S&P Global Ratings

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Summary:

St. Mary's County, Maryland; General Obligation

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Credit Profile		
US$30.0 mil GO cons pub imp bnds ser 2021 due 05/01/2041		
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 durable local economy that benefits from its exurban access to employment markets surrounding Washington D.C., as well as a strong management team that maintains conservative budgeting and formalized financial policies. We believe the county's employment and income tax base will remain solid, 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, it 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.

While we continue to monitor events related to COVID-19 and the economic recovery, 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.

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

- Adequate economy, with market value per capita of $115,799 and projected per capita effective buying income (EBI) at 103.7% of the national level;
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with operating results that we expect will be at least break-even in the near term, although we do not expect revenues will outpace expenditures by quite as much as they did in fiscal 2020, which closed with large operating surpluses in the general fund and at the total governmental fund level in fiscal 2020;

- Very strong budgetary flexibility, with an available fund balance in fiscal 2020 of 27% of operating expenditures;
- Very strong liquidity, with total government available cash at 43.2% of total governmental fund expenditures and 8.5x governmental debt service, and access to external liquidity we consider strong;
- Very strong debt and contingent liability profile, with debt service carrying charges at 5.1% of expenditures and net direct debt that is 53.3% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value; and
- Very strong institutional framework score.

Environmental, social, and governance factors

St. Mary's County's location along the Potomac and Patuxent rivers and Chesapeake Bay exposes it to a marginal degree of coastal and inland flooding. The county is currently updating its hazard mitigation plan, which will incorporate climate, weather, and disaster planning, and which is scheduled to be completed later in 2021. Overall we consider environmental risks to be in line with the sector standard. We view its social and governance risks as being generally in line with those of peers.

Stable Outlook

Downside scenario

Although unlikely, in our opinion, if the county were to experience significant fiscal pressures and reserves were used to bridge any imbalances over a prolonged period, we could lower the rating.

Upside scenario

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

Credit Opinion

Adequate economy

We consider St. Mary's County's economy adequate. The county has a population of 113,958. St. Mary's County is 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 in the county. The county has a projected per capita EBI of 103.7% of the national level and per capita market value of $115,799. Overall, market value grew by 2.7% over the past year to $13.2 billion in 2021. The county unemployment rate was 3.3% in 2019 and 4.8% in 2020.

Although St. Mary's County is not considered a part of the Washington D.C. metropolitan statistical area (MSA), its northern portion is about 40 miles southeast of the capital and residents have direct access to employment opportunities throughout the county and the D.C. 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. In that way, it also boosts talent attraction and training. In addition, it hosts more than 50 different tenants, which we believe increases resilience to policy or military funding changes.

Nondefense 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, as it is home to St. Mary's Hospital, the College of Southern Maryland, and St. Mary's College. Historically, the county unemployment rate has been below state and national averages. As a result of ongoing development and property revaluations, its 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). Management reports that new residential developments are continuing to sell quickly and construction timelines have been accelerated for several projects.

Very strong management

We view the county's 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:

- Management uses historical trend analysis for budget preparation and looks 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 annually adopts a five-year formal long-term financial plan with detailed anticipated expenditure and revenue trends.
- 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.

We have spoken with officials regarding cybersecurity and consider management conversant in the relevant risks and proactive in managing them. Regarding climate resiliency, officials noted that weather-related damage is rare, although the county occasionally sustains some flooding in the waterfront areas. The county is currently updating its hazard mitigation plan, which will reflect climate and weather risks, as well as disaster planning.

Strong budgetary performance

St. Mary's County's budgetary performance is strong, in our opinion. The county had operating surpluses of 5.5% of expenditures in the general fund and 5.1% across all governmental funds in fiscal 2020. We expect St. Mary's County's strong performance will continue, although we understand annual general fund surpluses may not be as large in the near term compared to the one in fiscal 2020.

The county increased fund balance in fiscal 2020 by approximately $38,000, while also transferring $13.0 million to the capital projects fund in support of pay-as-you-go capital spending. This result mainly reflects conservative revenue estimation. Income taxes in particular exceeded expectations, with receipts growing approximately 4.9%. Property tax collections were also strong, with average home sale prices increasing by approximately 7% year over year. In response to COVID-19, the county did implement certain spending restrictions, such as delaying a portion of planned capital projects. However, officials report that the county has already worked through the small backlog.

The fiscal 2021 general fund budget totals $253.2 million, representing no change from the previous year's figure. Management attempted to include conservative revenue assumptions to account for the effects of COVID-19 and the national recession. As a result, most revenue items are tracking well relative to the budget, with the small but notable exception of accommodations tax receipts. However, strength in income tax receipts should offset shortfalls elsewhere. Management approximately estimates being able to end the year with unassigned fund balance consistent with its 15% policy level and trend.

The county is in the process of finalizing the fiscal 2022 budget. Increases in tax base assessments and continued income tax growth provide some tailwinds for extra spending, and the introduced budget adds a number of positions in public safety, education, and county government infrastructure. Even so, the proposal also includes reduced revenue assumptions for the items that are trailing budgeted figures in the fiscal 2021 budget. Management indicates it expects to adjust revenue and expense estimates as necessary and that reserves will remain well above its policy. Property taxes accounted for approximately 46% of total general fund revenues in fiscal 2020, followed by income taxes at 43%, 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 that its 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, its 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 2020 of 27% of operating expenditures, or $63.4 million. Over the past three years, the total available fund balance has remained at a consistent level overall, totaling 28% of expenditures in 2019 and 27% in 2018.

The county has increased total fund balance reserves in each of the last four fiscal years. Its 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. The county annually calculates the amount of fund balance to use or reclassify from unassigned fund balance to maintain its policy level of 15%. Although it has designated $5 million for general fund non-recurring expenses in fiscal 2021, management anticipates replenishing a large portion of this through positive budget-to-actual variances during the year. We also expect unassigned fund balance 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 43.2% of total governmental fund expenditures and 8.5x governmental debt service in 2020.

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 consider aggressive. We do not believe it has contingent liquidity risks from financial instruments with payment provisions that change on the occurrence of certain events.

St. Mary's County maintains some privately placed equipment leases with TD Equipment Finance Inc. and Banc of America Public Capital Corp., totaling about $2.1 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 5.1% of total governmental fund expenditures, and net direct debt is 53.3% of total governmental fund revenue. Overall net debt is low at 1.1% of market value, which is, in our view, a positive credit factor.

Following this issuance, we calculate that the county will have approximately $147 million in direct tax-supported debt. The county's six-year CIP totals $310 million, a little less than half of which management expects to fund with additional debt issuances. We estimate the county could issue an estimated $25 million-$37 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 weaken the county's debt and liability factor score, considering its above-average amortization schedule.

Pension and other postemployment benefits

- Pension and other postemployment benefit (OPEB) liabilities are not an immediate source of credit pressure for St. Mary's County.
- Although pension plan assumptions, particularly the 7.4% 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.
- The county's strong OPEB pre-funding exceeds that of most state and national peers, which mitigates risk from cost and medical claims volatility.

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

- The State Retirement and Pension System of Maryland, which the state administers and which was 70.7% funded as of June 30, 2020, 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 (NPL) is $22.6 million assuming a 7.4% discount rate;
- Sheriff's Office Retirement Plan: A single-employer, defined-benefit plan covering police and correctional officers; 69.3% funded with a NPL for the county of $43.7 million;
- A Length of Service Award Program for volunteer firefighters and rescue, with a net liability of $19.8 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 93.6% 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, 2020, stood at $6.2 million, assuming a

7.08% discount rate.

St. Mary's County's combined required pension and actual OPEB contributions totaled 5.5% of total governmental fund expenditures in 2020. Of that amount, 4.1% represented required contributions to pension obligations, and 1.4% represented OPEB payments. The county made 96% of its required pension contribution in 2020. Pension contributions equaled our static funding metric and, as a result, we do not expect plan liabilities to materially increase over the next couple of years.

Very strong institutional framework score

The institutional framework score for Maryland municipalities is very strong.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- 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