access to basic services, along with access to health care, higher education, housing, and cultural institutions throughout the greater Cleveland metropolitan region.

### Governance

Avon's management has successfully improved its financial position over the past several years, pointing to the strong likelihood of its ability to sustain its strong profile going forward. Additionally, management is proactively trying to manage the city's growth by placing the temporary income tax initiative before voters in 2022. The city currently negotiates with five bargaining groups, and in the city's judgment, its employee relations have been and are excellent.

Ohio cities have an Institutional Framework score of "A", which is moderate. The sector's major revenue source, income tax, is subject to a 1.0% cap that can be overridden with voter approval only. Increases in property taxes also generally require voter approval, unless a city is currently levying a rate under its charter cap. Ohio has public sector unions, which can limit the ability to cut expenditures. Revenue and expenditures tend to be mostly predictable during times of economic stability, though income taxes in particular may materially fall during recessionary periods.

## Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching adjustments dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 2

| Scorecard Factors and Subfactors | Measure | Score |
|---|---|---|
| Economy/Tax Base (30%) [1] | | |
| Tax Base Size: Full Value (in 000s) | $2,825,185 | Aa |
| Full Value Per Capita | $122,839 | Aa |
| Median Family Income (% of US Median) | 163.7% | Aaa |
| Finances (30%) | | |
| Fund Balance as a % of Revenues | 55.3% | Aaa |
| 5-Year Dollar Change in Fund Balance as % of Revenues | 33.6% | Aaa |
| Cash Balance as a % of Revenues | 54.3% | Aaa |
| 5-Year Dollar Change in Cash Balance as % of Revenues | 41.0% | Aaa |
| Management (20%) | | |
| Institutional Framework | A | A |
| Operating History: 5-Year Average of Operating Revenues / Operating Expenditures (x) | 1.07x | Aaa |
| Debt and Pensions (20%) | | |
| Net Direct Debt / Full Value (%) | 2.7% | A |
| Net Direct Debt / Operating Revenues (x) | 2.1x | A |
| 3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%) | 2.8% | A |
| 3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x) | 2.2x | A |
| | Scorecard-Indicated Outcome | Aa1 |
| | Assigned Rating | Aa1 |

[1] Economy measures are based on data from the most recent year available.
[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology.
[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication.
*Sources: Moody's Investors Service, US Census Bureau, City of Avon audited financial statements*

## Endnotes

1 Moody's calculated operating funds include the city's general, police, fire, park, street, and debt service funds.

REPORT NUMBER 1315609

## CLIENT SERVICES

| | |
|---|---|
| Americas | 1-212-553-1653 |
| Asia Pacific | 852-3551-3077 |
| Japan | 81-3-5408-4100 |
| EMEA | 44-20-7772-5454 |