FITCH RATES ST. MARY'S COUNTY, MD'S GOS 'AA+'; OUTLOOK STABLE

Fitch Ratings-New York-21 June 2016: Fitch Ratings has assigned an 'AA+' rating to the following general obligation (GO) bonds of St. Mary's, Maryland (the county):

--$25 million consolidated public improvement tax-exempt bonds, series 2016.

The bonds are expected to be sold via competitive sale on July 26. Proceeds will be used to finance various county capital projects.

In addition, Fitch has affirmed the county's Issuer Default Rating (IDR) and the rating on $32.6 million of outstanding county GO bonds at 'AA+'.

The Rating Outlook is Stable.

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

KEY RATING DRIVERS

Analytical Conclusion (IDR): The IDR reflects the county's economic concentration in military, small long-term liability burden, strong control over revenues and spending, and Fitch's expectation for revenue growth in line with or above the level of U.S. economic performance absent any revenue-enhancement policy action.

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 2015 population of 111,413 has increased 6% since 2010. The county's population levels reflect, in part, the expansions at the Naval Air Station as well as the county's attractive location.

Revenue Framework: 'aaa' factor assessment
The county has strong revenue flexibility given the independent legal ability to increase property taxes without limitation. The county gains additional flexibility from the ability to increase the income tax rate. Revenue growth prospects are strong given Fitch's expectation of continued economic growth and a revenue system that captures that growth.

Expenditure Framework: 'aa' factor assessment
The county has significant control over spending, including the legal ability to decide on terms of labor given the absence of collective bargaining. This is somewhat offset by the limited flexibility to reduce education spending without state approval. Carrying costs for debt and retiree benefits are low at 9% of governmental spending. Spending is likely to grow in line with revenues in the absence of policy action.

Long-Term Liability Burden: 'aaa' factor assessment
The county's combined debt and unfunded pension liability burden is very low. Additional debt plans are affordable and should not notably impact ratios given rapid (77% in 10 years) amortization of outstanding debt and modest borrowing needs.

Operating Performance: 'aaa' factor assessment
The county has consistently maintained strong operating performance. The unrestricted fund balance at fiscal year-end 2015 was $44.6 million or 21.4% of general fund spending. Fitch believes the county will maintain reserves throughout the economic cycle solidly above the level consistent with a 'aaa' financial resilience assessment given the county's strong control over revenue and conservative budgeting. The county also maintains additional reserves outside of the general fund that are available for general fund purposes.

RATING SENSITIVITIES
Strong Military Presence: Fitch's rating assumes that any changes in federal and military funding that affect the Naval Air Station 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 an 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 21% 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 (UM), attracting private investments in research and manufacturing. UM will be constructing a UAS-focused research facility in the county to be completed in 2018.

Employment trends have been flat. The unemployment rate remains below the state and nation. Wealth indicators are above U.S. averages in part due to a cluster of higher-wage technology jobs in the area.

Revenue Framework
Typical of Maryland counties, property and income taxes produce the bulk of general fund revenue, at approximately 50% and 39%, respectively, for fiscal 2015. Property tax revenues have continued to increase, reflecting an appreciating underlying tax base and solid collections. The county's tax base remained stable throughout the recession. Income tax revenues have also continued to increase reflecting a growing economy.

General fund revenues grew ahead of inflation and mildly above national GDP over the 10 years through 2014 without any policy action. Given steady investment in the county, revenue growth prospects without policy action are positive.

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 county gains additional flexibility from the remaining margin below the maximum income tax rate.

Expenditure Framework
The county's largest expenditure category is education at roughly half of general fund outlays, followed by public safety at about 20%.

Given the county's steady population growth, the pace of growth in main expenditures is expected to increase but remain in line with expected revenue trends.

The county maintains adequate expenditure flexibility with modest spending associated with fixed carrying costs. According to the state's maintenance of effort mandate, education spending cannot decline year-over-year without state approval. Student enrollment growth has been moderate and Fitch expects costs to remain affordable. Unusual for the majority of Maryland counties, the county has not entered into any collective bargaining agreements.

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 9% of fiscal 2015 governmental spending; debt service accounted for about half of the total.

Long-Term Liability Burden

Total long-term liabilities are low at 2.8% of total personal income. Debt levels - more than half of the total at 1.8% of personal income - are expected to remain low because of the county's affordable debt issuance plans and rapid amortization. The fiscal 2017 to 2022 six-year capital improvement plan (CIP) totals approximately $278 million, compared to $95.7 million of outstanding debt, after this issuance. School projects account for the largest spending (34% of the total) followed by public facilities (27%) and highways (22%). The plan is slightly more than 52% debt-funded and 32% state/federally funded.

The county provides pension benefits to its employees through participation in the state plan and the St. Mary's Sheriff's Office Retirement Plan. The county has consistently contributed 100% of the actuarially calculated annual required contribution. The aggregate unfunded liability of both plans totals an adjusted $55.7 million (adjusted to a 7% return assumption) or just 1% of personal income.

For a number of years the county has over-funded its OPEB. As a result, as of 2015 the plan was 56.9% funded. The unfunded liability is $42.6 million or less than 1% of personal income.

Operating Performance

The county has historically maintained healthy reserve levels and continued to do so during the last recession. Fitch expects the county to manage through cyclical downturns while preserving a superior level of financial resilience. General fund reserves (21.4% of spending at fiscal 2015 year-end or 25.9% when available capital projects fund reserves are added) are well above the county's 15% reserve policy and comfortably above the minimum reserve safety margin that corresponds to the county's superior inherent budget flexibility and moderate 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 fiscal 2016 general fund adopted budget is $227 million; the budget includes a real property tax rate reduction to $.8523 per $100 of assessed value and appropriates $11.87 million of fund balance. Estimated year-end results show positive variances in spending mostly in public safety and debt service. Therefore, the county now estimates a net addition in fund balance of $5 million (3% of estimated spending) rather than a drawdown.

The adopted fiscal 2017 general fund budget of $222 million is a 2% decline from the fiscal 2016 adopted budget. The budget includes no fund balance appropriation and no adjustment to tax rates. The decline in the budget reflects a decline in appropriated fund balance for capital pay-go spending. Excluding the fund balance appropriation in fiscal 2016, the budget increased 3.1% and mostly funds increases for compensation and health insurance premiums, technology and business practices study.

Contact:

Primary Analyst
Evette Caze
Director
+1-212-908-0376
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Secondary Analyst
Parker Montgomery
Analyst
+-1-212-908-0356

Committee Chairperson
Laura Porter
Managing Director
+1-212-908-0575

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available at 'www.fitchratings.com'.

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

Applicable Criteria
U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=879478