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St. Mary's (County of) MD

Update to credit analysis

Summary

St. Mary's County (Aa1) benefits from a local economy that is anchored by the Naval Air Station Patuxent River (NAS Pax River), the navy's center for avionics research and development, testing, evaluation, and acquisition. The base hosts the Naval Air Systems Command and Naval Air Warfare Center Aircraft Division, and its presence attracts high technology industries with high-paying jobs to the area. As such, wealth and income levels are strong, and support the county's solid and improving financial position.

As heightened economic activity spurs population growth, additional infrastructure investment, particularly for the schools, public facilities, and roads is becoming increasingly important. Because of management's plans to address capital needs with more debt and less pay-go funding, St. Mary's County's debt burden will increase. However, it will likely remain manageable given the modest level of debt outstanding as well as overall low fixed costs.

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. We do not see any material immediate credit risks for St. Mary's County. However, the situation surrounding coronavirus is rapidly evolving and the longer term impact will depend on both the severity and duration of the crisis. If our view of the credit quality of St. Mary's County changes, we will update our opinion at that time.

Credit strengths

» Sizeable and stable tax base anchored by NAS Pax River

» Above-average wealth and income levels

» Formal fiscal policies

» Low debt and pension burdens

Credit challenges

» Local economy and employment vulnerable to federal military cuts

» Reliance on economically sensitive revenues

» Coastal location susceptible to weather-related events

Rating outlook

Outlooks are generally not assigned to local governments with this amount of debt outstanding.

Factors that could lead to an upgrade

- Significant and sustained increase in reserves and liquidity
- Material tax base growth

Factors that could lead to a downgrade

- Trend of structural imbalance yielding diminished reserve levels
- Deterioration of tax base and socioeconomic profile

Key indicators

Exhibit 1

St. Mary's (County of) MD	2015	2016	2017	2018	2019
Economy/Tax Base					
Total Full Value ($000)	$11,882,198	$12,040,217	$12,203,801	$12,432,117	$12,624,398
Population	109,614	110,675	110,979	111,531	111,531
Full Value Per Capita	$108,400	$108,789	$109,965	$111,468	$113,192
Median Family Income (% of US Median)	148.8%	145.7%	143.9%	142.5%	142.5%
Finances					
Operating Revenue ($000)	$209,431	$217,080	$223,616	$227,061	$231,654
Fund Balance ($000)	$44,604	$37,690	$47,375	$57,715	$63,265
Cash Balance ($000)	$73,226	$64,362	$81,474	$85,277	$100,127
Fund Balance as a % of Revenues	21.3%	17.4%	21.2%	25.4%	27.3%
Cash Balance as a % of Revenues	35.0%	29.6%	36.4%	37.6%	43.2%
Debt/Pensions					
Net Direct Debt ($000)	$82,605	$72,213	$85,866	$79,580	$98,318
3-Year Average of Moody's ANPL ($000)	$202,443	$216,933	$207,397	$235,339	$258,603
Net Direct Debt / Full Value (%)	0.7%	0.6%	0.7%	0.6%	0.8%
Net Direct Debt / Operating Revenues (x)	0.4x	0.3x	0.4x	0.4x	0.4x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	1.7%	1.8%	1.7%	1.9%	2.0%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.0x	1.0x	0.9x	1.0x	1.1x

Source: St. Mary's County, MD & Moody's Investors Service

Profile

St. Mary's County covers an area of 764 square miles and is located on a peninsula in southern Maryland (Aaa stable) with over 500 miles of shoreline. The county has a population of approximately 112,000.

Detailed credit considerations

Economy and tax base: technology-based local economy anchored by a major naval base

St. Mary's County's tax base will likely continue to grow given the strong technology sector anchored by NAS Pax River, which is the county's largest employer with approximately 25,000 employees. Further, the local economy is well diversified and includes tourism, healthcare, higher education, and advanced manufacturing. Ongoing development drove a five-year average annual tax base increase of 1.9%, reaching $13.2 billion in fiscal 2021. The county's tax base expanded steadily over the last ten years, anchored by military presence, and is below the median for Aa1-rated counties nationally (full value of $17.5 billion).

Given the number of high-paying technology-based jobs in the county, resident wealth levels continue to rise. The median family income is above average at 142.5% of the US median, and full value per capita is a strong $118,357, which exceeds the median ($105,612) of similary-rated counties. The January 2020 unemployment rate of 3.2% is below the state (3.6%) and nation (4%) for the same period.

Besides the naval base, other large private employers include MedStar St. Mary's hospital and a number defense contractors. Although the large amount of defense-related employers leaves the county vulnerable to federal military cuts, NAS Pax River has not experienced major cuts, likely because of its role as a strategic research base, and, given the US government's commitment to defense spending.

Financial operations and reserves: healthy and improving reserves and liquidity

The county's financial position will likely remain stable due to long-term financial planning and adherence to formal fiscal policies. Fiscal 2019 ended with a surplus of $5.5 million, yielding available (committed, assigned, and unassigned) general fund balance of $63.3 million (27.3% of revenues), which was consistent with projections. The county's reserves remain below the US median for Aa1-counties nationally (37%).

Property taxes are the main source of revenues at 47.6%, and have been growing as a result of the county's increasing assessed value. Economically sensitive income taxes are the second largest source of operating revenues at 42.1%. The local income tax rate was raised to 3.17% in January 2020 from 3.0% in fiscal 2019, and remains slightly below the cap of 3.2%, which affords the county future operating flexibility. The increase will likely help offset declines in income tax revenues because of job losses from the coronavirus.

The fiscal 2020 budget represents a 10% increase over fiscal 2019, in part because of the income tax rate increase. The budget initially allocated use of fund balance of $14.8 million, which was revised to include an additional $3 million because of the coronavirus. Still, the county maintains conservative budgeting assumptions, and year-end figures generally exceed budgetary expectations.

LIQUIDITY

General fund net cash at the end of fiscal 2019 is strong at $100.1 million, or 43.2% of general fund revenues, and exceeds fund balance because the county pools its cash in the general fund. This level is slightly above the national Aa1 median (33% of revenues).

Debt and pensions: low debt burden that will remain manageable despite additional issuances

The county's debt burden will increase in the next five years given additional debt plans, however, it will remain manageable due to the currently modest level of debt outstanding and above-average principal amortization. Post-issuance of the Series 2020 bonds, the county will have net direct debt of $128.3 million, which is a manageable 1% of 2021 full value. Because counties in Maryland issue bonds for schools, this figure is slightly above the median for Aa1-rated counties nationally (0.7% of full value), yet it remains below the median for counties in the state.

The county's 2020-2025 capital improvement plan (CIP) totals $346 million, and largely supports public facilities (21.8%), highways (21.5%), and public schools (20.8%). The plan will be funded by bonds (48%), with a portion funded by state and federal grants (31.2%).

DEBT STRUCTURE

All of the county's debt is fixed rate, and amortization of debt is average with 58.9% of principal retired in 10 years. Fiscal 2019 debt service accounted for approximately 5.1% of general fund expenditures.

DEBT-RELATED DERIVATIVES

The county is not a party to any derivative agreements.

PENSIONS AND OPEB

Pensions are not a source of credit pressure for the county. As of fiscal 2019, the county's (including its component units) adjusted net pension liabilities (ANPL), based on a 3.78% discount rate, totaled $284.3 billion. Comparatively, the GASB reported net pension liabilities, based on a 7.34% discount rate, totaled $103.5 million. The ANPL represents a manageable 1.23 times operating revenue and 2.25% of full value.

In fiscal 2019, the county contributed $16.4 million to the plans, which represents 141% of its "tread water indicator."[1]

The county also provides other post-employment benefits (OPEB) to employees (and the school system employees). Overall, total fixed costs (debt service, pension tread water, and OPEB costs) represented a manageable 11.53% of operating revenues in fiscal 2019.

Exhibit 2
Pension Dashboard

2019	(000)	% of Operating Revenues	Discount Rate
Operating Revenue	231,654	n/a	n/a
Reported Unfunded Pension Liability	103,527	45%	7.34%
Moody's Adjusted Net Pension Liability	284,276	123%	3.51%
Reported Net OPEB Liability	10,123	4%	7.07%
Moody's Adjusted Net OPEB Liability	-	0%	3.18%
Net Direct Debt	98,318	42%	n/a
Debt & unfunded retirement benefits (Moody's adjusted)	382,594	165.16%	
Pension Contribution	16,427	7.09%	n/a
OPEB Contribution	3,391	1.46%	n/a
Debt Service	11,635	5.02%	n/a
Total Fixed Costs	31,453	13.58%	n/a
Tread Water Gap	(4,752)	-2.05%	n/a
Moody's Adjusted Fixed Costs	26,701	11.53%	n/a

Source: St. Mary's County, MD & Moody's Investors Service

ESG considerations

Environmental

The county's exposure to long-term environmental trends is consistent with that of the US local government sector, which as a whole, is low. Environmental considerations are, however, material to the county's credit profile given its coastal location. According to data from Moody's affiliate Four Twenty Seven, the county has elevated exposure to water stress and extreme weather events, which is notable given that the region is an economic engine for the region with the naval base. Still, the county's operations and economy will likely be able to withstand weather-related events given the state and federal governments' history of providing disaster relief to local governments following a major weather event.

Social

Social issues, which include demographics, labor force, and income metrics, are material to the county's credit quality and are incorporated by way of full value per capita and median family income. While social issues do not currently pose a credit risk, we will continue to monitor a variety of factors such as demographics, income levels, population trends and employment levels, as these remain important key credit metrics.

Governance

Like issuers across every sector, governance considerations are material to the county's credit quality. St. Mary's County will continue to benefit from strong management, conservative budgeting practices, and adherence to multiple formal fiscal policies. The county has a policy to maintain fund balance of 15% of general fund revenues, inclusive of a "bond rating reserve" at 6% of revenues, a "rainy day fund" at $1.6 million, and the unassigned fund balance. Debt policies include limits on total debt at 2.15% of assessed value, and annual debt service at 10% of the general fund budget. Under the current CIP, debt service is projected to remain below 7% of revenues and debt outstanding is projected to remain below 2% of assessed value.

Maryland Counties have an Institutional Framework score of Aa, which is high compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. While the sector's largest revenue source, property taxes, is not subject to any statewide caps, income taxes account for approximately a third of revenues and are capped at 3.2%. Unpredictable revenue fluctuations tend to be minor, or under 5% annually.

Across the sector, fixed and mandated costs are generally greater than 25% of expenditures. Maryland has public sector unions, which can limit the ability to cut expenditures. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 3

St. Mary's (County of) MD

Rating Factors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$13,200,508	Aaa
Full Value Per Capita	$118,357	Aa
Median Family Income (% of US Median)	142.5%	Aa
Finances (30%)		
Fund Balance as a % of Revenues	27.3%	Aa
5-Year Dollar Change in Fund Balance as % of Revenues	8.2%	A
Cash Balance as a % of Revenues	43.2%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	2.4%	A
Management (20%)		
Institutional Framework	Aa	Aa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	1.0x	A
Notching Factors:[2]		
Unusually Strong or Weak Budgetary Management and Planning		Up
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	1.0%	Aa
Net Direct Debt / Operating Revenues (x)	0.6x	Aa
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	2.0%	Aa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	1.1x	A
	Scorecard-Indicated Outcome	Aa1
	Assigned Rating	Aa1

[1] Economy measures are based on data from the most recent year available.
[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology dated September 27, 2019.
Source: St. Mary's County, MD & Moody's Investors Service

Endnotes

1 Our "tread water" indicator measures the annual government contribution required to prevent reported net pension liabilities from growing, given the entity's actuarial assumptions. An annual government contribution that treads water equals the sum of employer service cost and interest on the reported net pension liability at the start of the fiscal year. A pension plan that receives an employer contribution equal to the tread water indicator will end the year with an unchanged net pension liability relative to the beginning of the year if all plan assumptions hold. Net liabilities may decrease or increase in a given year due to factors other than the contribution amount, such as investment performance that exceeds or falls short of a plan's assumed rate of return. Still, higher contributions will always reduce unfunded liabilities faster, or will allow unfunded liabilities to grow more slowly than lower contributions.

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