

CREDIT OPINION

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Kittery (Town of) ME

Update to credit analysis following upgrade to Aa1

Summary

Kittery, ME (Aa1) benefits from a growing tax base which completed a revaluation in 2020 and which benefits significantly from the institutional presence of the Portsmouth Naval Shipyard, where the federal government has authorized a \$150 million improvement project. Additionally, the town maintains a stable financial position driven by conservative budgeting practices, and very manageable long term liabilities with fixed costs of just 6% in fiscal 2020.

On January 19, 2021 we upgraded the rating on the town's general obligation bonds to Aa1 from Aa2.

Credit strengths

- » Growing tax base with strong institutional presence
- » Improving reserves driven by conservative budgeting practices
- » Strong management team practices long term financial planning

Credit challenges

- » Statewide property tax cap

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

- » Continued growth in the tax base
- » Material improvement in resident wealth and/or incomes
- » Substantial increase in reserves

Factors that could lead to a downgrade

- » Material decline in the tax base
- » Operating deficits leading to drop in reserves and/or cash balances
- » A material change to the federal government's operations/commitment to the Portsmouth Naval Shipyard

» Significant increase in long term liabilities

Key indicators

Exhibit 1

Kittery (Town of) ME	2016	2017	2018	2019	2020
Economy/Tax Base					
Total Full Value (\$000)	\$1,507,750	\$1,551,800	\$1,617,600	\$1,719,900	1,866,050
Population	9,614	9,649	9,726	9,731	9,731
Full Value Per Capita	\$156,829	\$160,825	\$166,317	\$176,744	\$191,763
Median Family Income (% of US Median)	136.5%	134.1%	134.2%	128.2%	128.2%
Finances					
Operating Revenue (\$000)	\$29,204	\$29,896	\$31,618	\$32,791	\$34,345
Fund Balance (\$000)	\$5,163	\$5,218	\$5,988	\$6,314	\$7,097
Cash Balance (\$000)	\$15,714	\$13,094	\$14,712	\$14,730	\$14,078
Fund Balance as a % of Revenues	17.7%	17.5%	18.9%	19.3%	20.7%
Cash Balance as a % of Revenues	53.8%	43.8%	46.5%	44.9%	41.0%
Debt/Pensions					
Net Direct Debt (\$000)	\$30,938	\$27,354	\$25,507	\$23,745	\$21,896
3-Year Average of Moody's ANPL (\$000)	\$17,716	\$15,347	\$16,865	\$16,689	\$16,552
Net Direct Debt / Full Value (%)	2.1%	1.8%	1.6%	1.4%	1.2%
Net Direct Debt / Operating Revenues (x)	1.1x	0.9x	0.8x	0.7x	0.6x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	1.2%	1.0%	1.0%	1.0%	0.8%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	0.6x	0.5x	0.5x	0.5x	0.5x

Note: The town's 2021 valuation is a draft number which is expected to be finalized in the first week of February 2021. The current estimate for 2021 full valuation is \$2,132,700,000.

Source: Audited financial statements, US Census Bureau, Moody's Investors Service

Profile

The town, located 50 miles south of Portland, ME (Aa1 stable) and just across the river from Portsmouth, NH (Aa1 stable) is home to approximately 9,700 people and benefits from institutional presence of the Portsmouth Naval Shipyard – a shipyard that repairs and maintains submarines for the federal government.

Detailed credit considerations

Economy and Tax Base: Tax Base anchored by Portsmouth Naval Shipyard and retail outlets

We expect the town's \$2.1 billion (draft 2021 valuation) tax base to continue growing given its favorable location across from Portsmouth, NH (Aa1 stable) and due to ongoing improvements at the Portsmouth Naval Shipyard (PNSY). Future growth will come from new and ongoing developments including hotel construction, a corporate headquarter relocation, and new development on previously vacant land. Additionally, the outlet malls located in Kittery are undergoing redevelopments that are expected to increase foot traffic over the long term.

The PNSY is an important regional employment center, providing year-round local economic stability, which is an important credit strength for Kittery. Although the base is expected to remain tax-exempt indefinitely, the value of its 297 acres of land, 179 buildings and equipment exceeds \$1 billion, and the shipyard employs 8,000 people generating almost \$300 million per year in salaries. Several years ago, the Department of Defense committed to upgrading the shipyard's facilities to increase throughput of simultaneous submarines that can be repaired from three to five. We expect this commitment, and future commitments, will ensure the shipyard remains an important economic center for the region for many years to come. Should the federal government's commitment to the shipyard change, we would have to review the rating for the town.

Resident wealth and incomes are strong for the area with median family income representing 128% of US median and median home values representing 146%. Full value per capita in 2021 will be almost \$220,000 and is enhanced by a sizeable second home

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population, though management reports a significant increase in long term residents as a result of people relocating due to the ongoing COVID-19 pandemic.

Financial Operations and Reserves: Healthy financial position supported by formal policy will continue

The town's financial position will remain stable given conservative budgeting and strong reserve levels guided by a formal policy. Fiscal 2020 audited financial results reflect a \$920,000 surplus which led available fund balance to increase to \$7.1 million or 21% of revenues. During the year, the town experienced some expenditure savings due to COVID-19 shutdowns and made about \$400,000 of year end transfers to various reserve funds. Importantly, 80% of fiscal 2020 revenues came from property taxes, limiting the town's exposure to possible reductions in state aid. The town remains in compliance with its policy to maintain unassigned reserves between two and three months of operating expenses as reserves.

Fiscal 2021 year to date results should result in a small surplus when published. The fiscal 2021 budget increased by 2.4% from the prior year. The tax levy increased 3.3% and management does not appropriate fund balance from year to year. Budgeting for fiscal 2022 will begin next month. Management is not expecting any major changes from prior years.

Liquidity

Cash and investments at the end of fiscal 2020 represented \$14.1 million or 41% of revenues. We believe cash balances are slightly overstated compared to the town's fund balance levels due to timing of when the audit published and when cash is generally received by the town.

Debt and Pensions: Very manageable long term liabilities

The town's total leverage is very manageable compared to its revenue base and tax base. The town's net direct debt burden of 1.2% is below the state average of 1.5% and will remain manageable in the coming years given a lack of future debt plans outside of the upcoming issuance, which will fund library renovations and provide debt service savings. Management is currently working on updating the capital improvement plan for 2021. Expected spending totals \$2 million per year and most projects are funded with pay as you go financing.

Legal security

The bonds are secured by the town's general obligation limited tax pledge, as debt service is subject to the state's statutory property tax limitation.

Debt structure

The entire debt portfolio is fixed rate with 68% of principal retired in ten years. Fiscal 2020 debt service represented \$828,000 or 2% of revenues.

Debt-related derivatives

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

Pensions and OPEB

The town's unfunded pension and OPEB liabilities are slightly larger than its debt and remain quite manageable given their small size as total leverage measures 147% of fiscal 2020 revenues. However, pensions and OPEB liabilities 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 2020 pension and OPEB contributions and unfunded liabilities.

Exhibit 2

Kittery, ME's fiscal 2020 debt, pension and OPEB contributions and unfunded liabilities

2020	\$\$\$ (000)	% of Operating Revenues	Discount Rate
Operating Revenue	34,345	n/a	n/a
Reported Unfunded Pension Liability	3,386	10%	6.75%
Moody's Adjusted Net Pension Liability	18,954	55%	4.14%
Reported Net OPEB Liability	9,590	28%	3.65%
Moody's Adjusted Net OPEB Liability	9,802	29%	3.51%
Net Direct Debt	21,896	64%	n/a
Debt & unfunded retirement benefits (Moody's adjusted)	50,652	147%	
Pension Contribution	957	2.79%	n/a
OPEB Contribution	345	1.01%	n/a
Debt Service	828	2.41%	n/a
Total Fixed Costs	2,130	6.20%	n/a
Tread Water Gap	(533)	-1.55%	n/a
Moody's Adjusted Fixed Costs	1,597	4.65%	n/a

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

Favorably, the town's 2020 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, and the town's OPEB costs could escalate as the number of retirees it covers grows and retirees age, but fixed costs remain very manageable at just 6% of operating revenues.

ESG considerations**Environmental**

The town has high exposure to rainfall and cyclones, and as a coastal town expected rising sea levels represent a potential major impact.

Social

Outside of the COVID-19 information discussed above, there are no major social considerations.

Governance

The management team employs conservative budgeting and financial management as evidenced in a stable financial position, compliance with a formal fund balance policy, and long-term planning for capital expenditures.

Maine Cities have an institutional framework score ¹ 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 Debt 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

Kittery (Town of) ME

Scorecard Factors and Subfactors	Measure	Score
Economy/Tax Base (30%) ^[1]		
Tax Base Size: Full Value (in 000s)	\$2,132,700	Aa
Full Value Per Capita	\$219,166	Aaa
Median Family Income (% of US Median)	128.2%	Aa
Notching Factors: ^[2]		
Institutional Presence		Up
Finances (30%)		
Fund Balance as a % of Revenues	20.7%	Aa
5-Year Dollar Change in Fund Balance as % of Revenues	2.3%	A
Cash Balance as a % of Revenues	41.0%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	7.3%	A
Notching Factors: ^[2]		
Other Scorecard Adjustment Related to Finances: Cash balances overstated due to timing		Down
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 (%)	1.0%	Aa
Net Direct Debt / Operating Revenues (x)	0.6x	Aa
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	0.8%	Aaa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	0.5x	Aa
	Scorecard-Indicated Outcome	Aa1
	Assigned Rating	Aa1

[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.

Sources: US Census Bureau, Moody's Investors Service

Endnotes

- 1 The institutional framework score assesses a municipality's legal ability to match revenues with expenditures based on its constitutionally and legislatively conferred powers and responsibilities. See [US Local Government General Obligation Debt \(July 2020\)](#) methodology report for more details.

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