27 JUN 2022

Fitch Rates St. Mary's County, MD's $30MM GO Bonds 'AA+'; Outlook Stable

Fitch Ratings - New York - 27 Jun 2022: Fitch Ratings has assigned a 'AA+' rating to the following St. Mary's County, Maryland general obligation (GO) bonds:

--$30 million Consolidated Public Improvement Bonds, Series 2022.

The bonds are expected to be sold competitively on July 26, 2022. The proceeds will be used to finance various capital projects within the county. In addition, Fitch has affirmed the county's Issuer Default Rating (IDR) and outstanding rated county GO bonds at 'AA+'. The Rating Outlook is Stable.

SECURITY

The bonds are general obligations of the county, whose full faith and credit and unlimited taxing power are irrevocably pledged to repayment of the bonds.

ANALYTICAL CONCLUSION

The 'AA+' IDR and GO rating reflect the county's superior gap-closing capacity underscored by its unlimited legal ability to raise revenue, solid expenditure flexibility and high reserves within the context of expected revenue volatility through economic downturns. The rating also reflects the county's low long-term liability burden and Fitch's expectation for natural revenue growth above the rate of inflation but below the rate of GDP growth. The county's economy is highly concentrated in the military and specifically with Naval Air Station (NAS) Patuxent River.

Economic Resource Base

St. Mary's County is located in the southern part of Maryland, bordering the Patuxent and Potomac rivers and Chesapeake Bay. The county's estimated 2021 population of about 114,500 has increased by roughly 9% since 2010. Population growth reflects, in part, continued expansion at the NAS, which is home to the Naval Air Systems Command and the Naval Air Warfare Center Aircraft Division headquarters.

KEY RATING DRIVERS

Revenue Framework: 'aaa'

Fitch expects county revenues to grow above the rate of inflation but below GDP given continued population growth and development at NAS. The county's property tax levy and rate are not subject to limitation, providing significant legal revenue-raising flexibility and a budgetary tool to counteract periods of income tax instability.

Expenditure Framework: 'aa'

The county's pace of spending growth is expected to be generally in line with revenue growth. Carrying costs for debt and retiree benefits are low, and the county has strong legal control over employment terms given the absence of collective bargaining. Education costs make up about one-half of the county's spending, and any reductions require state approval, somewhat limiting flexibility.

Long-Term Liability Burden: 'aaa'

The county's combined debt and net pension liability (NPL) burden is low at about 4% of personal income. Additional debt plans are not expected to notably impact ratios given the expectations for continued growth in the resource base.

Operating Performance: 'aaa'

The county's superior budget flexibility and strong general fund balance position it to manage through future economic downturns while maintaining a high level of fundamental financial flexibility.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Significant economic diversification and tax base growth that reduces the county's economic and revenue reliance on NAS.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Material reductions in federal and military funding to NAS that weaken the revenue growth prospects of the county;

--Expectations that the county's overall financial resilience will be sustained at levels materially below the historical trend.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CURRENT DEVELOPMENTS

The county ended fiscal 2021 with a general fund net operating surplus of about $22 million, which grew unrestricted reserve levels to $86 million (32% of spending). Positive results were primarily driven by very strong income tax collections, which were up about $20 million (19% yoy). Favorable variances in other local taxes and expenditure savings associated with vacancies also supported positive results.

The fiscal 2022 budget of $279 million was up about 14% yoy over the prior adopted budget and reduced the income tax rate to 3.1% from 3.17% given strong collections. The budget also included the utilization of about $11 million in fund balance. YTD results are favorable thus far, with income and recordation taxes both anticipated to exceed budget estimates at YE. The county has been allocated $22 million in ARP relief funds, and has earmarked a majority of the funding towards certain health related spending, broadband, and water/sewer improvements.

The fiscal 2023 adopted budget is up about 12.5% over the prior year budget, includes an additional reduction in the income tax rate to 3.0% from 3.1%, and appropriates $25 million in fund balance for pay-go capital and non-recurring spending items. The budget included compensation increases of 6.5% for sworn officers, and 3.0% cost of living adjustment for non-sworn pay scales. Given continued strength in collections, the county is still budgeting for about 7% in income tax growth despite the additional reduction in the tax rate.

CREDIT PROFILE

The NAS is a significant factor in the local economy with over 20,000 direct workers, and over 60,000 when including indirect and induced labor (the total civilian labor force for the local tri-county region totals about 196,000). Fitch's rating assumes the NAS's role as the United States Navy's principal research, engineering and test center makes severe cuts by the federal government unlikely.

The county's unemployment rate had generally trended slightly below state and national averages, reflective of the stability of federal funding for NAS. Wealth indicators are above U.S. averages in part due to a cluster of higher wage technology jobs in the area, largely supporting operations at NAS.

Revenue Framework

Typical of Maryland counties, property and income taxes produce the bulk of general fund revenue, at approximately 41% and 44%, respectively, in fiscal 2021. Property tax revenues have continued to increase, reflecting a slowly appreciating underlying tax base. Income tax revenues have increased at a stronger pace, reflecting modest employment growth and increasing wage levels.

General fund revenues grew ahead of inflation but below national GDP over the 10 years through fiscal 2021. The stability of property taxes and the federal funding that backs income tax collections related to NAS support Fitch's expectation of solid growth prospects for revenue.

The county's independent legal ability to increase the real property tax rate is not subject to any limitation on the tax rate or levy; the county last increased its tax rate in 2001, and its property tax rate is the fifth lowest in the state amongst counties. The income tax rate for fiscal 2023 is 3.0%, leaving modest flexibility below the statutory maximum rate of 3.2%.

Expenditure Framework

The county provides a wide range of services including education, public safety and public works. The county's largest expenditure category is education at roughly 45% of general fund outlays, followed by public safety at about 26%.

Fitch expects the natural pace of spending growth to remain in line with to marginally above expected revenue trends given steady population growth and employee compensation trends.

The county maintains solid expenditure flexibility with modest spending associated with debt service, actuarially determined pension payments and other post-employment benefit (OPEB) contributions, which totaled 9% of fiscal 2021 governmental spending. The county is not a party to any collective bargaining agreements, giving management broad legal control over employee-related spending that is the key driver of the general fund budget.

Maryland counties fund a significant portion of school budgets. According to the state's maintenance of effort mandate, education spending on a per pupil basis cannot decline yoy without state approval, which somewhat limits the county's spending flexibility. The state granted approval to reduce education spending during the Great Recession to some counties.

Long-Term Liability Burden

Total long-term liabilities associated with overall debt and Fitch-adjusted NPLs are low at roughly 4% of total personal income. The fiscal years 2022-2027 six-year capital improvement plan (CIP) totals approximately $316 million and is expected to be funded with roughly $155 million in new debt. While debt funding in the CIP is sizable compared to the county's outstanding direct debt of $156 million after this issuance, the debt burden would remain low when compared to personal income even if all planned debt were issued in the near term.

The county provides pension benefits to Sheriff's Office employees through the St. Mary's Sheriff's Office Retirement Plan (SORP). The county consistently funds 100% of its actuarially determined contribution to the SORP. All permanent full-time employees, other than those covered by the SORP, participate in the State Retirement and Pension System of Maryland, a cost-sharing defined benefit plan.

While the county has consistently funded its full required contribution to the plan, until 2017 the state had not fully funded the actuarially determined contribution, contributing to the somewhat weak ratio of fiduciary net position to total pension liability of 64% (when adjusted by Fitch to reflect its standard 6% discount rate assumption). The aggregate Fitch-adjusted NPL of the two plans totals $114 million or roughly 2% of personal income, which Fitch considers low.

The county provides OPEB to retirees under age 65. The county stopped advance funding its OPEB trust in fiscal 2016 and began making payments on a pay-as-you-go basis to offer taxpayer relief. As of June 30, 2021, the OPEB trust assets of $119 million exceeded liabilities of $105 million, utilizing an investment rate of return assumption of 7.5%.

Operating Performance

Fitch expects the county to manage through future economic downturns with a high level of fundamental financial flexibility given the consistency of its operating results and reserves through prior periods of stress.

The county has a track record of careful budgeting. During the Great Recession the county froze positions, deferred hiring, deferred replacement of vehicles and cut budgets by 5%, among other measures. The county also implemented spending controls at the onset of the pandemic, freezing positions and deferring capital expenditures (the hiring freeze was lifted in December 2020). Fitch expects that county management would take similar measures to in response to future downturns.

Asymmetric Additional Risk Considerations

The 'AA+' GO rating and IDR consider the employment concentration associated with the sizable presence of the NAS in the county to be an asymmetric risk to the rating. NAS and supporting industries constitute a significant portion of the county's economy. A base reduction or closure, although not anticipated, could present risks to the county's credit quality.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
St. Mary's County (MD) [General Government]	LT IDR	AA+ ●	Affirmed		AA+ ●
• St. Mary's County (MD) /General Obligation - Unlimited Tax/ 1 LT	LT	AA+ ●	Affirmed		AA+ ●

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	◉	◆
STABLE	●	

Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (pub.04 May 2021) (including rating assumption sensitivity)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

St. Mary's County (MD)	EU Endorsed, UK Endorsed

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