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New Issue

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City of Frederick, MD

New Issue - Moody's Assigns Aa1 to City of Frederick, MD's $101M 2016 GO Bonds

Summary Rating Rationale

Moody's Investors Service has assigned a Aa1 rating to the City of Frederick, MD's $25.9 million Taxable Refunding Bonds, Series 2016A, $18.9 million Tax-Exempt Public Improvement Bonds, Series 2016B, and $56.3 million Tax-Exempt Refunding Bonds, Series 2016C. Moody's maintains the Aa1 rating on the city's $166 million of outstanding general obligation (GO) debt. The Aa1 rating incorporates the city's sizeable and diverse tax base, which is anchored by Fort Detrick, above-average resident wealth levels, healthy reserves despite recent draws for one-time uses, above-average debt burden mitigated by self-supporting enterprise debt, and elevated pension liability.

Credit Strengths

» Sizeable and diverse tax base

» Above-average resident wealth levels

» Employment base anchored by Fort Detrick and expanding biotechnology sector

» Conservative management supported by formal fiscal policies

» Self-supporting enterprise debt

Credit Challenges

» Recent draws on reserves for one-time uses

» Elevated pension burden and total fixed costs

Rating Outlook

Outlooks are usually not assigned to local government credits with this amount of debt outstanding.

Factors that Could Lead to an Upgrade

» Elimination of fund balance appropriations and trend of operating surpluses leading to substantial increase in reserves and liquidity

» Material improvement in the city's pension systems' funded ratios

» Continued tax and employment base expansion and diversification resulting in significant enhancement of socioeconomic indicators

Factors that Could Lead to a Downgrade

» Failure to maintain structurally balanced operations in the city's General and enterprise funds leading to decline in reserves and liquidity

» Deterioration of the city's tax base and socioeconomic profile

Key Indicators

Exhibit 1

Frederick (City of) MD	2011	2012	2013	2014	2015
Economy/Tax Base					
Total Full Value ($000)	$ 7,183,212	$ 6,751,148	$ 6,807,189	$ 6,823,182	$ 7,050,858
Full Value Per Capita	$ 109,636	$ 102,550	$ 102,941	$ 101,182	$ 103,129
Median Family Income (% of US Median)	124.0%	120.0%	117.3%	117.3%	117.3%
Finances					
Operating Revenue ($000)	$ 67,516	$ 66,491	$ 66,758	$ 67,978	$ 73,277
Fund Balance as a % of Revenues	30.1%	33.4%	28.0%	20.4%	20.1%
Cash Balance as a % of Revenues	36.7%	39.4%	32.8%	25.6%	26.4%
Debt/Pensions					
Net Direct Debt ($000)	$ 87,403	$ 83,192	$ 82,829	$ 76,911	$ 70,938
Net Direct Debt / Operating Revenues (x)	1.3x	1.3x	1.2x	1.1x	1.0x
Net Direct Debt / Full Value (%)	1.2%	1.2%	1.2%	1.1%	1.0%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	2.5x	2.6x	2.7x	2.5x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	2.5%	2.6%	2.7%	2.6%

Source: Moody's Investors Service

Recent Developments

According to audited results, fiscal 2015 ended with a General Fund operating surplus of $1.4 million. The available fund balance at the end of fiscal 2015 increased to $14.7 million, or a healthy 20.1% of operating revenues.

Detailed Rating Considerations

Economy and Tax Base: Sizeable and Diverse Tax Base Anchored by Fort Detrick and Biotechnology Sector

The city's tax base will continue to expand in the next three years due to major developments within the biotechnology sector and given the city's strategic geographic location approximately 45 miles northwest of Washington, D.C. (Aa1 stable). The employment base is anchored by Fort Detrick, an Army Medical Installation for biomedical research and development, medical material management, and global telecommunications, which has a total estimated economic impact of over $2 billion. The Fort supports approximately 6,400 employees with an additional 2,700 employed by the Frederick National Laboratory for Cancer Research (FNLCR) located on the Fort. FNLCR recently opened an Advanced Technology Research Facility with 250 employees in the city's Riverside Research Park, which is expected to increase to 450 employees in the next three years.

Over 75 biotechnology companies are located in the area, supporting strong residential and commercial growth within the city. Other major developments include the construction of a U.S. Army Medical Research Institute for Infection Diseases Laboratory at the Fort, which is estimated to be completed in 2017. Additionally, AstraZeneca PLC (A3 stable) is investing $200 million to expand its biologics manufacturing facility in the city, which will add 300 new jobs in 2016. Another $275 million in developments have been proposed within the city, including a downtown hotel and conference center, which is estimated to start construction in 2017. Given the new developments in the next two years, management expects the city's sizeable $7.1 billion tax base to grow by approximately 2.5% annually in the near term.

Resident wealth levels are above-average, with the city's median family income at 117.3% of the US median, according to 2013 American Community Survey. At 4.8%, the city's unemployment rate in November 2015 was lower than the state (5.1%) and national (4.8%) rates for the same time period.

Financial Operations and Reserves: Healthy Reserves Despite Recent Draws for One-Time Uses

Despite recent draws on reserves for one-time uses, the city's financial position will remain healthy given a reduction in fund balance appropriations and conservative management practices. Though $9.7 million of fund balance was appropriated in the fiscal 2014 budget, the city drew only $4.5 million of reserves for one-time uses including the purchase of capital items and a one-time merit payment to employees. Fiscal 2014 ended with a still healthy $13.9 million in available fund balance, or 20.4% of operating revenues.

Fiscal 2015 ended with a General Fund operating surplus of $1.4 million, despite a budgeted use of $2.6 million of fund balance. The available fund balance at the end of fiscal 2015 was a solid $14.7 million, or 20.1% of operating revenues. Property taxes are the main source of operating revenues at 69.5%, followed by income taxes at 10.1%. Both revenue streams continue to increase given the growing local economy.

The amended fiscal 2016 General Fund budget represents a 2.16% increase over the final fiscal 2015 budget, mainly due to an increase in salaries and benefits. A fund balance appropriation of $1.1 million is included in the fiscal 2016 budget for capital projects. City management prepares quarterly budget updates, and reports that revenues and expenditures are tracking according to budget year-to-date.

LIQUIDITY

Net cash is healthy at $19.4 million, or 26.4% of operating revenues at the end of fiscal 2015. Additional cash is held in the Capital Improvement Projects Fund totaling $15.9 million, which is designated for pay-go capital projects.

Debt and Pensions: Above-Average Debt Burden Mitigated by Self-Supporting Enterprise Debt; Elevated Pension Liability

The city's debt burden will remain manageable given the self-supporting nature of approximately half of the city's outstanding debt. Post-sale, the city will have $242 million of GO debt outstanding. Approximately 50% of the city's outstanding debt is supported by the water and sewer enterprise, which has been self-supporting for the past five years. The city's post-sale direct debt burden will be above-average at 1.5% of full value.

The city's five-year capital improvement plan (CIP) for fiscal 2017 through 2021 totals $148 million for water and sewer, airport, parking, stormwater, and general capital improvements. The CIP will be funded by a combination of debt ($68.7 million), pay-go funding ($49 million), as well as grants and other sources. Management expects the Water and Sewer Fund to remain self-supporting as rates were increased by 3% last year, and annual rate increases between 3% and 5% are planned going forward.

DEBT STRUCTURE

All of the city's debt is fixed rate, and amortization of debt is average with 68.8% of principal retired in ten years. Fiscal 2015 debt service represents a moderate 10.6% of operating revenues.

DEBT-RELATED DERIVATIVES

The City of Frederick has no derivatives.

PENSIONS AND OPEB

The city's pension burden will remain elevated, though the city has historically paid 100% of its actuarially required contribution (ARC), due to low funded ratios of the city's pension plans. The city administers three single-employer pension plans, which have low funded ratios of 64%, 52%, and 67% according to the 2015 actuarial valuation; however, these funded ratios represent an improvement from three years prior of 47%, 42%, and 53%, respectively. For fiscal 2015, employer contributions to the plans totaled $10.9 million, or approximately a moderate 14.9% of operating expenditures. The city's combined adjusted net pension liability (ANPL) in fiscal 2015, under Moody's methodology for adjusting reported pension data, was $201 million, or an above-average 2.6 times operating revenues. For the fiscal 2016 budget, the city changed from a 30-year open to a 27-year closed amortization period for its unfunded pension liability, which should improve the funded ratio more quickly. Moody's uses the ANPL to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities.

The city provides other post-employment benefits (OPEB) to retirees, which will remain a small portion of the city's annual fixed costs given that it is financed on a pay-go basis and pre-funded through an OPEB trust established in fiscal 2011. Fixed costs, including annual debt service, pension, and OPEB costs, comprised an elevated 34.9% of fiscal 2015 operating revenues. OPEB costs of $6.9 million accounted for a moderate 9.4% of fiscal 2015 operating revenues. Changes to the city's OPEB plan will decrease OPEB costs going forward as employees hired after September 1, 2013 have been moved to a defined contribution OPEB plan. The city's OPEB liability was 17% funded as of July 1, 2014.

Management and Governance: Conservative Management Reinforced by Formal Fiscal Policies; Very Strong Institutional Framework

The city's adherence to formal fiscal policies and conservative management will continue to bolster its healthy financial position. Adopted policies include the maintenance of a rainy day account within the unassigned General Fund balance equal to 12% of General Fund revenues, the restriction of tax-supported debt to no more than 2.5% of assessed valuation, a cap on debt service at 13% of annual expenditures, and a pension funding policy adopted in July 2015 to improve the funded ratios of the city's pension systems.

Maryland cities have an institutional framework score of "Aaa," or very strong. Cities rely on property tax revenues, which are stable and highly predictable. Cities have high revenue-raising flexibility and can increase property tax revenues annually, without limit. Expenditures, which are primarily for personnel and public safety, are highly predictable. Cities have a high ability to reduce expenditures, if necessary, given a limited collective bargaining presence and modest fixed cost burdens.

Legal Security

The bonds are secured by the city's unlimited ad valorem tax pledge.

Use of Proceeds

Proceeds from the Refunding Bonds, Series 2016A and 2016C, will defease a portion and refund a portion of the city's Public Improvement Bonds, Tax-Exempt Series 2009A, and refund all or a portion of the city's Public Improvement Bonds, Taxable Series 2009B, for estimated net present value savings of $7.2 million, or 8.9% of the refunded bonds. Proceeds from the Tax-Exempt Public Improvement Bonds, Series 2016B will finance various city capital improvements and water and sewer projects.

Obligor Profile

The City of Frederick has a population of approximately 68,000 and serves as the county seat of Frederick County (Aa1 stable).

Methodology

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.

Ratings

Exhibit 2

FREDERICK (CITY OF) MD

Issue	Rating
Taxable Refunding Bonds, Series 2016A	Aa1
Rating Type	Underlying LT
Sale Amount	$25,900,000
Expected Sale Date	03/16/2016
Rating Description	General Obligation
Tax-Exempt Public Improvement Bonds, Series 2016B	Aa1
Rating Type	Underlying LT
Sale Amount	$18,870,000
Expected Sale Date	03/16/2016
Rating Description	General Obligation
Tax-Exempt Refunding Bonds, Series 2016C	Aa1
Rating Type	Underlying LT
Sale Amount	$56,265,000
Expected Sale Date	03/16/2016
Rating Description	General Obligation

Source: Moody's Investors Service

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