South Portland, ME

New Issue - Moody's assigns Aaa to South Portland, ME's GO Refunding Bonds; Outlook stable

Summary Rating Rationale
Moody's Investors Service has assigned a Aaa rating to the City of South Portland, ME $14.2 million 2017 General Obligation Refunding Bonds. Concurrently, Moody's has affirmed the Aaa rating on $56.4 million of outstanding rated general obligation debt. The outlook remains stable.

The Aaa rating reflects the city's stable and diverse tax base with average wealth levels, a growing labor force, well-managed financial position, and manageable debt and pension burdens.

Credit Strengths
» Stable tax base which serves as regional economic center
» Stable financial position guided by a formal policy
» Manageable pension and OPEB liabilities

Credit Challenges
» Moderately concentrated tax base

Rating Outlook
The stable outlook reflects our expectation of continued stability in the city's financial position driven by conservative budgeting and adherence to formal policies. The outlook also incorporates the strength of the regional economy.

Factors that Could Lead to a Downgrade
» Trend of operating deficits resulting in reserve declines
» Significant declines in the tax base or contraction of the regional economy
» Material growth in debt burden
Key Indicators

Exhibit 1

<table>
<thead>
<tr>
<th>South Portland (City of) ME</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Economy/Tax Base</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Full Value ($000)</td>
<td>$3,556,500</td>
<td>$3,516,250</td>
<td>$3,537,700</td>
<td>$3,580,100</td>
<td>$3,696,350</td>
</tr>
<tr>
<td>Full Value Per Capita</td>
<td>$142,277</td>
<td>$140,240</td>
<td>$140,642</td>
<td>$141,484</td>
<td>$147,842</td>
</tr>
<tr>
<td>Median Family Income (% of US Median)</td>
<td>103.2%</td>
<td>99.4%</td>
<td>97.9%</td>
<td>101.6%</td>
<td>101.6%</td>
</tr>
<tr>
<td><strong>Finances</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating Revenue ($000)</td>
<td>$71,972</td>
<td>$74,095</td>
<td>$79,346</td>
<td>$82,969</td>
<td>$85,125</td>
</tr>
<tr>
<td>Fund Balance as a % of Revenues</td>
<td>23.3%</td>
<td>23.8%</td>
<td>23.2%</td>
<td>23.5%</td>
<td>24.6%</td>
</tr>
<tr>
<td>Cash Balance as a % of Revenues</td>
<td>55.6%</td>
<td>53.1%</td>
<td>51.9%</td>
<td>47.8%</td>
<td>50.1%</td>
</tr>
<tr>
<td><strong>Debt/Pensions</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Direct Debt ($000)</td>
<td>$51,789</td>
<td>$50,408</td>
<td>$55,650</td>
<td>$50,970</td>
<td>$46,609</td>
</tr>
<tr>
<td>Net Direct Debt / Operating Revenues (x)</td>
<td>0.7x</td>
<td>0.7x</td>
<td>0.7x</td>
<td>0.6x</td>
<td>0.5x</td>
</tr>
<tr>
<td>Net Direct Debt / Full Value (%)</td>
<td>1.5%</td>
<td>1.4%</td>
<td>1.6%</td>
<td>1.4%</td>
<td>1.3%</td>
</tr>
<tr>
<td>Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)</td>
<td>N/A</td>
<td>0.2x</td>
<td>0.3x</td>
<td>0.4x</td>
<td>0.4x</td>
</tr>
<tr>
<td>Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)</td>
<td>N/A</td>
<td>0.5%</td>
<td>0.7%</td>
<td>0.8%</td>
<td>1.0%</td>
</tr>
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</table>

As of June 30 fiscal year-end
Source: Moody’s Investors Service; South Portland’s Audit Financial Statements

Recent Developments

This report remains largely unchanged since our last review. We have provided updates on the city’s expected fiscal 2017 operating results, the approved 2018 budget and discuss a potential new debt issuance which is expected to be supported by state aid and therefore budget neutral.

Detailed Rating Considerations

Economy and Tax Base: Modest Growth Expected for Diverse Tax Base

South Portland’s $3.7 billion tax base should continue to benefit from the presence of a vibrant retail sector and a sizable commercial/industrial component. Over the past five years (fiscal 2012-2017), state equalized value (full value) increased by a compound annual rate of just 1%. Values fell in 2011-2013 due, in part, to state legislation that exempted certain business personal property from taxation. Since then values have fully recovered and the city is positioned for continued stability given the housing demands of its growing labor force and the various new commercial and residential developments underway.

The tax base is moderately concentrated, with the top ten taxpayers accounting for 19.3% of fiscal 2018 assessed values (AV). Officials report that the largest taxpayer, the Maine Mall (6.8% of AV), operated by General Growth Properties (GGP), has a 98% occupancy rate, an improvement over previous years as the mall has continually filled in after the closure of stores. Management also reports that Macy’s, a large anchor tenant, is keeping its South Portland store open. Additionally, the city’s labor market is strong, with job growth in the Portland-South Portland Metropolitan Statistical Area outpacing most of its New England peers. The July unemployment rate of 2.8% is below the state (3.5%) and nation (4.6%), reflective of the fundamentally stable economy.

Wealth and income levels remain on par with state and national medians, with median family income at 107.7% and 101.6%, respectively. The full value per capita of $147,842 reflects the city’s large commercial and industrial sector (46.8% of assessed value when combined).

Financial Operations and Reserves: Stable Financial Position Supported by Formal Policy

The financial position will remain stable given conservative budgeting and strong reserve levels guided by a formal policy. The city has generated surpluses annually, and available General Fund reserves (excludes nonspendable and restricted) have been very stable over
the past five years, averaging 23.7% of revenues. Fiscal 2016 audited results reflect a large surplus of $1.4 million, driven by strong excises taxes and overall conservative budgeting. Available fund balance improved to $20.9 million or 24.6% of revenues. Unassigned fund balance increased to $13.3 million (15.6%), which is in excess of the formal policy to maintain this balance at 9-12% of GAAP expenditures.

Outside of the General Fund, the city maintains additional committed liquidity of approximately $3.5 million in its Capital Projects Fund (2016 year-end), which provides significant additional operating flexibility as the reserves may be reallocated for General Fund operations by the city council. In addition, financial flexibility is enhanced by $6.4 million of accumulated excess taxing capacity under the provisions of LD-1, representing the amount of allowable levy growth not utilized but available for future budgets.

Conservative budgeting led to another small expected surplus in fiscal 2017 (June year-end). The city will allocate a larger usual amount to capital projects and unassigned fund balance is therefore projected to decline slightly, to $12.9 million. The 2018 budget increased 3.8% and was balanced with a 1.9% tax levy increase.

South Portland derives its revenues from property taxes (80% of fiscal 2016 revenues) and state aid (15.2%). Education is the largest expenditure at 51.4%

LIQUIDITY
The General Fund cash position has been stable for the past several years, and was $42.6 million, or 50.1% of revenues, in fiscal 2016. When accounting for current liabilities, including summer teacher’s salaries and interfund loans payable, year-end cash declines to $17.7 million, or a still healthy 20.7%.

Debt and Pensions: Debt Burden Will Remain Manageable; Modest Pension Liability
The direct debt burden (1.5% of equalized valuation) will remain manageable given a strong commitment to pay-as-you-go financing, self-supporting enterprise debt, and moderate borrowing plans supported by the General Fund. The overall debt burden increases slightly to 1.7% when incorporating overlapping debt for Cumberland County (Aa1) and contingent obligation for the regional water utility. Despite a large potential bond issuance, the city’s debt burden is expected to remain stable. In November 2018, the city is expected to put a $50 million bond referendum to voters for the construction of a new middle school. The bond issuance will largely be budget neutral as the project has been approved for significant state reimbursement.

DEBT STRUCTURE
All debt is fixed rate and amortization of principal is below-average, with 63% repaid within ten years. Debt service, net of self-supporting enterprise debt, accounted for 6.9% of fiscal 2016 expenditures.

DEBT-RELATED DERIVATIVES
South Portland has no derivatives.

PENSIONS AND OPEB
South Portland’s has a modest pension liability that will remain affordable given adequate annual state and city contributions.

South Portland contributes to the Maine Public Employees Retirement Systems State Employee and Teacher Plan and the Consolidated Plan for Participating Local Districts, two cost-sharing multi-employer defined benefit pension plans. Moody’s adjusted net pension liability (ANPL) is $36.9 million or a below-average 0.43 times operating revenues. Moody's adjustments are not intended to replace the city’s reported liability information, but to improve comparability with other rated entities.

Additionally, the city’s OPEB liability is limited to the value of its implicit rate subsidy to retirees that buy into the health insurance benefit plan. As of January 2015, the total liability is only $4.2 million.

Total fixed costs for fiscal 2016, including debt service, required pension contributions and retiree healthcare payments, represented $7.8 million, or 9.2% of expenditures.

Management and 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 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’ 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.

Legal Security
The bonds are secured by the city’s general obligation unlimited tax pledge, as debt service is exempt from the state’s property tax limitation known as LD-1 since proceeds are refunding bonds used for school purposes.

Use of Proceeds
Bond proceeds will finance the refunding of the 2010 and 2012 bonds for an expected net present value savings of approximately $653,760 or 4.57% of refunded principal.

Obligor Profile
South Portland is the fourth largest city in Maine with a population of 25,000. The city is located on the southern coast of Maine in Cumberland County (Aa1).

Methodology
The principal methodology used in this rating was US Local Government General Obligation Debt published in December 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Ratings

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<th>South Portland (City of) ME</th>
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<td><strong>Issue</strong></td>
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<tr>
<td>2017 General Obligation Refunding Bonds</td>
</tr>
<tr>
<td>Rating Type</td>
</tr>
<tr>
<td>Sale Amount</td>
</tr>
<tr>
<td>Expected Sale Date</td>
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<td>Rating Description</td>
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Source: Moody’s Investors Service
ranging from JPY200,000 to approximately JPY350,000,000.

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