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Portland (City of) ME

Update to credit analysis

Summary

Portland, ME (Aa1 stable) benefits from a sizeable and diverse tax base that is the regional economic center for the state of Maine. Additionally, the city maintains a strong financial position and has a manageable pension liability. Going forward, the city's debt burden, which is already elevated, will continue to increase as management addresses a consent decree and completes renovation on four of its elementary schools. Any operating deficits over the near term combined with the increased debt burden could put negative pressure on the city's rating.

Credit strengths

» Anchor of regional economy

» Diverse tax base benefiting from ongoing new development

» Improving financial position guided by sound fund balance policy and conservative budgeting

» Manageable pension liability and no OPEB liability

Credit challenges

» Elevated debt burden will increase to address combined sewer overflows and school renovation projects

» Significant variable rate and swap exposure until maturity in June 2026

» Moderate revenue raising ability due to LD-1

Rating outlook

The stable outlook reflects our expectation that the city will maintain a healthy financial position given conservative budgeting and adherence to formal fiscal policies. Additionally, Portland's importance as the region's economic center and continued economic development will continue to enhance the overall credit profile.

Factors that could lead to an upgrade

» Continued material improvement in liquidity and reserves

» Continued tax base expansion and significant improvement in resident incomes

» Material decline in the debt burden and reduced exposure to variable rate debt

Factors that could lead to a downgrade

- Decline in reserves and/or lack of compliance with financial policies
- Contraction of local economic activity
- Significant declines in the tax base or deterioration of the demographic profile
- Material growth in debt relative to tax base

Key indicators

Exhibit 1

Portland (City of) ME	2014	2015	2016	2017	2018
Economy/Tax Base					
Total Full Value ($000)	$7,551,450	$7,707,200	$7,996,350	$8,501,550	$9,049,500
Population	66,317	66,490	66,649	66,715	66,882
Full Value Per Capita	$113,869	$115,915	$119,977	$127,431	$135,305
Median Family Income (% of US Median)	100.8%	101.2%	102.2%	108.1%	108.1%
Finances					
Operating Revenue ($000)	$238,968	$246,812	$263,196	$266,015	$281,208
Fund Balance ($000)	$44,525	$44,412	$52,409	$60,060	$66,349
Cash Balance ($000)	$46,023	$52,262	$62,835	$72,060	$77,599
Fund Balance as a % of Revenues	18.6%	18.0%	19.9%	22.6%	23.6%
Cash Balance as a % of Revenues	19.3%	21.2%	23.9%	27.1%	27.6%
Debt/Pensions					
Net Direct Debt ($000)	$222,777	$228,864	$305,801	$298,686	$327,959
3-Year Average of Moody's ANPL ($000)	$131,730	$121,121	$142,903	$170,748	$190,663
Net Direct Debt / Full Value (%)	3.0%	3.0%	3.8%	3.5%	3.6%
Net Direct Debt / Operating Revenues (x)	0.9x	0.9x	1.2x	1.1x	1.2x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	1.7%	1.6%	1.8%	2.0%	2.1%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	0.6x	0.5x	0.5x	0.6x	0.7x

Note: 2019 Full Valuation ($000s): $9,687,850
Source: Moody's Investors Service and issuer's audited financial statements

Profile

Portland is Maine's largest city and functions as the region's economic and cultural center. The city is located on the southern coast of Maine in Cumberland County (Aa2) and has a population of approximately 66,900.

Detailed credit considerations

Economy and Tax Base: Growth trend has been strong but may decelerate going forward

Portland's large and growing tax base will continue to increase in valuation in the near term though future growth prospects appear marginally weaker as the city wrestles with a tight labor market. As Maine's largest city, Portland functions as the region's economic and cultural center. The $9.7 billion tax base is very diverse - 59% is residential and 41% is commercial and industrial - and has grown at a breakneck 5.1% compound annual rate over the last five years. Important sectors of the city's broad economy include health care, port activities, financial services, government services, and wholesale and retail trade. Portland's port facilities include a major oil and gas terminal and piers for passenger cruise and ferry service.

As a regional employment center, the city attracts a large number of workers from surrounding communities. Major employers include the UNUM Group (Baa2 stable) and Maine Medical Center (A1), which, in addition to being the largest health care facility in northern New England, is currently in the process of completing a $500 million expansion project. Together, these two entities make up 71% of the jobs provided by the city's top 10 employers. The city's unemployment rate of 3.0% (January 2019) remains well below state and national rates.

Equalized value has increased in each of the past five years, including 7.1% in 2019, and the moderate growth will continue over the near term given ongoing residential development and new commercial projects. The largest of these projects is Bayside, a large mixed use development with 400 market-rate apartments, 90,000 square feet of commercial space, and a parking garage. Additionally, in early 2019, Wex Inc. completed its headquarters in downtown Portland, which is expected to house over 400 employees.

Resident wealth and incomes are average compared to the state and US but have improved slightly in recent years. Median family income represents 114% of state and 108% of US medians, while median home values represent 145% of state and 135% of US medians. Equalized value per capita of $144,850 has increased almost 21% since 2016.

Financial Operations and Reserves: Stable financial position guided by formal policies

The city's healthy financial position, guided by formal fund balance and debt issuance policies, will remain stable given continued conservative budgeting. Fiscal 2018 audited results reflect a $6.3 million operating fund surplus (General Fund and Debt Service Fund) due to strong revenue performance in excise taxes ($1.2 million above budget) and building permits ($600,000 above budget). The city also sold several parcels of land throughout the year generating one-time revenues of approximately $4.2 million. The surplus increased available operating fund balance to $66.3 million or 23.6% of revenues. The majority of fund balance remain unassigned ($43.4 million or 15.4%), and the city remains in compliance with its formal policy to maintain unassigned General Fund balance at 12.5% of budgeted expenditures in the subsequent year. The city's primary revenue sources are property taxes (59.2% of fiscal 2018 operating revenues), state aid (14.0%), and charges for services (13.7%). Education remains the largest expenditure at 37.5% of the total budget.

Management expects another surplus in fiscal 2019 as building permit revenues again come in higher than originally budgeted, and the city benefits from an increase in parking meter rates. Finally, following the change in the governor's office, the city is expecting more state aid. The fiscal 2019 budget increased by $12 million or 3.4% and was offset with an increase in the tax levy of 3.8%.

The fiscal 2020 budget, while not yet finalized, expects a $9 million increase in the general fund or 4.6% growth and is balanced with a 2.9% increase in the tax levy and higher expected contributions from state revenue sharing.

LIQUIDITY

Cash and investments at the end of fiscal 2018 represented $77.6 million or 27.6% of revenues.

Debt and Pensions: Elevated debt burden will continue to increase; manageable pension liability with presence of variable rate POBs; No OPEB liability

The city's 3.6% net direct debt burden will continue to climb as the city issues debt for its capital improvement plan and finances wastewater projects related to its consent decree with the state Department of Environmental Protection.

The city currently has $212 million of authorized, unissued debt that it expects to issue for water and sewer projects and elementary school renovations projects. The city expects to service the significant additional indebtedness for water and sewer projects through increases in sewer user fees and stormwater service charges of 3-4% per year.

A large portion of the city's outstanding debt (31%) is represented by variable rate Pension Obligation Bonds (POBs) issued in 2001 to eliminate an unfunded pension liability to the former Maine State Retirement System. Liquidity support for the variable rate debt is provided via a Standby Letter of Credit and Reimbursement Agreement with Sumitomo Mitsui Banking Corporation (A1 P-1 stable), which expires October 28, 2020. Portland's POBs have always been remarketed successfully. In the event of a failed remarketing the liquidity support provider would purchase the bonds with the interest rate resetting to a penalty rate of up to 15%. Debt service is projected to drop dramatically once the POBs mature. According to the current debt service schedule, the city will pay $15 million in debt service in 2027, down from $37 million in 2026.

DEBT STRUCTURE

The city issued variable rate POBs in 2001, which are hedged with a fixed rate swap, discussed below. All other debt is fixed rate. Amortization of principal is faster than average, with 81% repaid within ten years. Fiscal 2018 debt service represented 10.5% of total expenditures.

DEBT-RELATED DERIVATIVES

The city entered into a floating-to-fixed swap to manage interest rate exposure associated with the variable POBs. The notional amount (currently $98 million) declines as principal is paid down on the debt and the term of the swap matches that of the debt. Under the terms of the swap, Bank of New York Mellon (Aa2 P-1 stable) pays monthly LIBOR plus 40 basis points and receives a fixed rate of 8.903% through the termination date in June 2026. The fixed rate schedule was reportedly established to match the structure of the pension obligation. If either party's rating falls below A3, the swap could be terminated or collateral posting could be required at a level up to the termination payment, which is currently $26 million. Swap and termination payments are on parity with the city's general obligation bonds. The city has accumulated approximately $5 million in reserves as a result of positive swap performance. The city has the ability to bond for a termination payment, if needed. Favorably, only the city has the option of early termination.

PENSIONS AND OPEB

Portland 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 multiple employer defined benefit pension plans. The city fully funds its required contributions, which totaled $8.1 million in fiscal 2018 representing 3% of expenditures. The fiscal 2018 three-year combined adjusted net pension liability, based on Moody’s methodology for adjusting reported pension data, is $190.7 million, or an average 0.7 times General Fund revenues and 2.1% of equalized value.

The city does not offer other post employment benefits (OPEB) for health insurance to its retirees, and, as a result, has no OPEB liability.

Total fixed costs for fiscal 2017, including debt service and required pension contributions, represented $34.6 million, or 12.8% of expenditures.

Management and Governance

Portland's management maintains the city's strong financial position through careful budgeting and expense management as well as adherence to formally adopted fund balance and debt issuance policies.

The city is susceptible to environmental risks including rising sea levels and major storms. The city is working to establish a climate action plan and adaptation plan in conjunction with South Portland, ME (Aaa stable). In addition to these plans, Portland has committed to reducing community wide greenhouse gas emissions 80% by 2050 and transitioning to 100% clean energy for municipal operations by 2040.

Maine cities and towns have an Institutional Framework score of Aa, which is high compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. Cities' and towns’ major revenue source, 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 greater than 25% of expenditures. Maine has public sector unions, which can limit the ability to cut expenditures. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

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