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CREDIT OPINION
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# Maine (State of)

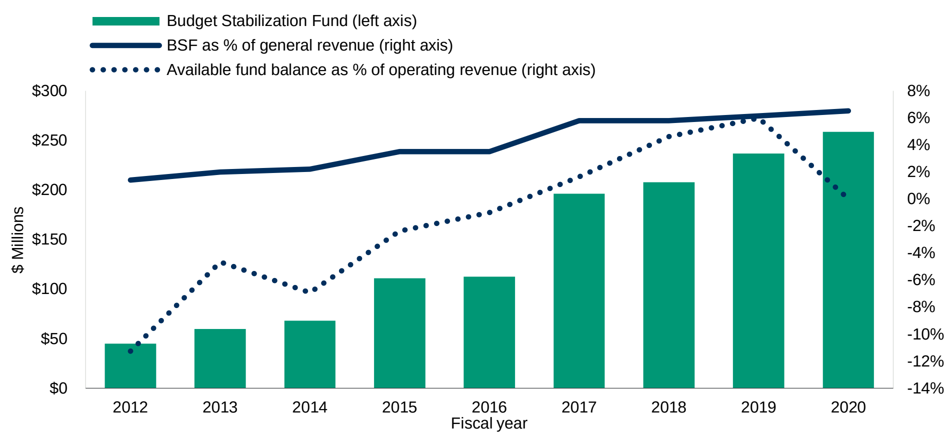
## Update to credit analysis

### Summary

The credit profile of the State of Maine (Aa2 stable) is characterized by a stable economy, strong fiscal and governance practices, an elevated combined debt and pension burden that is mitigated by rapid amortization of debt and pension liabilities and weak demographic trends.

The state's financial position remained solid over the last year, despite challenges presented by the coronavirus. Reserve levels continued to grow in fiscal 2020 and year-to-date general revenue for fiscal 2021 has performed well compared to budget and prior year revenue. The state took proactive measures to ensure budgetary balance in fiscal 2021, including curtailing budget allotments and continuing spending efficiencies implemented at the onset of the pandemic.

Exhibit 1
**Maine's growing reserves will continue to provide a buffer in case of revenue declines**




Fiscal 2018 and 2019 BSF balances exclude amounts set aside for Riverview Psychiatric Reserve.
*Sources: State of Maine audited financial reports and State of Maine Bureau of the Budget*

## Credit strengths

» Stable economy

» Strong financial position

» Institutionalized governance best practices

## Credit challenges

» Weak demographic trends

» Above-average combined debt and pension burden

## Rating outlook

Maine's stable outlook is based on a strong financial position and adherence to governance best practices that will enable the state to maintain budgetary balance.

## Factors that could lead to an upgrade

» Sustained population and employment growth coupled with a decline in debt and pension liabilities

» Maintenance of strong reserve levels that would provide satisfactory buffer in the event of an economic downturn and mitigate challenges of weak demographic trends and above-average liabilities

## Factors that could lead to a downgrade

» Return to severe structural imbalance

» Declines in population and employment that negatively impact wage and personal income growth

## Key indicators

| Maine (State of) | 2016 | 2017 | 2018 | 2019 | 2020 | 50-State Median (2019) |
|---|---|---|---|---|---|---|
| Operating Fund Revenues (000s) | $3,466,719 | $3,580,782 | $3,687,818 | $3,964,372 | $3,845,739 | $12,439,906 |
| Available Balances as % of Operating Fund Revenues | -1.0% | 1.7% | 4.6% | 6.0% | 0.0% | 9.1% |
| Nominal GDP (billions) | $59.8 | $61.7 | $64.6 | $67.7 | $66.2 | $250.6 |
| Nominal GDP Growth | 3.8% | 3.2% | 4.7% | 4.9% | -2.2% | 3.6% |
| Total Non-Farm Employment Growth | 1.2% | 0.9% | 1.0% | 1.0% | -6.4% | 0.9% |
| Fixed Costs as % of Own-Source Revenue | 12.4% | 13.5% | 12.3% | 11.7% | NA | 7.8% |
| Adjusted Net Pension Liabilities (000s) | $6,661,914 | $8,977,858 | $8,256,121 | $7,192,450 | NA | $11,258,253 |
| Net Tax-Supported Debt (000s) | $1,183,607 | $1,202,673 | $1,127,326 | $1,287,945 | $1,393,946 | $3,864,531 |
| (Adjusted Net Pension Liability + Net Tax-Supported Debt) / GDP | 13.1% | 16.5% | 14.5% | 12.5% | NA | 6.9% |

*Sources: State of Maine audited financial reports, US Bureau of Economic Analysis, US Bureau of Labor Statistics and Moody's Investors Service*

## Profile

The State of Maine is the 42nd largest state by population (1.4 million people in 2020) and the 43rd largest state by GDP ($66.2 billion in 2020 current dollars). The state's per capita personal income is below average at 90.8% of the US level.

## Detailed credit considerations

### Economy: Recovery from the pandemic will continue with increased vaccinations

Maine's economy will continue to recover well from the pandemic, aided by significant federal aid to individuals, businesses and to the state and its local governments. Given the ongoing vaccine rollout to the public, economic activity will likely continue to improve, especially in the leisure and hospitality industry. As of March, the state recovered about 67% of jobs lost from January through April 2020 because of the pandemic, which is better than the US as a whole, which has recovered 63% of jobs over the same period. Maine's unemployment rate peaked at 9.1% in April 2020 compared with 14.8% for the US in the same month. As of March, Maine's unemployment rate rebounded to 4.8% compared with 6.0% for the US in the same month. Maine's unemployment rate has trended below the nation's rate throughout the pandemic.

Maine's economy over the past several years before the pandemic had been stable despite social challenges presented by weak demographic trends. Maine is the oldest state by median age (45 years in 2019) and based on the proportion of its population aged 65 or older (21.2% in 2019). As Maine's prime working-age population declined, the state's aging population led to slow economic and employment growth. The state's ability to mitigate the potentially negative economic and fiscal effects of having a high proportion of its population over the age of 65 through policy actions to improve labor force participation and ensuring revenue matches expenses will be key to long-term economic stability.

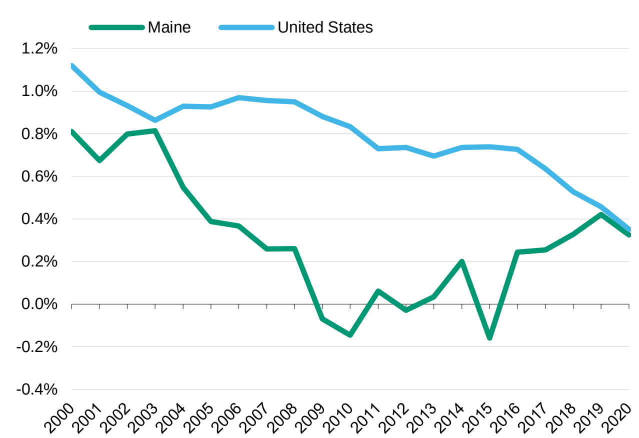
Maine's population growth has typically lagged the nation's growth rate (see Exhibit 3). Although growth improved slightly in the past few years, it still remains slow. Based on the US Census Bureau's July annual population estimates, Maine's population grew by 0.3% in 2020 compared with the US growth rate of 0.4%. Based on the 2020 decennial census, Maine's population increased by 2.6% from 2010 to 2020 compared with 7.4% growth for the US as a whole. Maine's 2020 decennial population count of 1,362,359 is 0.9% higher than the 2020 population estimate.

Employment growth also lags national growth rates (see Exhibit 4), but the picture will brighten in the coming months as travel resumes and federal aid continues to flow. Employment will likely grow as the summer tourist season begins in the state. Significant federal stimulus aid has helped mitigate the impact of job losses on the state's economy. State officials estimate that the CARES Act in 2020 provided up to $1.7 billion of additional funding that flowed through Maine's economy from federal aid to individuals and businesses that increased unemployment benefits and provided small business loans. In the second quarter of 2020, Maine's total personal income grew by 15% compared with the year before because of federal stimulus money provided to individuals. The state will receive roughly $1 billion of additional discretionary funds from the American Rescue Plan Act.

Exhibit 3

**Maine's population growth lags the US as working-age population declines**

**Annual population growth**

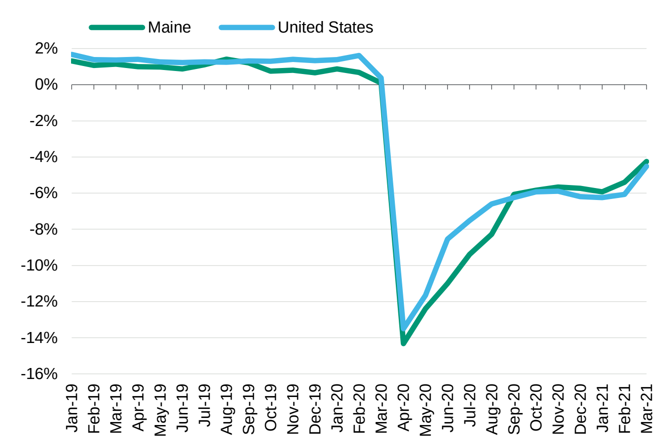



2020 population change figures are based on July annual estimates.
*Source: US Census Bureau*

Exhibit 4

**Maine has recovered about 70% of jobs lost because of the coronavirus**

**Year-over-year monthly job growth**




*Source: US Bureau of Labor Statistics*

## Finances and liquidity: Revenue performance remains strong despite the coronavirus

Despite the coronavirus, fiscal 2020 general revenue ended only 0.7% below budgeted revenue and grew by 3.1% compared with fiscal 2019 revenue. Maine's budgetary-basis general revenue figures in fiscal 2020 include $305 million of adjustments to individual and corporate income tax collections to recognize amounts due in April and June that were deferred until July. To address expected revenue shortfalls because of the pandemic, the state proactively excluded increased March revenue forecast revenue from spending, froze unspent allotments and implemented spending efficiencies such as hiring freezes during the last quarter of fiscal 2020.

On a GAAP-basis, Maine's fiscal 2020 unassigned fund balance declined to zero, likely because the deferred income tax revenue from fiscal 2020 will be recognized in the state's fiscal 2021 financial statements. Therefore, the available fund balance is likely to increase to a positive position again in fiscal 2021.

The state's Budget Stabilization Fund (BSF), which was nearly depleted at the end of fiscal 2009 following the Great Recession, continued to grow in fiscal 2020. The BSF reached $258.7 million at the end of fiscal 2020, or about 6.5% of general fund revenue (see Exhibit 1 on page 1).

As of April, fiscal 2021 year-to-date revenue is 12.8% above budgeted revenue (based on the December forecast). In December, the RFC revised the fiscal 2021 general revenue forecast upward by $273 million to $3.8 billion, which represents a 3.9% decline in revenue compared with fiscal 2020. The RFC also revised upward the revenue forecast for the next biennium compared with the August 2020 forecast. In May, the RFC revised the revenue forecast for fiscal 2021 upward again by another $479 million to $4.2 billion, representing a 5.1% increase compared with fiscal 2020. The revised forecast incorporates additional federal stimulus aid from the American Rescue Plan Act, resulting in expected increases in income and sales taxes.

Following the improved May revenue forecast for the fiscal 2022-23 biennium, the governor introduced a change package, which increases investments in Maine public schools to reach the state's objective to cover 55% of public education expenditures. The governor's change package also includes increased investments in the state's public health system, proposed funding for various infrastructure needs, climate change initiatives, restored municipal revenue sharing to 5%, and a $52 million addition to the BSF, which would bring the fund to $319 million, about 7.5% of projected fiscal 2022 general fund revenue. The state legislature will review and make proposed updates to the governor's change package over the next month during its special legislative session. The legislature has already enacted a "back to basics" budget for the fiscal 2022-23 biennium, ensuring government services will continue uninterrupted at the start of the biennium. In 2017, the state passed its biennium budget three days after the start of the fiscal year, causing a short government shutdown.

### LIQUIDITY

The state's overall liquidity position has improved significantly over the past few years. As of April, the balance of the treasurer's cash pool was $2.8 billion, which includes some unspent CRF money and is sizable compared to projected fiscal 2021 general revenue of $4.2 billion. The state's general fund liquidity has also improved significantly over the past few years. From fiscal 2009-14, the general fund ending cash balance was negative. As of mid-May, the general fund cash balance was $1.2 billion, which does not include unspent CRF money and is equal to nearly 30% of fiscal 2021 projected general revenue. The state has not borrowed tax anticipation notes since 2006 and does not anticipate the need to borrow for cash flow given its strong overall liquidity position.

## Debt and pensions: Elevated combined debt and pension burden

### DEBT STRUCTURE

Maine has a moderate debt profile (see Exhibit 5). Net tax-supported debt (NTSD) in 2020 of $1.4 billion is equal to 2.1% of GDP, which is slightly above the 2019 50-state median. Maine pays down its debt rapidly. It limits general obligation bonds to ten-year maturities. Rapid amortization increases short-term expenses, but enhances long-term fiscal health compared with other states.

Maine has $4.6 billion of gross tax-supported debt outstanding, which is large compared with its net tax-supported debt (see Exhibit 6). Most of Maine's gross tax-supported debt ($3.3 billion) is secured by a moral obligation of the state. Maine's moral obligation is pledged to debt issued by the Finance Authority of Maine (FAME), the Maine Municipal Bond Bank (MMBB), the Maine Health and Higher Education Facilities Authority (MHHEFA), and the Maine State Housing Authority (MSHA). No capital reserve fund restorations have been needed in the history of the moral obligation programs.

Exhibit 5

**Most of Maine's gross tax-supported debt ...**

**2020 outstanding debt by security**

| Security | Rating | Amount outstanding (000s) |
|---|---|---|
| General obligation | Aa2 stable | $572,700 |
| Lease rental revenue | Aa3 stable | $383,935 |
| GARVEEs | A2 stable | $129,450 |
| Highway revenue | not rated | $119,375 |
| Liquor revenue | A1 stable | $96,915 |
| Capital leases | not rated | $53,722 |
| Certificates of participation | not rated | $37,849 |
| **Net tax-supported debt** | | **$1,393,946** |
| **Moral obligation** | | |
| Maine State Housing Authority | A1 stable* | $1,419,645 |
| Maine Municipal Bond Bank | Aa2 stable | $1,269,325 |
| MHHEFA | A1 stable | $438,155 |
| Finance Authority of Maine | A2 stable | $125,131 |
| **Total moral obligation** | | **$3,252,256** |
| **Gross tax-supported debt** | | **$4,646,202** |

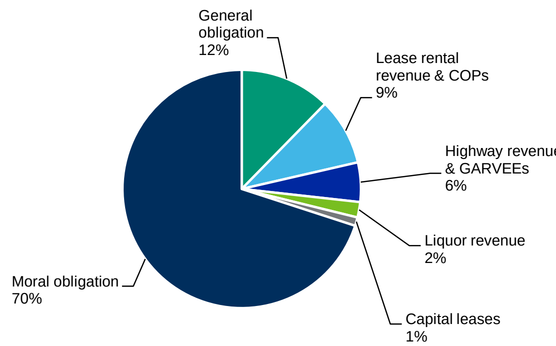
*A1 stable reflects rating on Maine Energy, Housing and Economic Recovery Fund Revenue Bonds, of which $23 million was outstanding at the end of fiscal 2020.

*Sources: State of Maine audited financial reports and Office of the Maine State Treasurer*

Exhibit 6

**... is secured by the state's moral obligation**

**Gross tax-supported debt by security**




*Sources: State of Maine audited financial reports and Office of the Maine State Treasurer*

### DEBT-RELATED DERIVATIVES

The State of Maine is not a party to any debt-related derivative agreements.

### PENSIONS AND OPEB

Maine has an above-average pension liability compared with other states, largely because of its support of teacher pensions. In fiscal 2019, the state's $7.2 billion Moody's-adjusted net pension liability (ANPL) was equal to 10.7% of GDP, higher than the 50-state median of 4.8%. Maine's pension liability is above-average despite enacting significant reforms in 2011 that reduced its unfunded liabilities, including limiting cost-of-living adjustments and increasing the retirement age. However, when including unrecognized teacher pension liabilities for all states, the 50-state median ANPL to GDP is 12.0% and Maine's ANPL burden is below average.

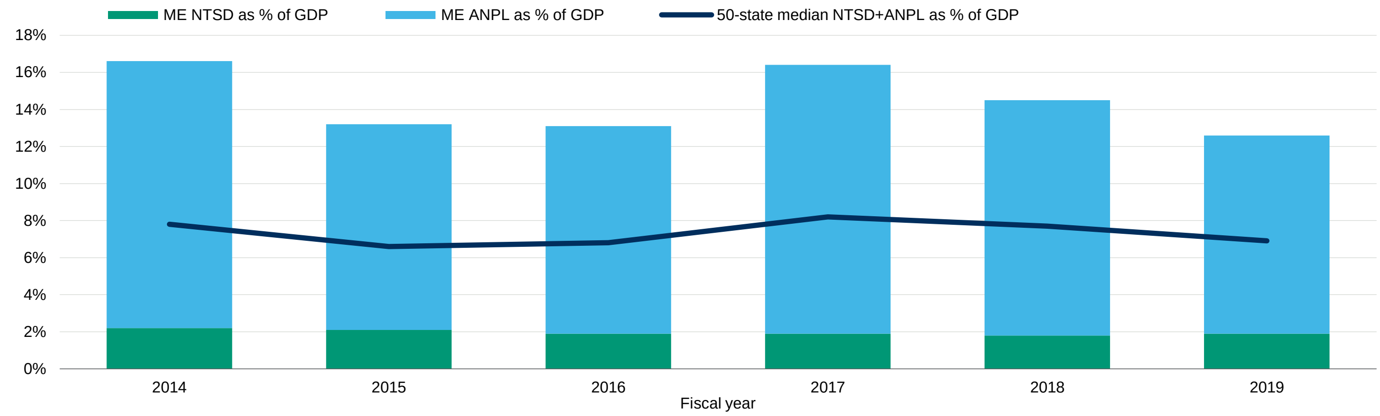
Maine has taken a proactive approach to addressing its pension liability. In fiscal 2017, the state's pension contribution fell slightly below its tread water payment, the annual amount required to maintain a stable net pension liability, assuming investment return and other actuarial assumptions are met for the year. However, contributions were higher than the tread water amount in fiscal 2018 and 2019. The state regularly contributes 100% of its actuarially required contribution and is constitutionally required to amortize substantially all of its liability by 2028. As with its policy of limiting general obligation debt to ten-year maturities, this requirement increases short-term costs, but puts Maine on a path to surer fiscal footing over the long term.

The state is more at risk of pension asset shock because of investment losses than other states, though the risk is low. We gauge the risk of pension investment losses to a government using our pension asset shock indicator, which represents the probability of a pension investment loss amounting to 25% of revenue. The state's pension asset shock indicator was 5.0% in fiscal 2019, the fifth highest among states and above the 50-state median of 0.3%. Maine has the highest level of pension assets as a percent of own-source revenue of all states at 220% in fiscal 2019.

Maine is also proactively addressing its unfunded other post-employment benefit (OPEB) liabilities. It has created a trust and is statutorily committed to fully funding the actuarially required contribution by 2037. For fiscal 2019, the state's Moody's-adjusted net OPEB liability was equal to $3.5 billion or 5.2% of GDP, which is above the 50-state median of 1.0%.

The state's combined ANPL and NTSD burden as a percent of GDP was 12.5% in fiscal 2019 (see Exhibit 7), ranking 13th highest among states. Total fixed costs in fiscal 2019, including debt service, pension costs on a tread water basis and OPEB contributions, were equal to 11.7% of own-source revenue, which is above-average for states. Although Maine is incurring higher short-term fixed costs, the rapid amortization of debt and pre-funding of OPEB costs will have a positive long-term effect on the state's finances.

Exhibit 7
**Maine's elevated combined liability burden attributable to above-average pension burden**




NTSD stands for net tax-supported debt.
ANPL stands for adjusted net pension liability.
*Sources: State of Maine audited financial reports, Moody's Investors Service*

## ESG considerations

### ENVIRONMENTAL

The US states sector overall has low exposure to environmental risks because of states' large and diverse economies, revenue-raising ability and federal government support for disaster recovery costs via FEMA. Nonetheless, according to data from Moody's affiliate and climate intelligence firm Four Twenty Seven, Maine is moderately exposed to climate risks related to extreme rainfall. Gross domestic product in Maine's coastal counties accounts for a significant 59.1% of the state's total, higher than the 50-state coastal county median of 38.6%. Housing in Maine is modestly exposed to flooding: 8.3% of coastal dwellings are in the 100/500 year flood plain compared with 16.8% of coastal dwellings for the US as a whole. Given Maine's location, the state is less exposed to property damage caused by hurricanes, but is more exposed to damage caused by severe winter storms.

The governor's approach to combating climate change mitigates these risks. The governor established the Maine Climate Council, which developed a four-year action plan to meet emission reduction goals and ensure climate change resiliency across the state. State grant programs are being used by communities and regions for adaptation planning to support infrastructure upgrades based on coastal storm and flood risks. Prioritized state investments in clean energy innovation will also create new opportunities in workforce development.

### SOCIAL

Social issues, such as demographics, labor force, income and education, are key influencers of a state's economy, governance stability and financial and leverage trends. Weak demographic trends including an aging population and declining working age population will hinder the state's ability to grow over the long term.

For more information on social factors, please see the economy section.

### GOVERNANCE

Maine engages in several long-standing governance best practices. Consensus revenue forecasts are binding and enhance budgetary discipline. Biannual forecasts for the current biennium and the next two biennia facilitate long-term planning. The state publishes financial reports on a timely basis and has a history of on-time budgets. Maine has adequate financial flexibility. There is no supermajority requirement to raise taxes, which enhances legislative flexibility. Also, the governor has the authority to curtail allotments to maintain balance between expected revenue and spending during the year.

In 2017, the state enacted a law requiring the Consensus Economic Forecasting Commission (CEFC) to provide two economic recession scenarios of varying severity to the state economist, state budget officer and associate commissioner for tax policy. The scenarios are used to issue a joint report with the Revenue Forecasting Committee (RFC) to the governor and legislature by October 1 of even-numbered years that analyzes the impact of the stress tests on general fund revenue projections. In addition, the report will provide an analysis of the sufficiency of the current level of the BSF and an estimate of a reserve amount necessary to offset declines in revenue because of a potential economic recession.

The state's most recent stress-test report from November 2020 determined that the BSF is at a level that would provide the governor and legislature time during the early stages of a moderate or severe recession to make any changes necessary to bring the budget back into balance. Our assessment of the state's recession preparedness is moderate based on moderate revenue volatility, reserve levels and financial flexibility.

## Rating methodology and scorecard factors

The US States and Territories Rating Methodology includes a scorecard, which summarizes the 10 rating factors generally most important to state and territory credit profiles. Because the scorecard is a summary, and may not include every consideration in the credit analysis for a specific issuer, a scorecard-indicated outcome may or may not map closely to the actual rating assigned.

Exhibit 8

**US states and territories rating methodology scorecard**

**Maine (State of)**

| Rating Factors | Measure | Score |
|---|---|---|
| **Factor 1: Economy (25%)** | | |
| a) Per Capita Income Relative to US Average [1] | 90.8% | Aa |
| b) Nominal Gross Domestic Product ($ billions) [1] | $66.2 | Aa |
| **Factor 2: Finances (30%)** | | |
| a) Structural Balance | Aa | Aa |
| b) Fixed Costs / State Own-Source Revenue [2] | 11.7% | Aa |
| c) Liquidity and Fund Balance | Aa | Aa |
| **Factor 3: Governance (20%)** | | |
| a) Governance / Constitutional Framework | Aa | Aa |
| **Factor 4: Debt and Pensions (25%)** | | |
| a) (Moody's ANPL + Net Tax-Supported Debt) / State GDP [2] [3] | 12.5% | Aa |
| **Factors 5 - 10: Notching Factors [4]** | | |
| Adjustments Up: None | 0 | |
| Adjustments Down: None | 0 | |
| **Rating:** | | |
| a) Scorecard-Indicated Outcome | | Aa2 |
| b) Actual Rating Assigned | | Aa2 |

[1] Economy measures are based on data from the most recent year available.
[2] Fixed costs and debt and pensions measures are based on data from the most recent debt and pensions medians report published by Moody's.
[3] ANPL stands for adjusted net pension liability.
[4] Notching factors 5-10 are specifically defined in the US States and Territories Rating Methodology.
*Sources: US Bureau of Economic Analysis, State of Maine audited financial reports and Moody's Investors Service*

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