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CREDIT OPINION
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St. Mary's (County of) MD

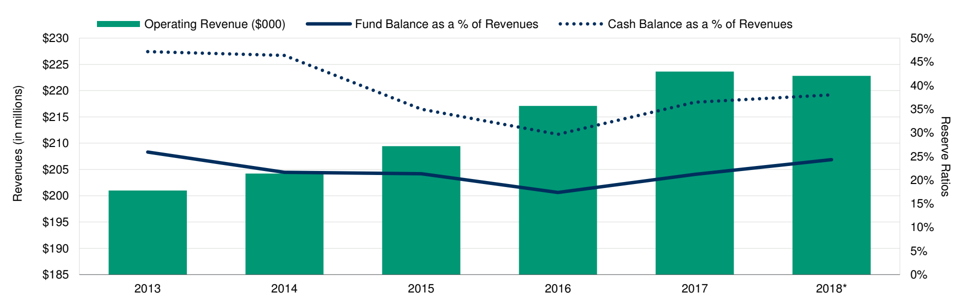
Update to credit analysis

Summary

St. Mary's County (Aa1) benefits from a local economy that is anchored by the Naval Air Station Patuxent River (NAS Pax River), 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 its presence attracts high technology industries with high-paying jobs to the area. As such, wealth and income levels are strong, and support the county's solid and improving financial position.

As heightened economic activity spurs population growth, additional infrastructure investment, particularly for the schools, public facilities, and roads is becoming increasingly important. Because of management's plans to address capital needs with more debt and less pay-go funding, St. Mary's County's debt burden will increase. However, it will likely remain manageable given the modest level of debt outstanding as well as overall low fixed costs.

Exhibit 1
Improving Reserve and Liquidity Position
Fiscal 2013-2018



*2018 figures are preliminary.
Source: St. Mary's County, MD & Moody's Investors Service

Credit strengths

» Sizeable and stable tax base anchored by NAS Pax River

» Above-average wealth and income levels

» 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 yielding diminished reserve levels

» Deterioration of tax base and socioeconomic profile

Key indicators

Exhibit 2

St. Mary's(County of) MD	2013	2014	2015	2016	2017
Economy/Tax Base					
Total Full Value ($000)	$11,460,098	$11,675,990	$11,882,198	$12,040,217	$12,203,801
Population	107,079	108,472	109,614	110,675	110,675
Full Value Per Capita	$107,025	$107,641	$108,400	$108,789	$110,267
Median Family Income (% of US Median)	147.1%	151.9%	148.9%	145.7%	145.7%
Finances					
Operating Revenue ($000)	$200,982	$204,231	$209,431	$217,080	$223,616
Fund Balance ($000)	$52,060	$44,178	$44,604	$37,690	$47,375
Cash Balance ($000)	$94,724	$94,659	$73,226	$64,362	$81,474
Fund Balance as a % of Revenues	25.9%	21.6%	21.3%	17.4%	21.2%
Cash Balance as a % of Revenues	47.1%	46.3%	35.0%	29.6%	36.4%
Debt/Pensions					
Net Direct Debt ($000)	$100,961	$92,172	$82,605	$72,213	$85,866
3-Year Average of Moody's ANPL ($000)	$171,790	$211,705	$202,443	$216,933	$207,397
Net Direct Debt / Full Value (%)	0.9%	0.8%	0.7%	0.6%	0.7%
Net Direct Debt / Operating Revenues (x)	0.5x	0.5x	0.4x	0.3x	0.4x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	1.5%	1.8%	1.7%	1.8%	1.7%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	0.9x	1.0x	1.0x	1.0x	0.9x

Source: St. Marys County, MD & Moody's Investors Service

Profile

St. Mary's County covers an area of 764 square miles and is located on a peninsula in southern Maryland (Aaa stable) with over 500 miles of shoreline. The county has a population of approximately 111,000.

Detailed credit considerations

Economy and tax base: technology-based local economy anchored by a major naval base

St. Mary's County's tax base will likely continue to grow given the strong technology sector anchored by NAS Pax River, which is the county's largest employer with approximately 25,000 employees. Further, the local economy is well diversified and includes tourism, healthcare, higher education, and advanced manufacturing. Ongoing development drove a five-year average annual tax base increase of 1.6%, reaching $12.7 billion in fiscal 2019. The county's tax base expanded steadily over the last ten years, anchored by military presence, and is slightly above the median for Aa-rated counties nationally (full value of $8.3 billion).

Given the number of high-paying technology-based jobs in the county, resident wealth levels continue to rise. The median family income is above average at 145.7% of the US median, and full value per capita is a strong $114,313, which exceeds the median ($84,145) of similary-rated counties. The May 2018 unemployment rate of 3.8% is aligned with the state (3.9%) and nation (3.6%) for the same period.

Besides the naval base, 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.

Financial operations and reserves: solid and improving reserves and liquidity

The county's financial position will likely remain stable due to long-term financial planning and adherence to formal fiscal policies. Fiscal 2017 ended with a surplus of $8.2 million, yielding available (committed, assigned, and unassigned) general fund balance of $47.4 million (21.2% of revenues), which was consistent with projections. Although the county's reserves remain below the US median for Aa-counties nationally (33.8%), they are above the county's policy level to maintain fund balance of 15% of general fund revenues, inclusive of a “bond rating reserve” at 6% of revenues, a “rainy day fund” at $1.6 million, and the unassigned fund balance.

Property taxes are the main source of revenues at 47.9%, 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%. The local income tax rate (3.0% in fiscal 2018) is markedly below the cap of 3.2%, which affords the county future operating flexibility.

In fiscal 2018, county management estimates the available fund balance to increase by $6.8 million to reach $54.1 million, or 24.3% of estimated fiscal 2018 revenues. The fiscal 2019 budget represents a 4% increase from fiscal 2018, with revenues exceeding expenditures by $4.8 million. Surplus funds will finance pay go capital projects and school safety costs. Year-end reserves are anticipated to remain in line with the prior year.

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 2017 is strong at $81.5 million, or 36.4% of general fund revenues. While this level is slightly below national median (39.4% of revenues) for Aa-rated credits, it is in-line with similarly-rated counties in the state.

Debt and pensions: low debt burden that will remain manageable despite additional issuances

The county's debt burden will increase in the next five years given additional debt plans, however, it will remain manageable due to the currently modest level of debt outstanding and above-average principal amortization. Post-issuance of the Series 2018 bonds, the county will have net direct debt of $110.6 million, which is a manageable 0.9% of 2019 full value. Although this is slightly above the median for Aa-rated counties nationally (0.5% of full value), it remains below the median for counties in the state.

The county's 2019-2024 capital improvement plan (CIP) totals $296 million, and largely supports public schools (31.3%), public facilities (20.9%), and highways (20.8%). The plan will be funded by bonds (51%), with a portion funded by state and federal grants (30.4%).

Debt policies include limits on total debt at 2.15% 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 2% of assessed value.

DEBT STRUCTURE

All of the county's debt is fixed rate, and amortization of debt is above-average with 64.4% of principal retired in 10 years. Fiscal 2017 debt service accounted for approximately 4.6% of general fund expenditures.

DEBT-RELATED DERIVATIVES

The 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 contribution to the plans was $14.4 million in fiscal 2017, or 6.7% of operating expenditures.

The county's Moody's adjusted net pension liability (ANPL) in fiscal 2017 was $238.5 million, or an average 1.07 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 provides other post-employment benefits (OPEB) to retirees. Fiscal 2017 OPEB contributions totaled $3 million, or a minimal 1.4% of operating expenditures. The reported OPEB liability was 68.5% funded at the end of fiscal 2017. After several years of pre-funding its OPEB trust, county management contributed only the pay-go amount of the OPEB cost beginning fiscal 2016.

Total fixed costs, including debt service, pension, and OPEB, are low at 12.7% of fiscal 2017 operating expenditures.

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.

The sector's largest revenue source, property taxes, is capped annually by the lesser of CPI or 5%, and income taxes, which account for approximately a third of revenues, 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.

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