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Ratings

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Summary:

Salisbury, Maryland; General Obligation

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Credit Profile		
US$9.025 mil GO bnds tax-exempt pub imp and rfdg bnds ser 2021 due 09/01/2036		
Long Term Rating	AA/Stable	New
US$3.08 mil GO taxable rfdg bnds ser 2021 due 09/26/2026		
Long Term Rating	AA/Stable	New
Salisbury GO pub imp and rfdg bnds		
Long Term Rating	AA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA' rating, with a stable outlook, to the City of Salisbury, Md.'s $9.0 million 2021 tax-exempt general obligation (GO) public improvement and refunding bonds, and to its approximately $3.0 million taxable refunding bonds 2021. At the same time, S&P Global Ratings affirmed its 'AA' rating and underlying rating on the city's GO debt outstanding. The outlook is stable.

A pledge of the city's full faith credit and resources, and an agreement to levy ad valorem property taxes without limitation as to rate or amount, secure these bonds. Bond proceeds will be used to refund certain bond series for budget savings, while also providing approximately $6.1 million to fund various capital projects.

Credit overview

The rating reflects our opinion of the city's strong historical financial results, supported by a stable property tax base. Despite the city's below-average economic metrics, management has been able to maintain balanced operations and very strong reserves, due in part to historically conservative budgeting as well as several formalized fiscal policies and practices.

Through management's strategies and close monitoring of expenses, we believe the city has insulated itself from the short-term effects of the COVID-19 pandemic. For more information on S&P Global Ratings' economic view, see "Economic Outlook U.S. Q3 2021: Sun, Sun, Sun, Here It Comes," published June 24, 2021, on RatingsDirect. We anticipate the city will continue to make the necessary budget adjustments to accommodate its growing fixed-cost burden, while also growing its revenues through its ongoing economic development projects.

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

- Adequate economy, with access to a broad and diverse metropolitan statistical area (MSA) and a local stabilizing institutional influence;
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with a slight operating deficit in the general fund but break-even operating results at

the total governmental fund level in fiscal 2020;

- Very strong budgetary flexibility, with an available fund balance in fiscal 2020 of 26% of operating expenditures;
- Very strong liquidity, with total government available cash at 42.0% of total governmental fund expenditures and 4.5x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability profile, with debt service carrying charges at 9.3% of expenditures and net direct debt that is 227.1% of total governmental fund revenue, but rapid amortization, with 72.6% of debt scheduled to be retired in 10 years; and
- Very strong institutional framework score.

Environmental, social, and governance factors

We analyzed Salisbury's environmental, social, and governance (ESG) risks relative to the city's credit factors and determined that all are in line with our view of the sector standard. We note the city is on the banks of the Wicomico River, but has taken steps to mitigate riverbank flooding through its capital project plans, and does not represent a significant environmental risk. The city also protects itself from cyber security incidents with additional resources and continuous monitoring and upgrades to systems from the in-house information technology department.

Stable Outlook

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 due to increased debt or pension expenses, we could lower the rating.

Upside scenario

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

Credit Opinion

Adequate economy

We consider Salisbury's economy adequate. The city, with an estimated population of 34,137, is located in Wicomico County in the Salisbury, MD-DE 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 64.1% of the national level and per capita market value of $67,745. Overall, the city's market value grew by 3.8% over the past year, to $2.3 billion in 2020. The county unemployment rate was 7.5% in 2020.

Salisbury, on the eastern shore of Maryland, is the county seat of Wicomico County and 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 is the midst of revitalization and redevelopment of its downtown corridor, with significant housing, student and otherwise, as well as mixed-use space. We anticipate these developments will result in improved economic metrics, albeit outside the outlook period.

The city's property tax base is very diverse, with the 10 leading taxpayers taking up 11.6% of assessed value (AV). Salisbury residents have access to various sectors, but education and health care are the leading sectors, at about 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 county employers include:

- Tidal Health (3,300 employees);
- Salisbury University (1,680)
- Perdue Farms (1,600); and
- Wal-Mart/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 more than 8,700 students, or about 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.

Strong budgetary performance

Salisbury's budgetary performance is strong, in our opinion. The city had slight deficit operating results in the general fund of 0.8% of expenditures, but a balanced result across all governmental funds 0.5% in fiscal 2020.

We have adjusted the city's audited results to consider transfers in and out of the general fund, as well as adjusting total governmental expenditures to account for capital expenditures funded with bond proceeds. Prior to transfer and additional revenue from capital lease issuances and sales, the city ended 2020 positively, despite the pressure from the COVID-19-induced recession. Overall revenues outperformed budgeted levels by almost $1 million, while expenses were under budget by $3.5 million. We note the city did not receive CARES Act funding in 2020, but has received FEMA reimbursements for COVID-19-related expenses. Property taxes are the city's leading revenue, accounting for about two-thirds of general fund revenues. Other local sources account for most of the remaining revenues.

The fiscal 2021 budget totals $43.6 million, with the use of $2.3 million of the fund balance appropriation, slightly higher than in previous year's budgets. The city anticipated a higher revenue figure as property tax revenue increased and the city's tax base continued to expand. The city did lower other revenue estimates that are more sensitive to economic factors, like building permits, red light cameras, and amusement/zoo ticket fees. Expenses increased primarily for contractual purposes. Management indicates that certain revenues did come in under budget; however, these revenue losses were offset by stronger revenue streams, driven by strong fourth-quarter revenue growth and savings on the expense side. Management expects to end the year with close to break-even results and without a material change to reserves.

The city recently adopted its 2022 budget of $45.2 million. We understand the real property tax rate of 98.3 cents per $100 of AV remained unchanged for the year, continuing the trend of a flat tax rate for residents. Although it is early in the fiscal year, management reports no major revenue or expenditure variances; therefore, we expect budgetary performance to remain strong over the outlook period.

Very strong budgetary flexibility

Salisbury's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2020 of 26% of operating expenditures, or $10.7 million.

The city's budgetary flexibility is very strong, in our view, with an available fund balance that has remained above 20% of operating expenditures in each of the past five years. We understand that the city does not anticipate utilizing reserves for its 2021 fiscal year, as operations were balanced, if not slightly positive. We also understand that Salisbury does not expect a material change to reserves in fiscal 2020, and should therefore 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 42.0% of total governmental fund expenditures and 4.5x governmental debt service in 2020. 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 (totaling approximately $450,000) outstanding that are GOs of the city, none of which has acceleration provisions. We do not view these loans as a risk to liquidity.

Weak debt and contingent liability profile

In our view, Salisbury's debt and contingent liability profile is weak. Total governmental fund debt service is 9.3% of total governmental fund expenditures and net direct debt is 227.1% of total governmental fund revenue. Approximately 72.6% of the direct debt is scheduled to be repaid within 10 years, which is, in our view, a positive credit factor.

The city's CIP identifies $77.6 million in governmental capital expenditures over the next five years, with $64.7 million specific to general capital projects. Funding sources for the $64.7 million are bonds (38% of capital plan), general fund revenue (17.8%), and lease debt (12%). Nevertheless, we do not believe Salisbury's CIP will materially alter its 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.

Pension and other postemployment benefits:

- We do not view the city's retirement liabilities as a credit pressure.
- Salisbury's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 8.2% of total governmental fund expenditures in 2020. The city made its full annual required pension contribution in 2020.
- However, we believe some of the pension plans' actuarial assumptions are somewhat weak and could lead to cost volatility. If costs rise, we could revise our view of the city's retirement liability profile and its effect on the overall credit profile.
- The city provides OPEB to certain eligible retirees. Costs remain low and the city's unfunded liability totals $25.1 million.

As of June 30, 2020, the city participated in the following defined-benefit plans:

- Maryland State Retirement System Employee Pension System: 72.3% funded, $9.7 million proportionate share of the net pension liability (NPL).
- Law Enforcement Officers' Pension System: 72.3% funded, $24.5 million proportionate share of the NPL as of June 30, 2019.

The city provides OPEB to eligible employees. Management indicates that it has made a couple of changes to OPEB benefits within the past few years, including increasing the mandatory number of years of service to 20 years for new hires to be eligible for benefits. The OPEB plan is 6.56% funded, with the city planning to increase funding to plan in the future. However, if pension and OPEB costs unexpectedly increase as a portion of budget, we believe the city's overall debt and contingent liability profile could weaken.

Very strong institutional framework

The institutional framework score for Maryland municipalities is very strong.

Related Research

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