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Ratings

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Summary:

Salisbury, Maryland; General Obligation

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Summary:

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Credit Profile		
Salisbury GO pub imp and rfdg bnds ser 2016 due 07/01/2036		
Long Term Rating	AA/Stable	Upgraded

Rationale

S&P Global Ratings raised its rating on Salisbury, Md.'s general obligation (GO) bonds outstanding to 'AA' from 'AA-'. The outlook is stable.

The one-notch upgrade reflects the city's improved economic factor score, in our view, following application of our broad and diverse adjustment to the Salisbury metropolitan statistical area (MSA), due to improved labor force growth as well as employment diversification. In addition, the city continues to maintain very strong budgetary flexibility.

The city's full-faith-and-credit pledge secures its GO bonds.

The rating reflects our opinion of the following factors of the city:

- Strong economy, with access to a broad and diverse MSA and a local stabilizing institutional influence;
- Strong management, with "good" financial policies and practices under our financial management assessment (FMA) methodology;
- Adequate budgetary performance, with a slight operating surplus in the general fund but an operating deficit at the total governmental fund level in fiscal 2016;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2016 of 28% of operating expenditures;
- Very strong liquidity, with total government available cash at 41.5% of total governmental fund expenditures and 5.6x governmental debt service, and access to external liquidity we consider strong;
- Very strong debt and contingent liability position, with debt service carrying charges at 7.4% of expenditures and net direct debt that is 64.9% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of market value and rapid amortization, with 72.9% of debt scheduled to be retired in 10 years; and
- Very strong institutional framework score.

Strong economy

We consider Salisbury's economy strong. The city, with an estimated population of 32,359, is located in Wicomico County in the Salisbury MSA, which we consider to be broad and diverse. The city also benefits, in our view, from a stabilizing institutional influence. The city has a projected per capita effective buying income of 74.9% of the national level and per capita market value of $63,944. Overall, the city's market value grew by 2.6% to $2.1 billion from 2015 to 2016. The county unemployment rate was 6.8% in 2015.

Salisbury, on the eastern shore of Maryland, is the county seat of Wicomico County and is the commercial hub of the Delmarva Peninsula. Located at the head of Wicomico River, the city is home to Maryland's second largest port. Salisbury is 96 miles south of Wilmington, Del.; 106 miles southeast of Baltimore; and 119 miles southeast of

Washington.

The city's property tax base is very diverse, with the 10 leading taxpayers taking up 12.1% of assessed value. Salisbury residents have access to various sectors, but education and health care are the leading sectors at roughly one-third of the city's business composition. Manufacturing, arts and entertainment, and retail combined make up another third of employment. Various other sectors account for the remainder. Leading city employers include:

- Peninsula Regional Medical Center (2,900 employees);
- Salisbury University (1,750);
- Perdue Farms (1,600); and
- Wal-Mart Stores Inc.#?#Sam's Club (750).

Both Salisbury University and University of Maryland Eastern Shore have been longstanding, stabilizing institutions for the city. Salisbury University enrollment totals roughly 25% of the city's population, which leads us to believe this somewhat depresses Salisbury's economic indicators and we have considered this in our analysis.

Strong management

We view the city'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 management's:

- Looking back at least five years at revenue and expenditures when budgeting;
- Quarterly reports on budget-to-actual results to the city council;
- Five-year capital improvement plan (CIP) that the city updates annually, with funding sources identified;
- Following of state guidelines for investments with formal quarterly reporting;
- Formal debt policy that states the city will not borrow funds if such borrowing is within 10% of its legal debt margin, except in emergencies when authorized by the city council in addition to annual debt service payments for the general fund not exceeding 10% of operating expenditures; and
- Formal reserve policy that states Salisbury will endeavor to maintain an undesignated fund balance equal to 10% of the following year's general fund budget for liquidity purposes with any amount in excess of 10% credited to a capital project account.

The city lacks a formal long-term financial plan at present.

Adequate budgetary performance

Salisbury's budgetary performance is adequate in our opinion. The city had slight surplus operating results in the general fund of 0.8% of expenditures and transfers, but a deficit result across all governmental funds of 2.1% in fiscal 2016 after accounting for capital outlay funded with bond proceeds. General fund operating results of the city have been stable over the last three years, with a result of 1.2% in 2015 and a result of negative 1.0% in 2014.

Fiscal 2016 ended with a slight surplus of $279,000 after transfers, despite management budgeting to use $2.6 million at the beginning of the year for one-time purposes, due primarily to conservative budgeting.

The fiscal 2017 budget totaled $38.5 million with the use of $2.5 million of fund balance appropriation to balance the budget, which is in line with Salisbury's historical budgeting practices. Estimated figures show the city could use from $300,000-$500,000 of reserves primarily because it undertook additional one-time capital projects during the year.

The preliminary fiscal 2018 budget totals nearly $40 million with the use of $2.1 million of the fund balance appropriation to balance the budget. Management indicates that the real property tax rate for owner-occupied houses will decrease to 90.0 cents from 94.3 cents, while the tax rate for non-owner occupied houses will increase to $1.06 from 94.3 cents. In addition, management indicates that the personal business tax rate could decline by about 10% to help promote businesses locating in the city. Nevertheless, management expects to end the year close to breakeven and without a material change to reserves. As such, we expect budgetary performance to remain, at least, adequate.

Very strong budgetary flexibility

Salisbury's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2016 of 28% of operating expenditures, or $9.7 million.

The city's available reserves have been above 25% of expenditures for at least the last four fiscal years. Despite a slight draw on reserves expected in fiscal 2017, we do not expect reserves to fall below 25% of expenditures. In addition, we understand that Salisbury's does not expect a material change to reserves in fiscal 2018, and as such, should maintain very strong reserves in our view, well above the city's 10% unassigned fund balance policy.

Very strong liquidity

In our opinion, Salisbury's liquidity is very strong, with total government available cash at 41.5% of total governmental fund expenditures and 5.6x governmental debt service in 2016. In our view, the city has strong access to external liquidity if necessary.

Demonstrated, in part, by its historical issuances of GO debt, we believe Salisbury has strong access to external liquidity if needed. The city maintains most of its cash in bank deposits. Investments are maintained in the Maryland Local Government Investment Pool.

Salisbury has three privately placed loans outstanding that are GOs of the city, none of which has acceleration provisions. We do not view these loans as a risk to liquidity.

Very strong debt and contingent liability profile

In our view, Salisbury's debt and contingent liability profile is very strong. Total governmental fund debt service is 7.4% of total governmental fund expenditures, and net direct debt is 64.9% of total governmental fund revenue. Overall net debt is low at 3.0% of market value, and approximately 72.9% of the direct debt is scheduled to be repaid within 10 years, which are in our view positive credit factors.

The city's CIP identifies $36.3 million in governmental capital expenditures over the next five years as well as $21.3 million of enterprise capital needs. We understand Salisbury could issue slightly more than $20 million of new-money debt over the next two years, which we do not view as having a significant effect on the city's debt profile. The city's debt management policy states it will not borrow funds if such borrowing is within 10% of its legal debt margin, except in emergencies when authorized by the city council. The policy also states Salisbury will not enter into swaps or variable-rate debt.

Salisbury's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 9.8% of total governmental fund expenditures in 2016. Of that amount, 8.5% represented required contributions to pension obligations, and 1.2% represented OPEB payments. The city made its full annual required pension contribution in 2016.

Most employees of the city participate in Maryland's Employees' Retirement and Pension Systems (employees plan). Law enforcement officers and firemen employed by the city participate in Maryland's Law Enforcement Officers Pension Systems (LEOPS). Both pension plans are cost-sharing, multiple-employer public retirement systems administered by the state. The city's proportionate share of the employees plan and the LEOPS plan totals $9.1 million and $20.4 million, respectively, assuming a discount rate of 7.55%.

The city provides other postemployment benefits (OPEB) to eligible employees. As of July 1, 2015, the unfunded actuarial liability for OPEB totaled $26.2 million and was 5.2% funded. Management indicates that it has made a couple of changes to OPEB benefits within the past year, including increasing the mandatory number of years for new hires to be eligible for benefits to 20 years of service. Management believes this will help lower OPEB costs.

Very strong institutional framework

The institutional framework score for Maryland municipalities is very strong.

Outlook

The stable outlook reflects the city's very strong budgetary flexibility and liquidity as well as an economy that benefits from stabilizing institutions and participation in a broad and diverse MSA. Salisbury's strong management provides further rating stability. Therefore, we do not expect to change the rating over the outlook's two-year horizon.

Downside scenario

If budgetary performance were to deteriorate, causing budgetary flexibility or liquidity to materially weaken, or if the city's debt profile were to materially weaken, we could lower the rating.

Upside scenario

If economic indicators were to improve and be sustained at levels more commensurate with higher rated peers, all other factors equal, we could raise the rating.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- 2016 Update Of Institutional Framework For U.S. Local Governments

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.