

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.

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. We do not see any material immediate credit risks for Scarborough, ME. However, the situation surrounding coronavirus is rapidly evolving and the longer term impact will depend on both the severity and duration of the crisis. If our view of the credit quality of Scarborough, ME changes, we will update our opinion at that time.

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	2015	2016	2017	2018	2019
Economy/Tax Base					
Total Full Value (\$000)	\$3,667,300	\$3,791,950	\$3,899,350	\$4,068,100	\$4,313,600
Population	19,348	19,348	19,620	19,844	19,844
Full Value Per Capita	\$189,544	\$195,987	\$198,744	\$205,004	\$217,376
Median Family Income (% of US Median)	146.0%	146.0%	154.5%	156.3%	156.3%
Finances					
Operating Revenue (\$000)	\$78,853	\$80,726	\$83,892	\$84,837	\$91,225
Fund Balance (\$000)	\$8,222	\$9,177	\$11,072	\$10,256	\$11,128
Cash Balance (\$000)	\$13,979	\$17,386	\$18,019	\$17,910	\$20,611
Fund Balance as a % of Revenues	10.4%	11.4%	13.2%	12.1%	12.2%
Cash Balance as a % of Revenues	17.7%	21.5%	21.5%	21.1%	22.6%
Debt/Pensions					
Net Direct Debt (\$000)	\$98,896	\$96,120	\$91,630	\$102,748	\$102,770
3-Year Average of Moody's ANPL (\$000)	\$17,244	\$20,557	\$23,752	\$27,569	\$28,314
Net Direct Debt / Full Value (%)	2.7%	2.5%	2.3%	2.5%	2.4%
Net Direct Debt / Operating Revenues (x)	1.3x	1.2x	1.1x	1.2x	1.1x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	0.5%	0.5%	0.6%	0.7%	0.7%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	0.2x	0.3x	0.3x	0.3x	0.3x

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 coronavirus is driving an unprecedented economic slowdown. We currently forecast US GDP to decline significantly during 2020 with a gradual recovery commencing toward the end of the year. Local governments with the highest exposure to the tourism, healthcare, retail, oil and gas and international trade sectors could suffer particularly severe impacts.

The diverse \$4.8 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 (Aa2). 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 5.4% over the past five years, driven by residential construction and a townwide revaluation project that is the first of its kind 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

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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. 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 164% of state and 156% of US medians, while median home values are stronger at 196% of state and 176% of US, reflecting in part high value coastal property. Because of those properties, full value is very strong at \$234,785.

Financial Operations and Reserves: Financial position remains adequate

Scarborough's overall financial position remains stable though three consecutive deficits have marginally weakened the town's reserve position. Fiscal 2019 audited results reflect a \$573,000 general fund deficit, which resulted in an available fund balance of \$11.1 million, representing 12.2% 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 2019, property taxes provided 79% of total revenues, while state aid made up 12%. 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 2019, the Haigis Parkway Fund's fund balance stood at negative \$2 million, a slight decrease from the prior year.

Fiscal 2020 year to date results suggest a small surplus as the town completed a revaluation, which led to increased property tax revenues. However, given the unexpected increase in asylum seekers in Portland, the town's budget for general assistance was significantly higher than originally planned. The 2020 budget reflected an increase of \$7.7 million or 8.3% from the prior year and was balanced without an increase in the tax levy of \$4.9 million, up partially because of the revaluation. Management does not typically appropriate fund balance in its budgeting process.

The fiscal 2021 budget is still under construction, though management is expecting an increase of about \$5.2 million from the prior year with little to no change in the tax levy. Given substantial uncertainty over federal and state funding to replace lost revenues and higher expenditures due to the coronavirus pandemic, management has proactively reduced some of its variable costs through layoffs and employee hour reductions.

LIQUIDITY

Cash and investments at the end of fiscal 2019 represented \$20.6 million or 22.6% 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 2.4% of equalized valuation will remain elevated given future borrowing plans. 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 complete the financing for a new public safety building and various other capital development needs. Future projects – which include expansion of the town library and school athletic field improvements – are currently being reconsidered given the uncertainty surrounding the fiscal 2021 budget.

DEBT STRUCTURE

The entire debt portfolio is fixed rate with 61% of principal retired in ten years. Fiscal 2019 debt service represented \$5.6 million or 6.1% of revenues.

DEBT-RELATED DERIVATIVES

The town is not party to any interest rate swaps or derivative agreements.

PENSIONS AND OPEB

While the town's unfunded pension and OPEB liabilities are smaller than its debt, they represent a potential future credit challenge. The town participates in two multiple employer cost-sharing pension plans and funds OPEB on a pay-go basis. The table below summarizes the town's 2019 pension and OPEB contributions and unfunded liabilities.

Exhibit 2

	Amount (\$ thousands)	% of Operating Revenues	Discount Rate
Operating Revenue	91,225		
Reported Unfunded Pension Liability	5,034	5.52%	6.75%
Moody's Adjusted Net Pension Liability	24,056	26.37%	4.14%
Reported Net OPEB Liability	8,147	8.93%	-
Moody's Adjusted Net OPEB Liability	7,860	8.62%	-
Pension Contribution	2,046	2.24%	-
Pension Tread Water Gap [1]	(161)	-0.18%	-
OPEB Contribution	189	0.21%	-
Net Direct Debt	102,770	112.66%	-
Debt Service	5,599	6.14%	-
Total Fixed Costs	7,834	8.59%	-

[1] A negative pension tread water gap reflects pension contribution in excess of the amount required to prevent the unfunded liability from increasing if all plan assumptions are realized. A positive tread water gap reflects the opposite.

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

Favorably, the town's 2019 pension contributions exceeded tread water, the amount required to prevent the unfunded liability from increasing if all plan assumptions are realized. To the extent that the multiple-employer pension plans in which the town participates experience returns on assets that fall short of their assumptions, the town's required pension contribution will increase.

Fiscal 2019 fixed costs, comprised of pensions, OPEB and debt service, represented a manageable 8.6% of operating revenues. However, return on assets in the state run pension plans and future escalation of OPEB costs could materially affect fixed costs going forward.

ESG considerations

Environmental considerations

There are no major environmental considerations.

Social considerations

There are no major social considerations.

Management and governance considerations

Management has taken decisive action to lower expenses in light of the coronavirus pandemic, including layoffs and reduced hours for certain non-union workers.

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 3

Scarborough (Town of) ME		
Scorecard Factors	Measure	Score
Economy/Tax Base (30%) ^[1]		
Tax Base Size: Full Value (in 000s)	\$4,778,350	Aa
Full Value Per Capita	\$240,796	Aaa
Median Family Income (% of US Median)	156.3%	Aaa
Finances (30%)		
Fund Balance as a % of Revenues	12.2%	A
5-Year Dollar Change in Fund Balance as % of Revenues	5.4%	A
Cash Balance as a % of Revenues	22.6%	Aa
5-Year Dollar Change in Cash Balance as % of Revenues	10.3%	Aa
Management (20%)		
Institutional Framework	Aa	Aa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures (x)	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.

[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication

Source: US Census Bureau, Moody's Investors Service

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