

RatingsDirect®

Summary:

Kittery, Maine; General Obligation

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Credit Profile		
US\$8.96 mil GO bnds ser 2021 due 03/01/2041		
Long Term Rating	AA+/Stable	New
Kittery GO		
Long Term Rating	AA+/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to the Town of Kittery, Maine's \$8.9 million series 2021 general obligation (GO) refunding bonds. At the same time, S&P Global Ratings affirmed its 'AA+' long-term rating on the town's GO debt outstanding. The outlook on all ratings is stable.

The town's full-faith-and-credit pledge secures the bonds. Although it is not restricted to a particular revenue source, Kittery has the power to levy ad valorem property taxes for bond repayment, subject to limitations of Maine's LD-1 legislation. Despite limitations imposed by the state levy limit law, we did not make a rating distinction for the limited-tax-GO pledge due to the town's flexibility under the levy limit. Proceeds will be used to refund Kittery's 2010 GO bonds for interest-rate savings and provide \$5 million in new money financing to support the town's Rice Memorial Library Project.

Credit overview

The rating on Kittery reflects the town's ongoing redevelopment projects, inclusive of new residential and mixed-use property development and ongoing renovations to the Portsmouth Naval Shipyard, and continued conservative budgeting practices, including a budgeted 11.0% decline in state revenue distributions and a 15.8% decline in recreation revenues related to the COVID-19 pandemic. Also supporting the stable outlook is the town's consistent operating profile, producing surpluses or near breakeven performance historically. Our outlook is generally for two years; however, we believe there remain risks associated with the continuation of the pandemic and recent recession over the next six-to-12 months.

The rating reflects our opinion of the following factors for the town:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2020;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2020 of 21% of operating expenditures;
- Very strong liquidity, with total government available cash at 36.7% of total governmental fund expenditures and

8.1x governmental debt service, and access to external liquidity we consider strong;

- Very strong debt and contingent liability profile, with debt service carrying charges at 4.5% of expenditures and net direct debt that is 93.2% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of market value and rapid amortization, with 70.0% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Environmental, social, and governance factors

We evaluated the town's environmental, social, and governance factors relative to Kittery's economy, financial measures, management, and debt and long-term liability profile. Absent the health and safety social risks stemming from the COVID-19 pandemic that could temporarily weaken the town's economy and financial profile, we consider Kittery's social risks in line with those of the sector. We view the town's governance risks as generally in line with those of peers. Given Kittery's coastal location, we view environmental risks as elevated but similar to those of other coastal locations. The town continues to actively address these risks through investments in seawalls and regional cooperation on sea-level resiliency planning efforts through a regional planning commission.

Stable Outlook

Downside scenario

While not anticipated during our outlook period, if management is unable to maintain balanced budgetary performance, leading to weakened budgetary flexibility, or if unexpected closure of the Portsmouth Naval Shipyard leads to declines in economic metrics, we could revise the outlook or lower the rating.

Upside scenario

We could raise the rating if the town continues to improve development efforts leading to stronger economic indicators more commensurate with those of 'AAA' rated peers.

Credit Opinion

Very strong economy

We consider Kittery's economy very strong. The town, with an estimated population of 9,652, is in York County in the Portland-South Portland MSA, which we consider to be broad and diverse. The town has a projected per capita effective buying income of 132% of the national level and per capita market value of \$220,959. The county unemployment rate was 2.7% in 2019.

Located along the southernmost tip of Maine, Kittery maintains direct access to both Interstate 95 and U.S. Route 1, and town residents maintain access to the Portsmouth labor market. As a coastal community, Kittery also remains a year-round destination for tourists, with access to Fort McClary State Park, Crescent Beach, and Seapoint Beach, along with shopping at various outlets and dining in the Foreside community along the Piscataqua River. This continued interest in the area helps support a stable tax base, with the market value rising by 14.3% in 2020 to \$2.1 billion in 2021. This growth was mainly due to the town completing a revaluation during the period. Historical growth has remained stable at about 5.5% per year over the past five years.

The town is primarily residential, with both developed properties and vacant areas zoned for residential accounting for 51.6% and 16.0% of the land acreage, respectively. To continue to support development, the town has made efforts to convert portions of the available commercial space into mixed-use areas, including rezoning portions around the Route 1 commercial corridor for residential development. Kittery has a history of rezoning former commercial areas into mixed-use areas, including success with a new 288-unit mixed-use development on the former site of a business park, and the redevelopment of an abandoned nursing home into two developments including a new 120-room Marriott Townplace Suites and 42 new market rate apartments.

In addition to being a tourist destination, the town is also home to the Portsmouth Naval Shipyard, which employs approximately 8,000. The shipyard is used by the U.S. Navy to refit nuclear attack submarines for the Atlantic Fleet. The base has survived several recommendations for closure and due to the specialized nature of its mission, we expect it will provide a certain level of economic stability into the future. The shipyard is currently undergoing modernization efforts, including a \$150 million renovation to a dry dock to expand capabilities to service both Virginia and Los Angeles class submarines and speed up refueling.

The shipyard is one of the town's main employers, with employment figures that have remained stable during the pandemic. The unemployment rate was 2.7% in 2019. In light of the pandemic, York County mirrored national trends, with the unemployment rate spiking to 10.6% in April 2020; however, it has recovered to 5.0% as of November 2020. Overall, given the ongoing development and improving employment numbers, we expect the economy to remain strong during our outlook period.

Strong management

We view the town's management as strong, with good financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Highlights include the town's sound budget assumptions rooted in historical trend analysis and strong monitoring practices. Kittery conducts monthly monitoring of budget-to-actuals and, more important, has established regular communication between the town and its school department regarding cash flow performance and other financial matters. We believe these procedures make it possible for the town to identify shortfalls early. While there is no formal financial forecasting, Kittery maintains a five-year capital improvement plan that is updated annually and that identifies revenues. The capital plan focuses on a save-as-you-go approach, through which the town builds reserves over and above the existing unassigned fund balance to support capital projects and preserve its bonding capacity for projects with longer useful lives. Kittery also maintains formal investment and formal reserve and liquidity policies. The latter provides that the unencumbered reserves will not fall to less than 8.3% of expenditures, which the town has stated is a desired liquidity level for working capital needs. The town has been in compliance with the policy historically.

Adequate budgetary performance

Kittery's budgetary performance is adequate in our opinion. The town had operating surpluses of 2.8% of expenditures in the general fund and of 2.9% across all governmental funds in fiscal 2020.

Fiscal 2020 performance resulted in the town reporting a surplus of more than \$900,000. Due to the onset of the pandemic in the last quarter of the fiscal year, Kittery instituted a spending freeze because of uncertainty surrounding

revenues. However, revenues came in approximately \$106,000 over projected due to favorable performance of vehicle excise taxes, code enforcement fees, and parking tickets, among other items. The gains were partially offset by a shortfall of approximately \$327,000 in recreation revenues due to the closure of the Kittery Community Center brought about by social distancing guidelines. To provide additional cushion in fiscal 2020, the town sought and received voter approval to use up to \$1 million in the fund balance during the year; however, with the spending freeze and favorable revenue performance, Kittery did not need to use any of the balance.

The town's main source of revenue is property taxes, accounting for approximately 80% of annual revenues. Collections remain solid at over 98% annually. Kittery does not maintain a sizable exposure to economically sensitive revenues; however, with the continued closure of the community center, that area remains a vulnerability for the town. Despite Kittery's surplus performance in fiscal 2020, our assessment takes into account potential downside risks from the COVID-19 pandemic and related recessionary pressures (for more information, see "Staying Home For The Holidays," published Dec. 2, 2020, on RatingsDirect).

For the town's fiscal 2021 budget, management presented a 1.34% decrease in spending compared with fiscal 2020, and further adjusted revenues to account for potential pandemic-related slowdowns, including an 11.0% reduction in state-sharing revenues, and a \$160,000 or 15.8% decline in recreation revenues. To date, Kittery is performing favorable to budget, with excise taxes, code enforcement fees, and parking fees, among other sources, tracking ahead of expectations compared with fiscal 2020. Expenses were again in line with expectations, with additional costs in the community center for preschool covered by grants received. Overall, with conservative budgeting practices and additional budgetary levers available to ease spending in the event of revenue slowdowns, we anticipate Kittery's performance will remain adequate for fiscal 2021.

Very strong budgetary flexibility

Kittery's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2020 of 21% of operating expenditures, or \$7.1 million.

With stable performance, the town continues to maintain a very strong fund balance, with the fiscal 2020 performance helping to increase the available fund balance over 12% from fiscal 2019. Management maintains the reserve policy to preserve available fund balances of no less than 1/12 (8.34%) of the general fund budget. Kittery has consistently exceeded this level, remaining above 15% over the past three fiscal years. While the town received approval to use \$1 million of the fund balance to assist with performance in fiscal 2020 and carried forward to fiscal 2021, it did not draw on the fund balance in fiscal 2020 and does not anticipate a need in fiscal 2021. If the town did draw down the full \$1.0 million, Kittery's fund balance of \$6.1 million would remain very strong, in our opinion, at over 15%. Given the lack of need to draw down on the fund balance, we anticipate the town will maintain very strong budgetary flexibility during our outlook period.

Very strong liquidity

In our opinion, Kittery's liquidity is very strong, with total government available cash at 36.7% of total governmental fund expenditures and 8.1x governmental debt service in 2020. In our view, the town has strong access to external liquidity if necessary.

The town continues to demonstrate strong market access by issuing GO bonds within the past several years. We

believe liquidity will remain very strong because Kittery does not anticipate any use of cash in the near term and does not have exposure to variable-rate debt or financial instruments subject to acceleration that could present contingent liquidity risks.

Very strong debt and contingent liability profile

In our view, Kittery's debt and contingent liability profile is very strong. Total governmental fund debt service is 4.5% of total governmental fund expenditures, and net direct debt is 93.5% of total governmental fund revenue. Overall net debt is low at 1.3% of market value, and approximately 70.1% of the direct debt is scheduled to be repaid within 10 years, which in our view are positive credit factors.

Including this issue, Kittery has about \$28.5 million of total direct debt. Of that amount, we have excluded approximately \$7.3 million of enterprise-related GO debt, based on three years of evidence that user charges have provided partial coverage to support the obligations. Management noted it does not have any additional debt plans in the near term.

Pension and other postemployment benefits

- We do not view pension and other postemployment benefits (OPEB) liabilities as an immediate source of credit pressure for Kittery.
- Although OPEB liabilities are funded on a pay-as-you-go basis, which, given claims volatility as well as medical cost and demographic trends is likely to lead to escalating costs, the town has legal flexibility to alter OPEB benefits, which we view as a potential means to mitigate escalating costs should they modify benefits.

Kittery participates in the following plans as of June 30, 2020:

- Maine Public Employees Retirement System (MainePERS): 90.6% funded, with the town's portion of the net pension liability amounting to \$3.1 million.
- Maine State Employees and Teachers Retirement System: 84.5% funded, with the town's school department share of the net pension liability amounting to \$9.4 million. The state is responsible for making contributions on behalf of the town's school department.
- A defined benefit health care plan that provides medical insurance benefits to retirees after age 55: 0% funded with an OPEB liability of about \$13 million.

The town's combined required pension and actual OPEB contributions totaled 3.9% of total governmental fund expenditures in 2020. Of that amount, 2.7% represented required contributions to pension obligations, and 1.3% represented OPEB payments. The discount rate of 6.75% for both plans remains above our guideline of 6.0% and could lead to contribution volatility. However, the town funds 100% of pension actuarially determined contribution for the MainePERS plan, and contributions in both plans remain above both static funding and minimal funding progress.

Kittery also provides OPEBs as an implicit rate subsidy to certain retirees across four employee groups.

Strong institutional framework

The institutional framework score for Maine municipalities is strong.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020 S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- 2020 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of January 15, 2021)

Kittery GO bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Kittery GO bnds ser 2002 dtd 11/01/2002 due 12/01/2003-2022		
<i>Long Term Rating</i>	AA+/Stable	Affirmed

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