

RatingsDirect®

Summary:

Kittery, Maine; General Obligation

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Credit Profile		
US\$1.14 mil GO bonds ser 2016 due 11/01/2026		
Long Term Rating	AA+/Stable	New
Kittery GO		
Long Term Rating	AA+/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to Kittery, Maine's series 2016 general obligation (GO) refunding bonds. At the same time, we affirmed our 'AA+' long-term rating and underlying rating (SPUR) on the town's outstanding GO debt. The outlook 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 the state'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 the town's 2006 GO bonds for interest rate savings.

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

- 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;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2015;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2015 at 23% of operating expenditures;
- Very strong liquidity, with total government available cash at 42.7% of total governmental fund expenditures and 7.1x governmental debt service, as well as access to external liquidity we consider strong;
- Strong debt and contingent liability position, with debt service carrying charges at 6.0% of expenditures, net direct debt at 95.7% of total governmental fund revenue, and low overall net debt at less than 3% of market value; and
- Strong institutional framework score.

Very strong economy

We consider Kittery's economy very strong. The town, with an estimated population of 9,595, is Maine's southernmost town, directly across the Piscataqua River from Portsmouth, N.H., in York County. It is in the Portland-South Portland MSA, which we consider to be broad and diverse. It has a projected per capita effective buying income of 115% of the national level and per capita market value of \$157,139. Overall, market value grew by 0.6% over the past year to \$1.5 billion in 2016. The county unemployment rate was 3.9% in 2015.

Interstate 95 and U.S. Route 1 traverse the town, providing residents with direct access to Portsmouth and other labor

markets, as well as bringing millions of tourists through Kittery each year as they travel to vacation spots statewide.

Over the past two decades, Kittery has also been a destination for shoppers attracted to its dozens of retail outlet shops. In addition, Portsmouth Naval Shipyard, which dates back to 1800, is also there. The shipyard, which employs 5,000, 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.

Looking ahead, based on our regional credit conditions forecasts, we anticipate employment growth remaining modest through 2017, and unemployment remaining stable. Kittery specifically has seen a recent uptick in economic development, and we note building permit activity has seen year-over-year growth since 2012. Further, recent data indicate that the region's median home prices are stable and improving in certain areas, and that housing starts remain positive. All these factors, we believe, are important because Kittery, along with other local governments in the region, largely looks to property taxes to meet rising expenditures.

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 historic trend analysis and strong monitoring practices. Budgetary assumptions are sound. The town conducts monthly monitoring of budget-to-actuals and, importantly, there is also now a process for regular communication between the town and its school department. 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 which identifies revenues. It also maintains a formal investment policy and a formal reserve and liquidity policy. 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.

Strong budgetary performance

Kittery's budgetary performance is strong, in our opinion. The town had operating surpluses at 2.9% of expenditures in the general fund and 2.5% across all governmental funds in fiscal 2015. General fund operating results have been stable over the last three years, with results of 1.7% in 2014 and 1.1% in 2013.

Management estimates it has closed fiscal 2016 with a \$1.1 million operating surplus, reflecting higher revenues compared to the budget of \$743,000. Expenditures came in less than anticipated.

Kittery's strong financial performance stems from several factors. The town has been very proactive in its budgeting and has enhanced financial management policies, practices, and controls. Over the past few years, it has demonstrated a commitment to strengthen financial reserves and has been active with department heads to keep costs in line with the budget.

Looking ahead, based on our macroeconomic forecasts (See "U.S. State And Local Governments Credit Forecast," published July 27, 2016, on RatingsDirect), credit conditions in New England are stable, which should translate into

consistent revenue performance. For fiscal 2017, the budget totals \$28.4 million and there is little indication that performance will deteriorate over the near term. State aid and local receipts have been stable. On the whole, property taxes comprise 81% of revenues and state aid 7.5%. Tax collections are strong and stable, with the town typically receiving 98% on a current basis.

Very strong budgetary flexibility

Kittery's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2015 at 23% of operating expenditures, or \$6.3 million.

In our calculations, we did include roughly \$2.2 million of committed reserves that can be used for any available purpose on a vote of the council.

We recognize the town saw a \$1 million improvement to reserves, reflecting a prior-period accounting adjustment. Those funds were accounted for outside the general fund but were considered available general fund monies. Nevertheless, reserves have improved over the past several years due to the town's strong budgetary performance. We anticipate they will remain at these high levels over the near term as there are no plans to draw on them and credit conditions remain stable.

Very strong liquidity

In our opinion, Kittery's liquidity is very strong, with total government available cash at 42.7% of total governmental fund expenditures and 7.1x governmental debt service in 2015. In our view, the town has strong access to external liquidity if necessary.

The town has demonstrated strong market access by issuing GO bonds within the past several years. Therefore, we believe liquidity will remain very strong since there is no significant deterioration of cash balances planned or expected. Furthermore, we note Kittery does not have any contingent liquidity risk from financial instruments with payment provisions that change on the occurrence of certain events. In addition, management is not aggressive in its use of investments.

Strong debt and contingent liability profile

In our view, Kittery's debt and contingent liability profile is strong. Total governmental fund debt service is 6.0% of total governmental fund expenditures, and net direct debt is 95.7% of total governmental fund revenue. Overall net debt is low at 2.0% of market value, which is, in our view, a positive credit factor.

Including this issue, Kittery has roughly \$31.2 million of total direct debt. Of that amount, we have excluded roughly \$2.2 million of enterprise-related GO debt, based on three years of evidence that user charges have provided partial coverage to support the obligations. The town recently issued debt through the state clean water revolving loan fund program. For now, we have included the roughly \$11.9 million in our direct calculations, but note this debt could be eligible for self-support in the future, which would potentially improve the overall factor score.

Kittery's combined required pension and actual OPEB contributions totaled 2.4% of total governmental fund expenditures in 2016.

Kittery participates in the Maine Public Employees' Retirement System. The town's pension liability with the plan is

overfunded, so its credit with the plan covers its annual contributions for general government employees. The Maine Department of Education currently makes contributions related to the teachers' group on the town's behalf.

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.

Outlook

The stable outlook reflects S&P Global Ratings' opinion of Kittery's focus on maintaining strong operating flexibility. We believe an improved economic outlook and consistent operating profile will likely result in balanced operations. We also believe that what we consider strong management conditions are a stabilizing rating factor.

Downside scenario

While we do not expect to change the rating within the two-year outlook period, if management cannot maintain balanced budgetary performance, leading to weakened budgetary flexibility, we could lower the rating.

Upside scenario

Consideration of a higher rating over time will require stronger economic indicators more commensurate with 'AAA' rated peers.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, July 27, 2016
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013

Ratings Detail (As Of September 12, 2016)		
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
Kittery GO		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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