27 APR 2021

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

Fitch Ratings - New York - 27 Apr 2021: Fitch Ratings has assigned a 'AA+' rating to the following St. Mary's County, Maryland general obligation (GO) bonds:

--$30 million Consolidated Public Improvement Bonds, Series 2021.

The bonds are expected to be sold competitively on May 11. The proceeds will be used to finance various capital projects within the county.

In addition, Fitch has affirmed the following county ratings at 'AA+':

--The county's Issuer Default Rating (IDR).

--$96 million outstanding county GO bonds.

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 '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 within the context of expected revenue volatility through economic downturns. 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 and specifically with 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 2019 population of about 113,500 has increased by roughly 8% since 2010. Population growth reflects, in part, continued expansion at the NAS, which is home to the Naval Air Systems Command and the Naval Air Warfare Center Aircraft Division headquarters.

Revenue Framework: 'aaa'

Fitch expects county revenues to grow above the rate of inflation but below GDP given continued population growth and development at NAS. The county's property tax levy and rate are not subject to limitation, providing significant legal revenue-raising flexibility and a budgetary tool to counteract periods of income tax instability.

Expenditure Framework: 'aa'

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 low, and the county has strong legal control over employment terms given the absence of collective bargaining. Education costs make up about one-half of the county's spending, and any reductions require state approval, somewhat limiting flexibility.

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 ratios given the rapid amortization of outstanding debt and the county's modest pension burden.

Operating Performance: 'aaa'

The county's superior budget flexibility and strong general fund balance position it to manage through the remainder of the current disruption and 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 revenue growth prospects of the county;

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

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CURRENT DEVELOPMENTS

Fiscal 2020 general fund operating results were flat, with unrestricted reserve levels at a solid $63.4 million (26% of spending). The fiscal 2021 adopted budget totaled $253 million and left the real property tax rate at prior year levels. The budget included a $3.3 million increase to school funding and the use of about $5 million in fund balance for pay-go capital projects. YTD results have been positive, with property tax revenues tracking in line with budget and income taxes expected to exceed budget estimates.

Income tax growth has been partially supported by the stability of employment and wages associated with NAS through the duration of the pandemic. The county received about $9.9 million in CARES funding that it utilized for offsetting eligible expenditures, primarily related to medical expenses and public health. Given current expenditure trends and favorable expectations for income tax revenues, the county anticipates that it will likely end the year with a modest surplus and no use of fund balance.

The recently enacted America Rescue Plan (ARP) will provide $350 billion in direct aid to state and local governments and additional funding for transit systems and school districts (through the states) as well as a significant amount of economic stimulus that should have a positive near-term impact on state and local government revenues. Fitch does not expect the stimulus aid to alter the long-term credit fundamentals of state and local governments, but should bridge near-term fiscal gaps. For more information, see "ARP Boosts State and Local Government Budgets" published March 11 and available on www.fitchratings.com.

The county will receive $22 million in ARP relief funds. The county has earmarked a portion of the funding towards certain health related spending and will allocate the remainder following receipt of U.S. Treasury Department guidance on permissible uses. The county's proposed fiscal 2022 budget totals $293 million (a 16% increase over the prior year's adopted budget). Growth in the budget is primarily driven by the inclusion of budget authorization for the expected ARP funds. The budget also includes funding for additional positions associated with a new animal shelter and an addition to the county's adult detention center. The budget is subject to public hearing and approval by the board of county commissioners, with final budget adoption expected on May 25.

CREDIT PROFILE

The NAS is a significant factor in the local economy with over 20,000 direct workers, and over 60,000 when including indirect and induced labor. Fitch's rating assumes the NAS' role as the United States 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, attracting private investments in research and manufacturing. The University System of Maryland is currently constructing an approximately $87 million UAS-focused research facility in the county that is expected to be completed in 2021.

The county's pre-pandemic unemployment rate had generally been in line with the state and national averages but the rate has trended below elevated state and national rates in recent months, 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.

Typical of Maryland counties, property and income taxes produce the bulk of general fund revenue, at approximately 45% and 43%, respectively, in fiscal 2020. Property tax revenues have continued to increase, reflecting a slowly appreciating underlying tax base. The county's tax base remained stable throughout the Great Recession. Income tax revenues have increased at a stronger pace, reflecting modest employment growth and increasing wage levels.

General fund revenues grew ahead of inflation but below national GDP over the 10 years through fiscal 2020. The income tax rate was increased in fiscal 2020, which provided a one-time boost to collections in that year. 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, and its property tax rate is the fifth lowest in the state amongst counties. The income tax rate for fiscal 2021 is 3.17%, leaving marginal flexibility below the statutory maximum rate of 3.2%.

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 half of general fund outlays, followed by public safety at about 22%.

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

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 2020 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 (MOE) mandate, education spending on a per pupil basis cannot decline 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.

Total long-term liabilities associated with overall debt and Fitch-adjusted NPLs are low at roughly 4% of total personal income. The fiscal 2021-2026 six-year capital improvement plan (CIP) totals approximately $368 million and is funded with roughly $190 million in new debt. While debt funding in the CIP is sizable compared to the county's outstanding direct debt of $137 million after 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 61% (when adjusted by Fitch to reflect its standard 6% discount rate assumption). The aggregate Fitch-adjusted NPL of the two plans totals $127 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, 2020, the OPEB trust covered approximately 94% of the total liability, utilizing a blended discount rate of 7.08%. The unfunded liability was less than 1% of personal income. Fitch does not expect OPEB liability growth to become a credit concern.

Fitch expects the county to manage through the remainder of the current disruption and future economic downturns with a high level of fundamental financial flexibility given the consistency of its operating results and reserves through prior and current 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 to mitigate any potential remaining financial stresses associated with the pandemic.

Asymmetric Additional Risk Considerations

The 'AA+' GO rating and IDR consider the employment concentration associated with the sizable presence of the Naval Air Station in the county to be an asymmetric risk to the rating. NAS and 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.

Criteria Variation

None

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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
St. Mary's County (MD) [General Government]	LT IDR	AA+	Affirmed		AA+
• St. Mary's County (MD) /General Obligation	LT	AA+	Affirmed		AA+

ENTITY/DEBT	RATING		RECOVERY	PRIOR
	- Unlimited Tax/ 1 LT			

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	◈
NEGATIVE	⊖	◈
EVOLVING	⭘	◆
STABLE	⭘	

Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (pub.27 Mar 2020) (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, v2.4.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

St. Mary's County (MD)	EU Endorsed, UK Endorsed

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