FitchRatings

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

Fitch Ratings-New York-23 August 2018: Fitch Ratings has assigned a 'AA+' rating to the following general obligation (GO) bonds of St. Mary's County, Maryland (the county):

--$30 million consolidated public improvement bonds, series 2018.

In addition, Fitch has affirmed the county's Issuer Default Rating (IDR) and the rating on $49.5 million of outstanding county GO bonds at 'AA+'.

The Rating Outlook is Stable.

The bonds are expected to be sold via competitive sale on Sept. 18. Proceeds will be used to finance various capital projects in the county.

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 economic concentration in the military, low long-term liability burden, solid spending controls, unlimited legal ability to raise revenues, and Fitch's expectation for natural revenue growth in line with to above the level of U.S. economic performance.

Economic Resource Base
St. Mary's County is located in the southern part of Maryland bordering the Patuxent and Potomac Rivers as well as Chesapeake Bay. The county's 2017 population of 112,667 has increased by roughly 7% since 2010. Population growth reflects, in part, continued expansion at the Naval Air Station (NAS).

KEY RATING DRIVERS

Revenue Framework: 'aaa'
Fitch expects county revenues to grow at a pace in line with to above U.S. GDP growth given the strong growth in income tax collections and steady appreciation of property values. The county's property tax levy and rate are not subject to limitation, providing significant legal revenue-raising flexibility. The county gains additional flexibility from its ability to increase the income tax rate within the statutory cap.

Expenditure Framework: 'aa'
The county maintains solid control over spending. 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 burden is low. Additional debt plans are not expected to notably impact ratios given the rapid amortization of outstanding debt and the county's modest pension burden.

Operating Performance: 'aaa'
The county's superior budget flexibility and strong general fund balance position it to manage comfortably through economic downturns without diminishing its overall financial flexibility.

RATING SENSITIVITIES
Strong Military Presence: Fitch's rating assumes that any changes in federal and military funding that affect the NAS would not be sufficiently severe as to alter the county's credit fundamentals. Divergence from this assumption, without sufficient action by the county to preserve a sound financial position, could have a negative impact on the rating.

CREDIT PROFILE

The NAS is a significant factor in the local economy with over 25,000 workers, approximately 22,500 of whom are civilian personnel. Federal employment accounts for approximately 22% of the county's employment base; however, supporting industries increase the concentration around the NAS. Fitch's rating assumes that the NAS' role as the Navy's principal research, engineering and test center makes severe cuts at the federal level unlikely.

The county's regional airport was designated a Federal Aviation Administration test site for unmanned aircraft systems (UAS) in 2014, in partnership with the University of Maryland, attracting private investments in research and manufacturing. The University System of Maryland will be constructing an approximately $80 million UAS-focused research facility in the county that is expected to be completed in 2020.

Employment trends have been somewhat slow, although the unemployment rate has remained generally in line with the state and national averages. 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 48% and 40%, respectively, in fiscal 2017. Property tax revenues have continued to increase, reflecting an appreciating underlying tax base. The county's tax base remained stable throughout the Great Recession. Income tax revenues have also continued to increase, 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 2017, although revenue growth was subdued by a property tax rate decrease in 2016. Taxable assessed values and income tax collections outpaced national GDP growth over the same period. Given those historical trends as well as steady investment in the county, Fitch considers revenue growth prospects absent policy action to be strong.

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. The income tax rate for fiscal 2019 is 3.0%, leaving some flexibility below the maximum rate of 3.2%.

Expenditure Framework
The county provides a wide range of services, including education, public safety, public works, health, social services, economic development, recreation and parks, community services, and planning and zoning. The county's largest expenditure category is education at roughly half of general fund outlays, followed by public safety at about 19%.

Fitch expects that the natural pace of spending growth will remain in line with to marginally above expected revenue trends, given steady population growth and solid spending controls.

The county maintains solid expenditure flexibility with modest spending associated with fixed carrying costs. Carrying costs associated with debt service, actuarially determined pension payments (including the normal cost for teachers' pensions) and other post-employment benefits (OPEB) actual contributions totaled 11% of fiscal 2017 governmental spending. The county is not a party to any collective bargaining agreements, giving management additional spending flexibility.

Maryland counties fund a significant portion of school budgets. According to the state's maintenance of effort (MOE) mandate, education spending on a per pupil basis cannot decline year-over-year 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 communities. Annual increases in the MOE are limited to 2.5% year-over-year. Student enrollment growth has been moderate and Fitch expects costs to remain affordable.

Long-Term Liability Burden
Total long-term liabilities are low at roughly 4% of total personal income. The fiscal 2019 to 2024 six-year capital improvement plan (CIP) totals approximately $296 million and is funded with roughly $151 million in new debt. While debt funding in the CIP is sizable compared to the county's outstanding direct debt of $107 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 plan. 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 historically funded the actuarially determined contribution, contributing to the somewhat weak ratio of fiduciary net position to the total pension liability of 54.5% (when adjusted by Fitch to reflect a 6.0% discount rate assumption). The aggregate Fitch adjusted net pension liability of the two plans totals a modest $104 million or roughly 2% of personal income.

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 the June 30, 2017 actuarial report, the OPEB trust covered approximately 69% of the total liability. The unfunded liability was less than 1% of personal income. Fitch does not expect OPEB liability growth to become a credit concern.

Operating Performance
The county has historically maintained healthy reserve levels and continued to do so during the Great Recession. Fitch expects the county to manage through cyclical downturns while preserving a superior level of financial resilience. General fund unrestricted reserves (roughly 22% of spending at fiscal 2017 year-end) are above the county's 15% reserve policy and comfortably above the minimum reserve safety

margin that corresponds to a 'aaa' assessment of financial resilience when considering the county's superior inherent budget flexibility and modest sensitivity to economic downturns indicated by results of the Fitch Analytical Sensitivity Tool (FAST).

During the recession the county froze positions, deferred hiring, deferred replacement vehicles and cut budgets by 5% among other measures. Fitch expects county management would respond in a similar manner during another economic downturn.

The adopted fiscal 2018 general fund budget was $221 million and included a real property tax rate reduction to $0.8478 per $100 of assessed value and no appropriation of fund balance. Unaudited year-end results show positive variances in property taxes and other local taxes, as well as savings in general government, public safety and social services spending. The county is estimating a net addition to fund balance of $6.8 million (roughly 3% of estimated spending) in fiscal 2018.

The fiscal 2019 general fund adopted budget of $230 million is up 4% from the prior year. The budget maintains the real property tax and income tax rates from the prior year and includes fund balance appropriations of slightly over $2 million to fund pay-as-you-go capital spending and increased school safety costs.

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Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (pub. 03 Apr 2018) (https://www.fitchratings.com/site/re/10024656)

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