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Ratings

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Summary:

Portland Water District, Maine; General Obligation; Water/Sewer

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Credit Profile		
US$3.9 mil wastewtr sys rev bnds ser 2020 due 11/01/2030		
Long Term Rating	AA+/Stable	New
Portland GO		
Long Term Rating	AA+/Stable	Affirmed
Portland Wtr Dist GO		
Long Term Rating	AA+/Stable	Upgraded

Rating Action

S&P Global Ratings has corrected its long-term rating on Portland Water District, Maine's series 2013 wastewater system revenue bonds by raising it to 'AA+' from 'AA'. We also assigned our 'AA+' long-term rating to the district's series 2020 wastewater system revenue bonds. The outlook is stable.

Due to an error, we did not revise our rating on the wastewater system revenue bonds when we raised our long-term rating on the city of Portland's general obligation (GO) debt on Feb. 24, 2017. The rating on the revenue bonds should have been raised at that time to a level on par with our GO rating on the city.

The series 2013 wastewater system revenue bonds were issued to provide funds to finance improvements to Portland's collection lines at Peaks Island. The series 2020 wastewater system revenue bonds are being issued to finance a primary clarifier upgrade at the East End Treatment Plant in Portland.

Pursuant to its charter, the district is required to apportion all of the associated debt service to the city. If not already factored into its sewer use charges, Portland's assessors will include the amount needed to be raised by municipal tax or assessment or, in the case of a supplemental certification, funds otherwise available. The apportioned cost (which includes debt service) constitutes a statutory unconditional obligation of the city that, once certified, we consider on par with its GO debt. Therefore, the rating reflects Portland's GO pledge.

As part of this rating action, S&P Global Ratings also affirmed its 'AA+' long-term rating on the city's GO debt outstanding.

Credit overview

Portland enters the national recession triggered by the outbreak of COVID-19 with strong budgetary reserves and flexibility, and well-embedded financial management policies, particularly in the areas of budgeting and planning.

Supporting the long-term rating are the city's strong property tax base growth and desirable location in New England. In our opinion, economic growth in Portland has been favorable, which has allowed for continued positive strong budgetary performance that has led to improved reserves. Furthermore, the management environment has been strong with a good focus on climate change resilience given the city's exposure along the coast. In our view, its debt profile, while a bit high, is manageable with no prudent future debt plans.

While we note significant uncertainty around certain revenue shortfalls and potential state aid cuts that could weaken the city's performance as it heads into fiscal year 2021, we understand management has already taken measures to cushion the effects of potential revenue shortfalls and has additional measures at its disposal that it could implement should significant cuts happen. Lending further stability to the rating and the outlook are the city's very strong liquidity and stable revenue mix, with the predominant revenue stream of property taxes, which have historically been collected upward of 98% during the fiscal year payable. That said, given that there is still much uncertainty related to the potential effects of COVID-19 and the ensuing economic recession on the city's finances, we will continue to monitor for any material adverse effects throughout the outlook period. For more information on the coronavirus' effect in U.S. Public Finance, please see our reports titled "The COVID-19 Outbreak Weakens U.S. State And Local Government Credit Conditions" (published April 2, 2020 on RatingsDirect) and "The U.S. Faces A Longer And Slower Climb From The Bottom" (published June 25, 2020).

The rating further reflects our view of the city's:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong 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 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 22% of operating expenditures;
- Very strong liquidity, with total government available cash at 24.9% of total governmental fund expenditures and 2.3x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges at 10.6% of expenditures and net direct debt that is 89.2% of total governmental fund revenue, as well as rapid amortization, with 66.0% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Environmental, social, and governance factors

We evaluated the city's environmental, social, and governance (ESG) factors relative to its economy, financial measures, management, and debt and long-term liability profile. We acknowledge, absent the implications of COVID-19, we consider the city's social risks in line with those of the sector. We view environmental risks and their potential effect on taxable properties as slightly above average relative to peers given coastal exposure. Management, however, has been proactive in addressing these risks and has undertaken a coordinated response to local climate resilience, including working with local businesses and other communities. Governance factors generally align with the sector as a whole. We note the city's positive efforts to protect itself from cyberattacks.

Stable Outlook

Downside scenario

While unlikely, we could lower the rating if budgetary performance were to deteriorate, leading to substantially weakened reserves.

Upside scenario

If economic indicators were to improve, coupled with a stronger debt and contingent liability profile, while management maintains its very strong budgetary flexibility through positive financial performance, we could raise the rating.

Credit Opinion

Strong economy

We consider Portland's economy strong. The city, with a population of 66,417, is in Cumberland County in southern Maine, on the Atlantic Coast, about 110 miles north of Boston. It is in the Portland-South Portland MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 105.0% of the national level and per capita market value of $119,490. Overall, market value grew by 1.1% over the past year to $7.9 billion in 2020.

While the city is primarily residential, it also has a sizable commercial and industrial component. Although the mostly residential city maintains a stable year-round population, economic activity increases significantly in the summer. Its harbor and deep-water port allow for an active commercial fishing and shipping industry and provide tourism activity as a cruise-ship destination in the summer. Furthermore, Portland has the state's deepest economy with health care, financial services, higher education, and retail components.

In January 2020, Northeastern University in Boston announced plans to launch a graduate school and research campus in Portland called The Roux Institute. Northeastern provided a $100 million grant to support the start-up, infrastructure, and operational costs for this project. The Roux Institute will offer graduate programs in machine learning and artificial intelligence. Portland officials believe that the city will benefit from the influx of students, researchers, and employees.

The county unemployment rate was 2.4% in 2019. Despite this very low figure, rapidly evolving economic conditions due to the pandemic have significantly affected the labor market (see "U.S. Jobs Market Buckles Under The Coronavirus Pandemic," published April 2, 2020). While the regional economy showed resilience in the past recession, high unemployment, particularly if it exceeds 10%, is a risk we are monitoring.

Very strong management

We view the city's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Management has taken significant steps to mitigate exposure to cyber-related risks and has been active in addressing concerns related to rising sea levels that could directly affect taxable properties. In particular, Portland has collaborated with South Portland on a climate action and adaptation plan called "One Climate Future" to reduce greenhouse gas emissions 80% by 2050 and transition to 100% clean energy for municipal operations by 2040. In addition, the city has conducted studies on sea-level rise and inundation from inclement weather to inform its decisions on how to prepare against flooding.

Portland's revenue and expenditure assumptions are conservative, and the city makes regular efforts to determine whether revenue or expenditures will deviate from long-term trends. When creating the budget, management typically uses 10 years of historical data. Officials regularly monitor budgetary performance, and ensure adjustments are timely; management makes monthly reports on budget-to-actual results to the city council.

The city also maintains an internal long-term financial plan to assist in building the operating budget, and management expects to expand this detail by department. Furthermore, Portland maintains a formal capital improvement plan it reviews and prioritizes yearly that identifies funding sources. While the city has its own formal investment policy, it does not report holdings and returns frequently to the council.

The debt management policy limits annual debt service, net of enterprise-supported and state-reimbursed school debt service, to 15% of general fund expenditures and 1.5% of per capita income, as determined by the U.S. Bureau of Economic Analysis for the Portland-South Portland-Biddeford region. The reserve policy calls for an unassigned general fund balance equal to 12.5% of expenditures, and it sets a minimum 8.3% of expenditures based on cash flow.

Adequate budgetary performance

Due to the sudden rapid economic deterioration, we have revised our budgetary performance assessment to adequate from strong. This assessment incorporates heightened near-term uncertainty that exists due to the recessionary pressures related to the COVID-19 pandemic and resulting financial challenges. The city had slight surplus operating results in the general fund of 1.1% of expenditures, and surplus results across all governmental funds of 2.1% in fiscal 2019. Its general fund operating results have been stable over the past three years, with results of 1.9% in 2018 and 2.6% in 2017.

Prior to the pandemic, Portland had strong financial performance as demonstrated by management's conservative budgeting practices, particularly its careful budget planning and in-year performance monitoring. For the past eight audited fiscal years (before fiscal 2019), it achieved an operating surplus or almost break-even results despite facing state revenue pressure. Management mainly attributes past favorable budgetary performance to conservative budgeting and modest local fee and tax recovery in an improving economy.

Fiscal 2019 officials attribute the fiscal 2019 general fund surplus mainly to higher-than-budgeted revenue, including excise taxes, parking revenue, licenses and permits, and property taxes. The city benefits from its growing economy and desirable location on the water, which is within driving distance of Boston.

For fiscal 2020, despite certain revenue shortfalls in the fourth quarter, the city estimates it will close with similar results as in years past, with no significant drawdowns on fund balance planned, which reflects revenues coming in well over budget prior to the pandemic. Throughout the pandemic, Portland has implemented several cost-containment measures, with any savings rolled into any potential shortfalls in fiscal 2021.

For fiscal 2021, the city is anticipating finalizing its budget in September, and in the meantime, has put into place a contingency budget with a 5% expenditure reduction across all departments due to anticipated revenue decreases in its economically sensitive revenues. In addition, it has identified further spending reductions it could initiate and is currently working with collective bargaining units. All COVID-19-specific expenditures will likely be fully reimbursable to the city.

The city's revenue mix has generally been stable during past recessions, particularly property taxes, which generate 61% of general fund revenue. Tax collections remain strong, averaging 99% in the past three years. Intergovernmental revenue has been challenging in the past, but following the state's biennial budget, the city will receive more than in the past. Currently, intergovernmental aid is at 14% of general fund revenues.

Very strong budgetary flexibility

Portland's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 22% of operating expenditures, or $62.7 million.

The city has maintained very strong budgetary flexibility in the past three fiscal years. Available reserves improved to $62.2 million in fiscal 2018 from $39.0 million in fiscal 2015 due to consistent positive financial performance. Officials do not anticipate any drawdowns of reserves. Therefore, we expect budgetary flexibility will likely remain very strong as it heads into 2021. Management also adheres to its formal reserve policy of maintaining available reserves equal to 12.5% of expenditures with a minimum 8.3% of general fund expenditures.

Very strong liquidity

In our opinion, Portland's liquidity is very strong, with total government available cash at 24.9% of total governmental fund expenditures and 2.3x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary.

We adjusted Portland's fiscal 2019 cash for restricted cash and cash equivalents, largely bond proceeds. The city has demonstrated strong access to external liquidity through frequent GO debt issuance. Portland largely invests cash in highly collateralized bank deposits and money market funds. Due to strong performance and projected positive operations in fiscal 2020, we do not expect liquidity deterioration during the two-year outlook period.

We note Portland issued pension obligation bonds (POBs) in 2001 as variable-rate bonds, and it simultaneously entered into a floating- to fixed-rate swap agreement to fix the bonds synthetically. The Bank of New York Mellon Corp. is the swap's counterparty. In our opinion, despite the swap's current negative marked-to-market value of about $28.1 million, which is down significantly from previous years, the swap poses a low credit quality risk because there is a sufficient spread between the current rating and 'BBB-'; if the rating were to fall below 'BBB-', the city would be obligated to post additional collateral.

A standby letter of credit (SLOC) provided by Sumitomo Mitsui Banking Corp., effective Oct. 28, 2015, substituting for a previous standby bond purchase agreement provided by JPMorgan Chase Bank N.A., enhances the city's series 2001 bonds. The SLOC covers principal and 37 days' interest at a maximum 15% annual rate for the purchase price of bonds not successfully remarketed. The SLOC expires Oct. 28, 2020, at which time we will remove the short-term component of the rating on the series 2001 bonds unless the SLOC is either extended or terminated beforehand according to its terms. We understand that the city is currently evaluating its options and will likely extend the existing terms of the SLOC or substitute the SLOC with another bank.

We note that the SLOC contains certain automatic termination and suspension events and that the SLOC agreement would automatically terminate should the rating on Portland fall below 'BBB-'. We have reviewed these events and we consider them consistent with our criteria; we also think there is a sufficient spread between the current rating and the SLOC's rating termination trigger.

Adequate debt and contingent liability profile

In our view, Portland's debt and contingent liability profile is adequate. Total governmental fund debt service is 10.6% of total governmental fund expenditures, and net direct debt is 89.2% of total governmental fund revenue. Approximately 66.0% of the direct debt is scheduled to be repaid within 10 years, which is, in our view, a positive credit factor.

Portland has roughly $457 million of debt outstanding, including general airport revenue bonds, $105 million of which are self-supporting through enterprise funds. In the next two years, management plans to issue about $20 million of debt annually for various capital improvements, including combined sewer and general capital improvements, offset by similar-sized maturing bonds. We do not expect additional debt issuance to have a negative effect on overall debt due to the city's current amortization schedule.

Pension and other postemployment benefits

- Pension and other postemployment benefits (OPEB) liabilities are not an immediate source of credit pressure for the city, given the well-funded status of the pension plans and the limited long-term liabilities.
- Any increases in contributions will likely remain affordable, based on the strength of Portland's revenue base, strong reserves, and conservative budgeting.
- The city offers OPEBs but recognizes no liability. The liability for the plan represents an implicit rate subsidy.

The city participates in the following plans:

- Maine Public Employees Retirement System Consolidated Plan for Local Participating Districts Plan (PLD Plan), which is 90.62% funded and has a $32.4 million net pension liability (NPL)
- Maine Public Employees Retirement System State Employee and Teacher Plan (SET Plan), which is 82.73% funded and has a $7.2 million NPL

Portland's combined required pension and actual OPEB contributions totaled 2.8% of total governmental fund expenditures in 2019. The city made its full annual required pension contribution in 2019.

In 2001, the city issue POBs to pay its unfunded portion of the state plan; these bonds' final maturity is in 2026. Portland has about $92.6 million outstanding for the POBs. The PLD and SET plans are cost-sharing, multiple-employer, defined-benefit pension plans. Both systems use a 6.75% discount rate. Positively, both plans met both our static funding metric in the most recent year as well as our minimum funding progress calculation, indicating that they are addressing current costs and making headway addressing their unfunded liabilities.

Portland's OPEB liability is due to the implicit subsidy of its retirees' eligibility to enroll in the city's health care plan at 100% of the premium cost to the retiree. At June 30, 2019, the last actuarial valuation study, the net OPEB liability was a minimal $4.6 million.

We believe that retirement costs do not have a material effect on finances or operations at present and that they will likely remain manageable in the next three-to-four years.

Strong institutional framework

The institutional framework score for Maine municipalities is strong.

Portland's Sewer System

The district provides wastewater service to Portland. The city owns and maintains collector sewer lines and is responsible for their maintenance, improvements, and expansion. The sewer system contains two separate treatment facilities. The mainland facility, East End Wastewater Treatment Facility, processes wastewater for the city, trucked in waste and thickened sludge from the Peaks Island and Cape Elizabeth South treatment facilities. Peaks Island Wastewater Treatment Facility processes wastewater for Peaks Island, part of the city, to a thickened sludge product.

The Portland Water District owns and operates a sewer interceptor system and pumping stations in the city, and operates the treatment plants for sewage delivered to the plants by Portland, for which the city pays a monthly assessment fee. The district sets an annual assessment at an amount needed to operate the treatment plants and pay related debt service.

Portland's city council sets the sewer rates, which are not regulated. It considers sewer rate increases each year. Typical annual increases are 3%-5% per year. The district bills and collects for the city.

The districts passes on to Portland assessments for its sewer system. These assessments are a statutory obligation of the city. Portland may pay the assessments through sewer rates or through some other sources, like appropriations from its general fund, if necessary. District officials, however, say the city has never made these general fund appropriations.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of July 10, 2020)		
Portland GO		
Long Term Rating	AA+/A-1/Stable	Affirmed
Portland GO		
Long Term Rating	AA+/Stable	Affirmed
Portland GO		
Long Term Rating	AA+/Stable	Affirmed

Ratings Detail (As Of July 10, 2020) (cont.)		
Portland GO		
Long Term Rating	AA+/Stable	Affirmed
Portland GO		
Long Term Rating	AA+/Stable	Affirmed
Portland GO		
Long Term Rating	AA+/Stable	Affirmed
Portland GO		
Long Term Rating	AA+/Stable	Affirmed
Portland GO		
Long Term Rating	AA+/Stable	Affirmed