

CREDIT OPINION

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Scarborough (Town of) ME

Update to credit analysis

Summary

Scarborough, ME (Aa3) benefits from a moderately sized, growing tax base with above average wealth levels, adequate financial reserves, manageable debt burden, and low pension liabilities.

Credit strengths

- » Growing tax base with above average resident wealth and incomes
- » Low pension and OPEB liabilities resulting in low fixed costs

Credit challenges

- » Outstanding General Fund subsidy due to TIF district debt
- » Elevated debt burden with additional debt expected
- » Reserve position is below average for the rating category

Rating outlook

Moody's does not usually assign outlooks to local government credits with this amount of debt outstanding.

Factors that could lead to an upgrade

- » Large increase in liquidity and reserves
- » Continued growth in the tax base
- » 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	2014	2015	2016	2017	2018
Economy/Tax Base					
Total Full Value (\$000)	\$3,579,450	\$3,667,300	\$3,791,950	\$3,899,350	\$4,068,100
Population	19,209	19,348	19,582	19,620	20,208
Full Value Per Capita	\$186,342	\$189,544	\$193,645	\$198,744	\$201,311
Median Family Income (% of US Median)	145.4%	146.0%	149.8%	154.5%	154.5%
Finances					
Operating Revenue (\$000)	\$74,891	\$78,853	\$80,726	\$83,892	\$84,837
Fund Balance (\$000)	\$6,213	\$8,222	\$9,177	\$11,072	\$10,256
Cash Balance (\$000)	\$11,256	\$13,979	\$17,386	\$18,019	\$17,910
Fund Balance as a % of Revenues	8.3%	10.4%	11.4%	13.2%	12.1%
Cash Balance as a % of Revenues	15.0%	17.7%	21.5%	21.5%	21.1%
Debt/Pensions					
Net Direct Debt (\$000)	\$98,492	\$98,896	\$96,120	\$91,630	\$102,748
3-Year Average of Moody's ANPL (\$000)	\$14,668	\$17,244	\$20,557	\$23,752	\$27,569
Net Direct Debt / Full Value (%)	2.8%	2.7%	2.5%	2.3%	2.5%
Net Direct Debt / Operating Revenues (x)	1.3x	1.3x	1.2x	1.1x	1.2x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	0.4%	0.5%	0.5%	0.6%	0.7%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	0.2x	0.2x	0.3x	0.3x	0.3x

Note: 2019 Full Valuation (\$000s): 4,313,600

Data as of June 30 fiscal year end

Source: Moody's Investors Service and issuer's audited financial statements

Profile

Scarborough has a population of 19,620 and is located on the southern coast of Maine, approximately 7 miles south of Portland, ME (Aa1 stable).

Detailed credit considerations

Economy and Tax Base: Growing tax base with above-average resident wealth and incomes

The diverse \$4.3 billion tax base, which is about 75% residential and 25% commercial and industrial, will continue to grow at a moderate pace given its availability of developable land and 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. Equalized value declined only modestly during the recession and values have grown rapidly at a compound average annual rate of 3.8% over the past five years, driven by residential construction and a town-wide revaluation project that is the first in over a decade.

Future growth will be driven by both residential and commercial development, including a 288 apartment complex which has almost finished completion on the Haigis Parkway. The town remains well positioned for continued growth along this corridor. Furthermore, Maine Medical Center is building a \$59 million facility, which, while largely exempt from property tax rolls, will add a substantial amount of jobs and new investment into the area. Construction completion is expected in early 2021. Finally, new growth is expected as a result of developments at Scarborough Downs, which was recently sold to a new investor. As part of the development, the town plans to offer tax incentives, but importantly, those incentives are contingent on performance of the developer.

Median family income represents 163% of state and 155% of US medians, while median home values are slightly stronger at 187% of state and 174% of US, reflecting in part high value coastal property. Because of those properties, full value is very strong at \$213,460.

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Financial Operations and Reserves: Financial position remains adequate

Scarborough's overall financial position remains stable though back to back deficits have marginally weakened the town's reserve position. Fiscal 2018 audited results reflect a \$1.8 million general fund deficit as school revenues were lower than originally budgeted, though excise fees and building permit revenues contributed more revenues than expected. The deficit lowered available fund balance to \$10.3 million or 12.1% of revenues. The town remains in compliance with its formal policy, which requires unassigned fund balance to be maintained at 10% of the prior year's budgeted expenditures (budgetary basis) and above 8.3% of current year expenditures. The policy also states that unassigned fund balance in excess of 12% can be allocated for capital projects or to mitigate tax increases. In fiscal 2018, property taxes provided 80% of total revenues, while state aid made up 11%. The largest expenditures for the town were education at 57% and public safety at 13%. Negatively, the town makes transfer payments out of the General Fund to support the Haigis Parkway Fund until such time that the TIF revenues have grown enough to become self-supporting. In fiscal 2018, the Haigis Parkway Fund's fund balance decreased from negative \$1.7 million to negative \$1.9 million.

Fiscal 2019 year to date results suggest a small surplus as expenditures are tracking about 10% below budget with only a month to go in the fiscal year. Additionally, the town received a one-time revenue payment from the state for about \$127,000. The 2019 budget reflected an increase of \$1.7 million or 2% from the prior year and was balanced without an increase in the tax levy or use of fund balance. Instead, the budget was balanced off a town-wide commercial and industrial revaluation project which is expected to significantly increase assessed property values. The town is currently undergoing a similar revaluation for residential properties.

The finalized 2020 budget reflects an increase of \$2.7 million or 4% with the additional revenues resulting from the residential revaluation expected to more than make up for the increase in expenditures. In addition, the town is expecting more revenue from the state as the governor discusses a potential increase to the state's municipal revenue sharing.

LIQUIDITY

Cash and investments at the end of fiscal 2018 represented \$17.9 million or 21.1% of revenues.

Debt and Pensions: Debt burden will remain elevated, but low pension and OPEB liabilities keep fixed costs low

Scarborough's net direct debt burden of 2.5% of equalized valuation will remain elevated given future borrowing plans. The town will continue to finance its capital improvement plan, which currently considers \$42.5 million of spending through fiscal 2024, or about \$8.5 million per year. While some of that amount will be pay-go financing, management will return to the bond market to finance the remaining amount.

The town has developed a long range facilities plan to identify town and school capital needs for the next 30 years. The upcoming bond issuance will finance a new public safety building and various other CIP projects, while future projects consider renovations at the three elementary schools and expansion of the library. The larger projects in the plan will be financed with debt (pending voter approval), and future reviews will focus on the town's ability to manage the increasing debt service costs while maintaining healthy reserves.

DEBT STRUCTURE

The entire debt portfolio is fixed rate with a below average 61% of principal retired in ten years. Fiscal 2018 debt service represented \$4.9 million or 5.6% of expenditures.

DEBT-RELATED DERIVATIVES

Scarborough is not party to any interest rate swaps or other derivative agreements.

PENSIONS AND OPEB

Scarborough contributes to the Maine Public Employees Retirement System's State Employee and Teacher Plan and the Consolidated Plan for Participating Local Districts, two cost-sharing multi-employer defined benefit pension plans. The town fully funds its required contributions for both plans, which were \$1.9 million in fiscal 2018 or a low 2.2% of expenditures. The fiscal 2018 three year average combined Moody's adjusted net pension liability, under Moody's methodology for adjusting reported pension data, is \$27.6 million, or a below average 0.32 times General Fund revenues.

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 June 30, 2018, the total OPEB liability measured \$3.3 million or just 0.04 times revenues.

Fixed costs, including annual debt service, pensions, and OPEB costs, totaled just 8% of fiscal 2018 operating expenditures.

Management and Governance

Implementation of and compliance with the town's financial and fiscal policies demonstrates an experienced management team employing conservative budgeting and financial management practices.

Maine towns and cities have an Institutional Framework score of "Aa", which is strong. The sector's major revenue source of property taxes are subject to a cap, which can be overridden at the local level. The cap is based on statewide personal income growth and local property growth. The cap allows for moderate revenue-raising ability. Taxes raised for school purposes, including school debt service, are not subject to the cap. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally less than 25% of expenditures. Fixed costs are driven mainly by debt service. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

Rating methodology and scorecard factors

The US Local Government General Obligation Rating 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 factors 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

Scarborough (Town of) ME		
Rating Factors	Measure	Score
Economy/Tax Base (30%) ^[1]		
Tax Base Size: Full Value (in 000s)	\$4,313,600	Aa
Full Value Per Capita	\$213,460	Aaa
Median Family Income (% of US Median)	154.5%	Aaa
Finances (30%)		
Fund Balance as a % of Revenues	12.1%	A
5-Year Dollar Change in Fund Balance as % of Revenues	5.9%	A
Cash Balance as a % of Revenues	21.1%	Aa
5-Year Dollar Change in Cash Balance as % of Revenues	8.5%	A
Management (20%)		
Institutional Framework	Aa	Aa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	1.0x	A
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	2.2%	A
Net Direct Debt / Operating Revenues (x)	1.1x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	0.6%	Aaa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	0.3x	Aaa
Scorecard-Indicated Outcome		Aa2
Assigned Rating		Aa3

[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 dated December 16, 2016.

[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs Updated for 2018 publication.

Source: US Bureau of Economic Analysis, Moody's Investors Service

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