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Ratings

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Summary:

St Marys County, Maryland; General Obligation

Primary Credit Analyst:
Timothy W Barrett, Washington D.C. (1) 202-942-8711; timothy.barrett@spglobal.com

Secondary Contact:
John Kennedy, New York + 1 (212) 438 2128; john.kennedy@spglobal.com

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Summary:

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Credit Profile		
US$30.0 mil GO bnds cons pub imp bnds ser 2020 due 05/01/2040		
Long Term Rating	AA+/Stable	New
St Marys Cnty		
Long Term Rating	AA+/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' rating to St. Mary’s County, Md.'s, series 2020 public improvement general obligation (GO) consolidated public improvement bonds, totaling $30 million. At the same time, S&P Global Ratings affirmed its 'AA+' rating on the county's existing GO debt. The outlook is stable.

The bonds are a GO of the county, secured by its full-faith-and-credit pledge. Proceeds from this issue will fund various capital projects.

Credit overview

The rating reflects the county's strong financial position following years of balanced operating results, primarily due to a very strong local economy that benefits from its access to Washington DC, as well as a strong management team that maintains conservative budgeting and formalized financial policies. We believe the county's large and diverse property tax base will likely continue to experience good growth, in part, due to the Pax River Naval Air Base within its borders, as well as a stable health care and education base. St. Mary's County has a history of managing its operating expenses well. In addition, the county maintains some financial flexibility, with its ability to increase its property tax rate. Given this flexibility and strong economic fundamentals, we believe the county should maintain balanced financial operations.

S&P Global Economics believes the COVID-19 pandemic has caused the national and global economy to fall into recession. (For further information, see "A Massive Hit To World Economic Growth," published March 24, 2020, on RatingsDirect.) We think this will lead to significant economic headwinds in the first two quarters in 2020. While we continue to monitor events related to COVID-19, we do not expect it to materially affect the county's ability to maintain budgetary balance, given St. Mary's County's reliance on property taxes, which account for nearly half of general fund operating resources. Furthermore, any changes in revenue collections are somewhat offset by the county's ability to raise taxes as well as its very strong liquidity position. For more information, see "All USPF Sector Outlooks Are Now Negative" (published April 1, 2020).

In our opinion, the rating reflects the county's:

- Strong economy, with projected per capita effective buying income at 126% of the national level and market value per capita of $113,201;

- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong 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 28% of operating expenditures after accounting for committed reserves that are ultimately available to fund operating expenses if necessary;
- Very strong liquidity, with total government available cash at 39.7% of total governmental fund expenditures and 8.1x governmental debt service, and access to external liquidity we consider strong;
- Very strong debt and contingent liability profile, with debt service carrying charges at 4.9% of expenditures and net direct debt that is 49.9% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of market value; and
- Very strong institutional framework score.

Stable Two-Year Outlook

Upside scenario

If St. Mary's County were to experience continued improvement in its economic metrics, as well maintain the county's positive financial operations, holding all other factor scores constant, we could raise the rating.

Downside scenario

Although unlikely in our opinion, if the county were to experience significant fiscal pressures and reserves were used to bridge any imbalances, either for capital or operations, we could lower the rating.

Credit Opinion

Strong economy

We consider St. Mary's County's economy strong. The county has an estimated population of 113,510.with a projected per capita effective buying income of 126% of the national level and per capita market value of $113,201. Overall, the county's market value grew by 1.8% over the past year to $12.8 billion in 2020. The county unemployment rate was 3.8% in 2018.

St. Mary's County is situated on a peninsula in southern Maryland and bounded by the Patuxent River, Chesapeake Bay, and the Potomac River. Leonardtown is the county seat and sole overlapping municipality within the county. Although St. Mary's County is not technically a part of the Washington D.C. metropolitan statistical area (MSA), the northern portion of the county is located about 40 miles southeast of the capital and residents have direct access to employment opportunities throughout the county and the DC MSA. The Naval Air Station Patuxent River (Pax River) is the county's largest employer and anchors the area economy. Pax River is headquarters for the Naval Air Warfare Center Aircraft Division and Naval Air Systems Command, and more than 50 other tenant commands. The military installation employs about 25,000 people and continues to foster growth, particularly in the form of additional defense, engineering, and technology jobs.

Non-defense industry-related economic development also continues at a modest pace, particularly in technology-related and retail developments. The county's health care and higher education component also remains stable, with St. Mary's Hospital, the College of Southern Maryland and St. Mary's College located within the county. Historically, the county unemployment rate has been below state and national averages.

As a result of ongoing development and property revaluations, the county's tax base has experienced consistent growth of about 2% annually over the past decade. There is no concentration in the tax base, with leading taxpayers accounting for less than 4.0% of total assessed value (AV).

Very strong management

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

Highlights include the use of historical trend analysis for budget preparation and looking back three to four years for both revenues and expenditures. Budget-to-actuals are monitored monthly with reports provided to the board monthly from all eight departments. The county adopted a five-year formal long-term financial plan in 2017 that it was updated in fiscal years 2018 and 2019, and management indicates it will continue to update its financial projections on an annual basis. St. Mary's County maintains a six-year rolling capital improvement plan (CIP) that identifies all projects and funding sources. It also maintains its own investment policy. Investments and performance are monitored monthly, with reports provided to the board monthly. The county's formal debt management policy requires total debt not to exceed 2.15% of AV or debt service expenditures above 10% of the general fund budget. The county's formal reserve policy requires a minimum 15% of general fund revenues, consisting of the bond rating fund (6% of revenues), the rainy-day fund, and the unassigned general fund. In addition, St. Mary's County has a make-up provision requiring replenishment of reserves over one to three years.

Strong budgetary performance

St. Mary's County's budgetary performance is strong in our opinion. The county had operating surpluses of 3.7% of expenditures in the general fund and of 5.9% across all governmental funds in fiscal 2019. General fund operating results of the county have been stable over the last three years, with a result of 2.8% in 2018 and a result of 2.4% in 2017.

The county increased general fund reserves by $5.5 million in fiscal 2019 due primarily to conservative budgeting as well as good revenue growth of about 4% for the year. Actual revenues came in about $3.2 million above budget due primarily to better-than-expected income tax revenues.

The original fiscal 2020 budget included the planned use of $14.8 million in unassigned fund balance reserves for nonrecurring capital expenditures. The property tax rate remained unchanged for the year. The county increased the income tax rate to 3.17% from 3.0% in January 2020, which was the primary driver behind a 7.8% increase in income taxes expected for the year. Nevertheless, given conservative budget estimates, and year-to-date actuals that compare well relative to budget, we understand that although the county could use some reserves in fiscal 2020 for pay-as-you-go capital purposes, the ending available balance should remain very strong and well above policy levels.

We understand the county is in the process of finalizing the fiscal 2021 budget and is currently reviewing some of its revenue assumptions in light of the COVID-19 outbreak and the potential impacts to income taxes in particular. Management indicates it expects to adjust revenue and expense estimates as necessary and that reserves will continue to remain well above its policy.

Property taxes accounted for nearly half of total general fund revenues in fiscal 2019, followed by income taxes at 40%, with both sources showing consistent growth over the past five years. In addition, St. Mary's County maintains some taxing flexibility, in our view, given the county's property tax rate of 84.78 cents per $100 of AV compares well to peers' in Maryland. The county has not increased its property or income tax rates in many years. However, the county's income tax revenue raising flexibility is limited following the recent tax rate increase to 3.17%, which is just slightly below the state mandated 3.20% maximum.

Very strong budgetary flexibility

St. Mary's County's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 28% of operating expenditures, or $63.3 million.

The county has increased fund balance reserves in each of the last three fiscal years. St. Mary's County 's available reserves consist of unassigned and assigned general fund reserves as well as committed general fund reserves, consisting of rainy-day and bond rating reserves.

Although we understand a portion of unassigned reserves could be used for nonrecurring capital expenses in fiscal 2020, we understand reserves should remain well above the minimum 15% fund balance policy at year-end.

Very strong liquidity

In our opinion, St. Mary's County's liquidity is very strong, with total government available cash at 39.7% of total governmental fund expenditures and 8.1x governmental debt service in 2019. In our view, the county has strong access to external liquidity if necessary.

In our view, St. Mary's County has had strong external access to liquidity, issuing GO debt, when required, over the past 20 years. The county does not hold any investments we deem aggressive.

St. Mary's County maintains some privately placed equipment leases with TD Equipment Finance Inc. and Banc of America Public Capital Corp., totaling about $7.4 million in principal outstanding for both governmental and enterprise purposes. While some of the events of default associated with these leases might be viewed as permissive, given the county's very strong liquidity and available reserves, we do not believe these private placements, or any of the county's other financial instruments, pose a material contingent liquidity risk.

Very strong debt and contingent liability profile

In our view, St. Mary's County's debt and contingent liability profile is very strong. Total governmental fund debt service is 4.9% of total governmental fund expenditures, and net direct debt is 49.9% of total governmental fund revenue. Overall net debt is low at 1.0% of market value, which is in our view a positive credit factor.

The county's six-year CIP totals $346.2 million, about half of which management expects to fund with additional debt issuances. We estimate the county could issue an estimated $25 million-$30 million of new money GO debt each year over the six-year CIP to finance various capital needs. Despite the possible issuances and likely increases in debt service costs, we do not expect this plan to negatively affect the county's debt and liability factor score, considering St Mary's County's above-average amortization schedule.

Pension and other postemployment benefits

In our view:

- Pension and other postemployment benefits (OPEB) liabilities are not an immediate source of credit pressure for St. Mary's County.
- Although pension plan assumptions, particularly the 7.45% discount rate associated with the state-administered pension plan and 7.25% discount rate associated with the county's sheriff's plan, could increase contribution volatility, we believe St. Mary's County can absorb year-to-year increases into the budget without straining finances.
- Pension contributions equaled our static funding metric and, as a result, we do not expect plan contributions to materially change over the next couple of years.

St. Mary's County's combined required pension and actual OPEB contributions totaled 7.0% of total governmental fund expenditures in 2019. Of that amount, 5.6% represented required contributions to pension obligations and 1.4% represented OPEB payments. The county made its full annual required pension contribution in 2019.

As of the latest measurement date, the county participates in:

- The State Retirement and Pension System of Maryland, which the state administers and which is 72.3% funded as of June 30, 2019. The plan is a cost-sharing, multiple-employer, defined benefit plan, in which most of the county's employees participate. St. Mary's County's proportionate share of this plan's net pension liability is $21.8 million assuming a 7.45% discount rate.
- Sheriff's Office Retirement Plan: A single-employer, defined benefit plan covering police and correctional officers; 68.2% funded with a net pension liability for the county of $42.6 million;
- A Length of Service Award Program for volunteer firefighters, with a net liability of $21.7 million that is pay-as-you-go financed; and
- An OPEB plan to eligible employees, which is a single-employer, defined benefit health care plan that is 89.5% funded. The county established a trust to fund the plan. It historically has contributed 100% of OPEB costs annually, including a portion of the unfunded actuarial liability, which as of June 30, 2019, stood at $10.1 million, assuming a 7.07% discount rate.

Very strong institutional framework score

The institutional framework score for Maryland municipalities is very strong.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019

- 2019 Update Of Institutional Framework For U.S. Local Governments