

## CREDIT OPINION

21 April 2016

### New Issue

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## Scarborough (Town of) ME

New Issue - Moody's Assigns Aa3 to Scarborough, ME's \$7.5M GO Bonds

### Summary Rating Rationale

Moody's Investors Service has assigned a Aa3 rating to the Town of Scarborough, ME's \$7.5 million 2016 General Obligation Bonds. Concurrently, Moody's has affirmed the Aa3 rating on \$92.2 million of outstanding general obligation debt.

The Aa3 rating reflects the town's moderately sized tax base with above average wealth levels, slightly improving financial position with satisfactory reserves, and manageable debt and pension liabilities.

### Credit Strengths

- » Modestly growing tax base with above average wealth levels
- » Manageable pension and OPEB liabilities

### Credit Challenges

- » Moderate revenue raising ability due to state statutes
- » Ongoing General Fund subsidy to cover TIF district debt

### Rating Outlook

Outlooks are usually not assigned to local government credits with this amount of debt outstanding.

### Factors that Could Lead to an Upgrade

- » Multi-year trend of surplus operations leading to a large increase in liquidity and reserves
- » Elimination of the interfund loan receivable related to the Haigis Parkway TIF District

### Factors that Could Lead to a Downgrade

- » Trend of operating deficits resulting in reserve declines
- » Material increase in the General Fund receivable due from the Haigis Parkway TIF fund
- » Trend of tax base declines or deterioration of the demographic profile
- » Material growth in debt burden

## Key Indicators

Exhibit 1

Scarborough (Town of) ME	2011	2012	2013	2014	2015
Economy/Tax Base					
Total Full Value (\$000)	\$ 3,564,150	\$ 3,556,750	\$ 3,482,500	\$ 3,579,450	\$ 3,667,300
Full Value Per Capita	\$ 188,390	\$ 189,330	\$ 183,860	\$ 185,051	\$ 187,835
Median Family Income (% of US Median)	151.8%	143.8%	144.1%	145.4%	145.4%
Finances					
Operating Revenue (\$000)	\$ 66,883	\$ 68,483	\$ 71,596	\$ 74,891	\$ 78,853
Fund Balance as a % of Revenues	5.7%	6.7%	7.3%	8.3%	10.4%
Cash Balance as a % of Revenues	11.9%	14.6%	14.9%	15.0%	17.7%
Debt/Pensions					
Net Direct Debt (\$000)	\$ 67,872	\$ 82,937	\$ 96,802	\$ 98,492	\$ 98,896
Net Direct Debt / Operating Revenues (x)	1.0x	1.2x	1.4x	1.3x	1.3x
Net Direct Debt / Full Value (%)	1.9%	2.3%	2.8%	2.8%	2.7%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	N/A	N/A	0.2x	0.2x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	N/A	N/A	0.4%	0.5%

Source: Moody's Investors Service

## Detailed Rating Considerations

### Economy and Tax Base: Modestly Growing Tax Base With Above-average Wealth

Scarborough's diverse \$3.8 billion tax base (73% residential and 21% commercial/industrial) will continue to grow at a modest pace given its favorable location in Cumberland County (Aa1). The town is a wealthy suburb of Portland (Aa1 stable) and is bisected by both U.S. Route 1 and Interstate 95, which provides convenient commuter and commercial access to this employment and economic center. The five year (fiscal 2011-2016) annual compound growth in equalized (full) value is a modest 1.2% - declines in 2012 and 2013 were offset by growth for the past three years, including a 3.4% increase in 2016, mostly driven by residential construction. Building permit value, which was fairly stable throughout the recession and averaged \$240,000 from 2008-2014 (as of December 31), saw a sizeable increase in 2015 to \$449,000. The town is well positioned for continued growth along the Haigis Parkway. Furthermore, along US route 1, an 18,000 square foot healthcare facility is currently under construction. In addition, the largest taxpayer – a coastal retirement community that accounts for 1.7% of 2016 assessed value - continues to expand.

Wealth and income levels are above state and national medians, with a median family income of \$95,159 (153.9% and 145.4%, respectively). Housing values are strong as evidenced by a robust full value per capita of \$194,220 (225% of the US median).

### Financial Operations and Reserves: Slightly Improving Financial Position with Satisfactory Reserves

Scarborough's overall financial position is stable and reserves have improved modestly over the past few years due to management's conservative budgeting and eliminated reliance on reserves to balance municipal budgets. Fiscal 2015 audited results reflect a \$592,000 operating surplus mostly due to a favorable variance in excise taxes, though total General Fund balance increased \$2.1 million when incorporating bond proceeds. As of fiscal 2015 year end, available fund balance (excludes nonspendable and restricted) improved to \$8.2 million (10.4% of revenues). Positively, the majority of this amount (\$5 million or 6.3%) is unassigned. The town remains in compliance with its formal policy to maintain unassigned fund balance between 5% and 8.3% of current year budgeted expenditures (budgetary basis). Primary revenues are property taxes (77% of fiscal 2015 revenues) and state aid (13.1%). Current year property tax collections remain strong at over 98.5%.

Approximately \$2.7 million of total General Fund balance is restricted to account for an illiquid receivable from the Haigis Parkway TIF fund. For several years, the town has been subsidizing debt payments for general obligation bonds that were intended to be self-

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supporting through TIF revenues and special assessments. The amount of the receivable did not change materially from 2014 to 2015, as expected. A 2012 debt restructure provides additional time for the district to develop and become self-supporting, and therefore the receivable is expected to remain largely unchanged until fiscal 2018 when debt service payments increase to over \$1 million from approximately \$400,000. The receivable will continue to be accounted for as restricted General Fund balance, and future reviews will continue to focus on the operating health of the district. A material growth in the receivable could burden the General Fund and pressure the rating.

Management reports that excise taxes and building permits are trending positively in fiscal 2016 and expenditures are stable. Projections indicate another small surplus for both town and school operations. The proposed fiscal 2017 budget reflects a 3.5% increase in expenditures mostly driven by public safety costs, and will be balanced with a tax levy increase. The Town Council approved tax levy increases above the tax limit (known as LD-1) in fiscal years 2013-2016. Management does not appropriate fund balance towards the municipal budget, but usually appropriates some reserves to balance the school department's budget.

#### LIQUIDITY

The year-end cash position has been increasing modestly since fiscal 2011, and improved to \$14 million (17.7% of revenues) in fiscal 2015.

#### Debt and Pensions: Debt Burden Will Remain Above-average; Manageable Pension and OPEB Liabilities

Scarborough's direct debt burden (2.5% of equalized valuation) will remain elevated but affordable given below-average principal amortization and moderate future borrowing plans. The overall debt burden increases slightly to 2.6% when incorporating overlapping debt for Cumberland County (Aa1). The town will continue to finance its Capital Improvement Plan with annual borrowings of approximately \$6 million, but is also increasing its commitment to pay-as-you-go financing. Per the fund balance policy discussed in the finance section, the town can (with Town Council approval) appropriate excess General Fund balance towards capital projects, and the proposed fiscal 2017 budget includes \$500,000 for this purpose. Over the longer term, the town may borrow for a public safety building and a library.

#### DEBT STRUCTURE

All debt is fixed rate and amortization of principal is below-average, with 60% repaid within ten years. Debt service accounted for a manageable 5.9% of General Fund expenditures in fiscal 2015

#### DEBT-RELATED DERIVATIVES

Scarborough has no derivatives.

#### PENSIONS AND OPEB

Pensions and OPEB

Scarborough participates in the Maine Public Employees Retirement System's Consolidated Plan for Participating Local Governments, a cost-sharing multi-employer defined benefit pension plan. The town funds its required contribution, which was \$624,901 in fiscal 2015. The town's teachers participate in the Maine Public Employees Retirement System's Teacher Plan, which is administered at the state level. While the state pays the majority of the costs for this plan, Scarborough was required to contribute \$626,859. The combined contributions represent only 1.6% of expenditures.

The fiscal 2015 combined adjusted net pension liability, under Moody's methodology for adjusting reported pension data, is \$19.9 million, or a below average 0.25 times General Fund revenues. Moody's uses the adjusted net pension liability to improve comparability of reported pension liabilities. The adjustments are not intended to replace the town's reported liability information, but to improve comparability with other rated entities. We determined the town's share of liability for the state-run plans in proportion to its contributions to the plans.

The OPEB liability is limited to the value of its implicit rate subsidy to retirees that buy into the health insurance benefit plan offered to active employees. As of the June 2014 valuation, the total liability is a manageable \$2.7 million.

Total fixed costs for fiscal 2015, including debt service, required pension contributions and retiree healthcare payments, represented \$5.9 million, or a below average 7.5% of expenditures.

## Management and Governance

Maine cities and towns have an institutional framework score of "Aa," or strong. Revenues are highly predictable and mostly consist of property taxes, with a smaller portion coming from state aid. Cities and towns have moderate revenue-raising ability since property taxes are subject to the state property tax cap known as LD 1, although the cap can be exceeded by a majority vote of the legislative body or with voter approval. Expenditure predictability is moderate, as most expenditures are for education, general government and public safety. Cities and towns have a moderate expenditure reduction ability due to public sector union presence.

The experienced management team employs conservative financial management as evidenced in a recent trend of slightly improving reserve levels, compliance with a formal fund balance policy, and long-term planning for capital expenditures. Management is also working to establish a formal policy for capital budgeting and planning.

## Legal Security

The majority of the bonds (\$6 million) are secured by the town's general obligation limited tax pledge, as debt service is subject to the state's property tax limitation known as LD-1. The remaining \$1.5 million is secured by a general obligation unlimited tax pledge since bonds issued for school projects are exempt from LD-1.

## Use of Proceeds

Approximately \$3.8 million of bond proceeds will advance refund certain maturities of the outstanding 2006, 2007, 2008 and 2009 bonds for estimated net present value savings of \$280,000, equal to 6.9% of refunded principal, with no extension of final maturity. The remaining \$3.8 million of proceeds will finance various projects in the Capital Improvement Plan.

## Obligor Profile

Scarborough has a population of 19,500 and is located on the southern coast of Maine, approximately 7 miles southeast of Portland.

## Methodology

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Ratings Methodologies page on [www.moody.com](http://www.moody.com) for a copy of this methodology.

## Ratings

Exhibit 2

### Scarborough (Town of) ME

Issue	Rating
2016 General Obligation Bonds	Aa3
Rating Type	Underlying LT
Sale Amount	\$7,510,000
Expected Sale Date	04/26/2016
Rating Description	General Obligation

Source: Moody's Investors Service

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