

CREDIT OPINION

23 October 2017

New Issue

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St. Mary's County, MD

New Issue - Moody's Upgrades St. Mary's County (MD) from Aa2 to Aa1

Summary Rating Rationale

Moodys Investors Service has assigned a Aa1 rating to St. Mary's County, MD's \$14.8 million Public Improvement Refunding Bonds, Series 2017. Concurrently, Moodys has upgraded to Aa1 from Aa2 rating on the county's \$83.6 million of general obligation (GO) debt outstanding.

The Aa1 rating incorporates the county's sizeable and stable tax base anchored by the Naval Air Station Patuxent River (NAS Pax River), above-average wealth levels, satisfactory financial and liquidity positions supported by formal fiscal policies, and low debt and pension burdens.

Credit Strengths

- » Sizeable and stable tax base anchored by NAS Pax River
- » Above-average socioeconomic profile
- » Formal fiscal policies
- » Low debt and pension burdens

Credit Challenges

- » Local economy and employment vulnerable to federal military cuts
- » Reliance on economically sensitive revenues

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 leading to deterioration of reserve levels
- » Deterioration of tax base and socioeconomic profile

Key Indicators

Exhibit 1

St. Mary's (County of) MD	2012	2013	2014	2015	2016
Economy/Tax Base					
Total Full Value (\$000)	\$ 11,400,733	\$ 11,460,098	\$ 11,675,990	\$ 11,882,198	\$ 12,040,217
Full Value Per Capita	\$ 108,035	\$ 107,025	\$ 107,641	\$ 108,400	\$ 109,842
Median Family Income (% of US Median)	142.7%	147.1%	151.9%	148.8%	148.8%
Finances					
Operating Revenue (\$000)	\$ 202,802	\$ 200,982	\$ 204,231	\$ 209,431	\$ 217,080
Fund Balance as a % of Revenues	29.2%	25.9%	21.6%	21.3%	17.4%
Cash Balance as a % of Revenues	46.2%	47.1%	46.3%	35.0%	29.6%
Debt/Pensions					
Net Direct Debt (\$000)	\$ 97,665	\$ 100,961	\$ 92,172	\$ 82,605	\$ 72,213
Net Direct Debt / Operating Revenues (x)	0.5x	0.5x	0.5x	0.4x	0.3x
Net Direct Debt / Full Value (%)	0.9%	0.9%	0.8%	0.7%	0.6%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	0.9x	1.0x	1.0x	1.0x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	1.5%	1.8%	1.7%	1.8%

Source: Moody's Investors Service; St. Mary's County MD 2012-2016 Audits

Detailed Rating Considerations

Economy and Tax Base: Technology-Based Local Economy Dominated by Major Navy Base

The local economy will likely continue to grow given the county's strong technology sector anchored by NAS Pax River, which is the county's largest employer with approximately 25,000 employees. NAS Pax River is 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 had a total economic output of \$7.5 billion in 2012. The presence of NAS Pax River attracts high technology industries to the county.

The county's economy is well diversified, including tourism, healthcare, higher education, and advanced manufacturing. Continued economic development resulted in tax base growth averaging 1.4% annually for the five years ending in 2017. Projections for the tax base's full-value growth estimate a 2.1% increase in 2018 to \$12.5 billion, which is below the US median for similarly-rated counties. While this projection exceeds the five-year average, county's tax base has grown steadily over the last ten years, anchored by the military presence.

Given the number of high-paying technology-based jobs in the county, resident wealth levels continue to increase with the median family income at 148.9% of the US median, which is stronger than income levels of similarly-rated counties. The August 2017 unemployment rate of 4.1% is approximates the state (4.0%) and is lower than the national (4.5%) rate for the same period. Besides NAS Pax River, 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, should remain stable.

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Financial Operations and Reserves: Satisfactory Reserve Levels Expected to Grow In Near Term

The county's financial position will remain stable, given management's trend of conservative budgeting and adherence to formal fiscal policies. Although the county's reserves remain below the US median for Aa1 counties nationally, they still exceed the county's policy level. The county maintains a fund balance policy to maintain its reserves at 15% of general fund revenues, including a "Bond Rating Reserve" at 6% of revenues, a "Rainy Day Fund" at \$1.6 million, and the unassigned fund balance.

The county's use of fund balance in fiscal 2013 and 2014 were strictly to fund post-employment benefit (OPEB) trust and pay-go capital projects, rather than operations. Another draw in fiscal 2016 was also for capital, leaving the county with an available fund balance of \$37.9 million, or a satisfactory 17.4% of General Fund revenues.

Property taxes are the main source of operating revenues at 48.5%, 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 39.4%. County management has the ability to increase the income tax rate to augment revenues, if needed, given that the current income tax rate of 3.0% is below the statutory limit.

In fiscal 2017, county management estimates the available fund balance to increase by \$8.8 million to \$46.7 million, or 20.9% of estimated fiscal 2017 revenues, still below the median for Aa1 counties. The fiscal 2017 budget represents a 3.1% increase from the previous year's budget and does not include the use of fund balance. In its five-year budget forecast, the county plans to reduce the amount of capital projects funded by pay-go going forward, which will allow the county to rebuild general fund reserves.

LIQUIDITY

General Fund net cash at the end of fiscal 2016 is strong at \$64.4 million, or 29.6% of General Fund revenues. While this level is below national medians, it is in-line with similarly-rated counties in the state.

Debt and Pensions: Low Debt Burden to Remain Manageable Despite Planned Issuance

The county's debt burden will increase in the next five years given additional debt plans, but will remain low due to the currently modest level of debt outstanding and rapid principal amortization. Including the new issuance, the direct debt burden will remain in-line with other Aa2-rated counties nationally at 0.8% of full value. However, this is materially lower than similarly-rated counties in the state.

The county's 2018-2023 Capital Improvement Plan totals \$296 million, and largely supports public schools (29.1%), public facilities (27.9%), and highways (22.3%). The plan will be mostly bond-funded (54%), with a portion funded by state and federal grants (29.1%).

Debt policies include limits on total debt at 2% 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 1.5% of assessed value.

DEBT STRUCTURE

All of the county's debt is fixed rate, and amortization of debt is rapid with 75.2% of principal retired in 10 years. Fiscal 2016 debt service accounts for a low 4.2% of General Fund revenues.

DEBT-RELATED DERIVATIVES

St. Mary's County is not a party to any derivative agreements.

PENSIONS AND OPEB

The county participates in multi-employer, defined benefit retirement plans administered under the State Retirement and Pension System of Maryland for county and school employees. The county also administers a Sheriffs Office Retirement Plan, a single-employer defined benefit pension plan, as well as a length of service program for the Volunteer Fire Departments, Rescue Squads and Advanced Life Support Unit. The county's combined contributions to the plans was \$14.4 million in fiscal 2016, or 6.6% of operating revenues.

The county's adjusted net pension liability (ANPL) in fiscal 2016, under Moody's methodology for adjusting reported pension data, was \$2.14 million, or an average 0.99 times operating revenues. Moody's uses the ANPL to improve comparability of reported pension liabilities. The adjustments are not intended to replace the county's reported liability information, but to improve comparability with other rated entities.

The county funds its OPEB liability through a trust. Fiscal 2016 OPEB contributions totaled \$2.7 million, or a minimal 1.2% of operating revenues. The reported OPEB liability was 66.7% funded at the end of fiscal 2016. After several years of pre-funding its OPEB trust, county management plans to contribute only the pay-go amount of the OPEB cost going forward. Total fixed costs, including debt service, pension, and OPEB, are low, at 12.2% of fiscal 2016 operating revenues.

Management and Governance

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.

Legal Security

The bonds are secured by the county's absolute and unconditional ad valorem tax pledge.

Use of Proceeds

Proceeds from the 2017 GO bonds will be used to refund the county's outstanding 2009B Build America Bonds for a net present value savings of \$1 million.

Obligor Profile

St. Marys County covers an area of 764 square miles and is located on a peninsula in southern Maryland with over 500 miles of shoreline. The county has a population of approximately 111,000.

Methodology

The principal methodology used in this rating was US Local Government General Obligation Debt published in December 2016. Please see the Rating Methodologies page on www.moody's.com for a copy of this methodology.

Ratings

Exhibit 2

St. Mary's (County of) MD

Issue	Rating
Public Improvement Refunding Bonds, Series 2017	Aa1
Rating Type	Underlying LT
Sale Amount	\$14,845,000
Expected Sale Date	10/24/2017
Rating Description	General Obligation

Source: Moody's Investors Service

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