FitchRatings

RATING ACTION COMMENTARY

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

Wed 15 Nov, 2023 - 5:21 PM ET

Fitch Ratings - New York - 15 Nov 2023: Fitch Ratings has assigned a 'AA+' rating to the following St. Mary's County, Maryland bonds:

--$30 million general obligation consolidated public improvement bonds, series 2023.

In addition, Fitch has affirmed the county's Issuer Default Rating (IDR) and outstanding rated county general obligation (GO) bonds at 'AA+'.

The bonds are expected to be sold competitively on Dec. 5, 2023. The proceeds of the bonds will be used to finance various capital projects within the county.

The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
St. Mary's County (MD) [General Government]	LT IDR Affirmed	AA+ Rating Outlook Stable	AA+ Rating Outlook Stable

St. Mary's County (MD) /General Obligation - Unlimited Tax/1 LT	LT	AA+ Rating Outlook Stable	AA+ Rating Outlook Stable
	Affirmed		

VIEW ADDITIONAL RATING DETAILS

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 that positions the county well to address periods of economic stress. 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 due to 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 2022 population of about 114,900 has increased by roughly 9% since 2010. Population growth reflects, in part, continued expansion at the Naval Air Station, which is home to the Naval Air Systems Command and the Naval Air Warfare Center Aircraft Division headquarters. The county seat of Leanordtown has also grown relatively quickly, and the county's regional airport is slated to expand in the coming years.

KEY RATING DRIVERS

Revenue Framework: 'aaa'

Fitch expects county revenues to grow above Fitch's anticipated long-term rate of inflation but below GDP given continued population growth and development at NAS. The county's property tax levy and tax rates are not subject to limitation, providing significant legal

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 moderate, and the county has solid ability to reduce spending in the event of a moderate economic downturn. Education costs make up about one-half of the county's spending, and any reductions require state approval, somewhat limiting flexibility. The county maintains strong legal control over employment terms given the absence of collective bargaining.

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 the liability ratio 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 county's revenue growth prospects;

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

CURRENT DEVELOPMENTS

delays in planned capitalized equipment orders. Additionally, income taxes came in with a $1.6 million positive variance (0.6%) relative to budget.

The fiscal 2023 budget of $325 million was up about 12.5% over the prior adopted budget and reduced the income tax rate to 3.0% from 3.1% given strong collections. The budget also included the utilization of about $25 million in fund balance and includes a 3% COLA for non-sworn pay scales and a 6.5% market increase to sworn scales in the sheriff's office. According to management, YTD fiscal 2023 general fund operating performance is favorable relative to budget.

The fiscal 2024 adopted budget represents a decrease of about 2% from the prior year budget, with unchanged income and property tax rates and a $14 million general fund balance appropriation. The budget includes compensation increases of 6% for sworn officers, and 4.5% cost of living adjustment for non-sworn pay scales, with an additional mid-year COLA of 2.3% to meet the $15 minimum wage. The county also introduced an excise tax to replace the county impact fee, expected to bring in $3.8 million in revenue annually, an improvement of about $1.2m annually over the previous impact fee.

CREDIT PROFILE

The NAS is a significant factor in the local economy with over 20,000 direct workers, and over 60,000 workers 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 U.S. Navy's principal research, engineering and test center makes severe cuts by the federal government unlikely in the medium term.

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 42% and 43%, respectively, in fiscal 2022. Property tax revenues have continued to increase, reflecting an underlying tax base that is gradually appreciating in

General fund revenues grew ahead of inflation but below national GDP over the 10 years through fiscal 2022. 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. The income tax rate for fiscal 2024 remains 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 24%.

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 2022 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 below the state-mandated level 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. In FY2024, St. Mary's County funded public schools over $13 million over the maintenance of effort level, providing the county with additional expenditure flexibility should it be necessary.

Long-Term Liability Burden

excise taxes. While debt funding in the CIP is sizable compared to the county's outstanding direct debt of $177 million (about 2.4% of personal income) including 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 $124 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, 2022, the OPEB trust assets of $113 million exceeded liabilities of $111 million, utilizing an investment rate of return assumption of 6%.

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 in response to future downturns.

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

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

FITCH RATINGS ANALYSTS

Nicholas Rizzo
Senior Analyst
Primary Rating Analyst
+1 212 908 0596
nicholas.rizzo@fitchratings.com
Fitch Ratings, Inc.
Hearst Tower 300 W. 57th Street New York, NY 10019

Grace Wong
Director
Secondary Rating Analyst
+1 212 908 0652

Committee Chairperson
+1 212 908 0593
shannon.mccue@fitchratings.com

MEDIA CONTACTS

Sandro Scenga
New York
+1 212 908 0278
sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

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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)

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Dodd-Frank Rating Information Disclosure Form

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Endorsement Policy

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. Sector-specific best- and worst-case scenario credit ratings are listed in more detail at https://www.fitchratings.com/site/re/10238496

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