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

Fitch Ratings-New York-23 October 2017: Fitch Ratings has assigned a 'AA+' rating to the following general obligation (GO) bonds of St. Mary's County, Maryland (the county):

--$14.8 million public improvement refunding bonds, series 2017.

The bonds are expected to be sold via competitive sale on Oct. 24. Proceeds will be used to refund the county's outstanding series 2009B consolidated public improvement build America bonds.

In addition, Fitch has affirmed the county's Issuer Default Rating (IDR) and the rating on $51 million of outstanding county GO bonds at 'AA+'.

The Rating Outlook is Stable.

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 IDR and GO rating reflect the county's economic concentration in the military, low long-term liability burden, strong control over revenue-raising, solid spending controls, and Fitch's expectation for natural revenue growth in line with or 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 2016 population of 112,587 has increased by 7% since 2010. Population growth reflects, in part, the expansions at the Naval Air Station (NAS).

KEY RATING DRIVERS

Revenue Framework: 'aaa'
The county has strong revenue flexibility given its independent legal ability to increase property taxes without limitation. The county gains additional flexibility from its ability to increase the income tax rate. Fitch expects county revenues to grow at a pace in line with to above U.S. GDP growth.

Expenditure Framework: 'aa'
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 moderate. Fitch expects spending to grow in line with revenues in the absence of policy action.

Long-Term Liability Burden: 'aaa'
The county's combined debt and unfunded pension liability burden is low. Additional debt plans are not expected to notably impact ratios given rapid amortization of outstanding debt.

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 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 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 (UM), attracting private investments in research and manufacturing. UM will be constructing a UAS-focused research facility in the county that is expected to be completed in 2020.

Employment trends have been slow, although the unemployment rate remains below the national average. 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 40%, respectively, for fiscal 2016. Property tax revenues have continued to increase, reflecting an appreciating underlying tax base. The county's tax base remained stable throughout the recession. Income tax revenues have also continued to increase, reflecting slow employment increases and growing wage levels.

General fund revenues grew ahead of inflation but below national GDP growth over the 10 years through 2016, although revenue growth was subdued by property tax rate decreases in 2007 and 2016. Taxable assessed values and income tax collections have outpaced national GDP growth over the same period. Given those historical trends as well as steady investment in the county, revenue growth prospects without policy action are 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 2018 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 20%.

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

The county maintains solid 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. 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 10% of fiscal 2016 governmental spending.

Long-Term Liability Burden
Total long-term liabilities are low at roughly 3% of total personal income. The fiscal 2018 to 2023 six-year capital improvement plan (CIP) totals approximately $296 million and includes roughly $160 million in new debt. While debt funding in the CIP is sizable at almost double the county's outstanding debt, 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 its employees through participation in the state Employees' Retirement System of Maryland and the St. Mary's Sheriff's Office Retirement Plan. The county has consistently contributed 100% of the actuarially determined contribution. The aggregate net pension liability of the plans totals $100 million (adjusted by Fitch to reflect a 6% discount rate assumption) 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 July 1, 2017 actuarial report, the OPEB trust covered over 60% of the total liability. The unfunded liability was $40 million or 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 last recession. Fitch expects the county to manage through cyclical downturns while preserving a superior level of financial resilience. General fund unrestricted reserves (roughly 17% of spending at fiscal 2016 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 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. Unaudited year-end results show positive variances in spending mostly in general government, public safety and economic development. The county is estimating a net addition to fund balance of $9 million (roughly 4% of estimated spending).

The fiscal 2018 general fund adopted budget is $221 million; the budget includes a real property tax rate reduction to $.8478 per $100 of assessed value without any appropriation of fund balance.

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

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Applicable Criteria
U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017)
https://www.fitchratings.com/site/re/898466