

08 Jul 2020 | New Issue

## Fitch Rates Maryland's \$1.1B GOs 'AAA'; Outlook Stable

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Fitch Ratings-New York-08 July 2020:

Fitch Ratings has assigned a 'AAA' rating to the following \$1.07 billion State of Maryland GO bonds, state and local facilities loan of 2020, second series:

--\$540 million series A, tax-exempt bonds (competitive);

--\$155 million series B, tax-exempt current refunding bonds (competitive);

--\$375 million series C, taxable advance refunding bonds (competitive).

The bonds are expected to be offered by competitive sale on or about July 22, 2020.

Additionally, Fitch has affirmed the Issuer Default Rating (IDR) of the State of Maryland at 'AAA' and the following ratings on securities that are linked to the IDR:

--GO bonds at 'AAA';

--Certificates of participation (COPs) issued by the Maryland Department of Transportation supported by annual state general and transportation appropriations at 'AA+';

-- Maryland Stadium Authority lease revenue bonds at 'AA+';

--The public-private partnership (PPP) counterparty obligation rating for the Maryland Department of Transportation's Purple Line PPP Project at 'AA-'.

The Rating Outlook is Stable.

### SECURITY

The bonds being issued are general obligations for which the state's full faith and credit are pledged.

Appropriation-backed debt issued by the Maryland Department of Transportation and the Maryland Stadium Authority is rated one notch below the state's IDR, reflecting repayment from annual state appropriations.

## ANALYTICAL CONCLUSION

Maryland's 'AAA' IDR reflects its broad, diverse and wealthy economy, very strong fiscal management with consensus-oriented long-term planning and multiple sources of flexibility, all of which position the state well to address implications of the ongoing coronavirus pandemic. Although liabilities are elevated for a state, they are moderate relative to resources and carefully managed. The state's economy has long benefited from proximity to the nation's capital, although exposure to federal budget cuts poses a greater uncertainty for Maryland than for most states given its large federal agency presence and associated private contracting.

### Economic Resource Base

Maryland's economy is wealthy, diverse and service-oriented. The federal government's presence has long served as an important anchor to Maryland's economy, with numerous federal agencies, military facilities and contractors supporting the state's solid economic performance. Trade and port activity are also significant given Baltimore's prominence. Economic growth continued through the national expansion that followed the Great Recession, despite several years of drag caused by federal sequestration. The state reports a sharp and severe downturn driven by the coronavirus pandemic - the preponderance of federal employment may provide a cushioning effect through this recession and mitigate labor market implications.

### KEY RATING DRIVERS

#### Revenue Framework::'aaa'

Maryland's revenue growth is expected to be in line with or above the level of U.S. economic growth, given the state's solid economic base. Maryland retains unlimited legal authority to raise operating revenues. Cyclical revenue performance is a risk given both the prominence of the personal income tax in overall state revenues and the state's exposure to changes in federal spending. However, overall growth prospects for revenues remain strong.

#### Expenditure Framework::'aaa'

Maryland has a strong ability to change its spending commitments in response to shifting economic and revenue circumstances. Education and Medicaid remain the largest components of

spending. Carrying costs for liabilities remain moderately low but are above the median for states, partly due to the state's extensive role in funding education needs, including for capital and accrued pension liabilities.

#### Long-Term Liability Burden::'aa'

The burden of debt and net pension liabilities is elevated for a state but only a moderate burden in relation to Maryland's resource base. Pensions are the more significant burden; however, the state has implemented multiple changes to benefits and contribution policies to improve pension sustainability and accelerate improvement in the ratio of pension assets to liabilities over time.

#### Operating Performance::'aaa'

Financial resilience is extremely strong, with a well-funded budgetary reserve and a willingness to trim spending commitments and increase revenues in response to changing circumstances, as demonstrated by the state's timely actions to address the current downturn driven by the coronavirus. Multiyear forecasting and planning are disciplined, including measuring actual performance against structural targets. Consensus-oriented practices ensure steady management of budgetary conditions and liabilities.

#### RATING SENSITIVITIES

Factors that could, individually or collectively, lead to a positive rating action/upgrade:

--Not applicable for an 'AAA' rating.

Factors that could, individually or collectively, lead to a negative rating action/downgrade:

--A severe economic contraction extending well into the second half of the year or beyond, consistent with Fitch's coronavirus downside scenario, which triggers greater than anticipated, sustained and deep revenue declines and materially erodes the state's gap-closing capacity

#### 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

### Sector-Wide Coronavirus Implications

The coronavirus outbreak creates an uncertain global environment for U.S. state and local governments and related entities in the near term. Fitch's ratings are forward looking, and Fitch will monitor developments in state and local governments as a result of the virus outbreak as it relates to severity and duration. The agency will incorporate revised expectations for future performance and assessment of key risks.

In its baseline scenario, Fitch assumes sharp economic contractions hit major economies in the 1H20 at a speed and depth that is unprecedented since World War II. Recovery begins from the 3Q20 onward as the health crisis subsides after a short but severe global recession. GDP remains below its 4Q19 level until mid-2022. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the April 2020 reports "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update" and "Fitch Ratings Updates Coronavirus Scenarios for U.S. State and Local Tax-Supported Issuers" on [www.fitchratings.com](http://www.fitchratings.com).

### Federal Aid Provides Some Support for State Budgets

Federal aid measures enacted in recent months will benefit state budgets, although details remain fluid. The Families First Coronavirus Response included a 6.2 percentage point (pp) increase in the Federal Medical Assistance Percentage (FMAP) for Medicaid for every quarter of the national public health emergency. FMAP is the rate at which the federal government reimburses states for Medicaid spending. Maryland anticipates receiving \$250 million in 1H20 from the enhanced FMAP and at least \$125 million in fiscal 2021. The ultimate value of the FMAP rate increase will depend primarily on the state's actual Medicaid spending.

Under the Coronavirus Aid, Relief and Economic Security (CARES) Act enacted on March 27, the U.S. Treasury department distributed \$150 billion from the coronavirus relief fund (CRF) to state

and local governments using a population-based formula. The statute limits the use of the CRF to coronavirus expense reimbursement rather than to offset anticipated state tax revenue losses. Maryland and its directly eligible local governments received \$2.3 billion with \$1.7 billion going directly to the state. Maryland allocated \$90 million in a fiscal 2020 budget adjustment to cover public health and public safety costs and reduce state spending in those areas. The governor proposes \$175 million of such allocations in fiscal 2021 as part of his budget balancing plan discussed further below. Eligible Maryland localities received \$691 million in direct CRF money from the U.S. Treasury from the \$2.3 billion allocation, and the state distributed \$364 million of its \$1.7 billion share to the rest of the state's localities.

#### Coronavirus - Maryland Liquidity Update

Fitch anticipates Maryland will address short-term liquidity pressure with no interruption in timely payments for key operating expenses, including debt service. The state retains ample resources to address any potential cash flow challenges resulting from the deferral of tax revenues and the overall economic effects of the pandemic. Maryland does not intend to access the Federal Reserve's \$500 billion Municipal Liquidity Facility.

Maryland extended its due date for personal and corporate income tax (PIT and CIT) payments by 90 days, to July 15, aligning with the federal government's extension. The state also pushed back the remittance date for sales and use tax collections otherwise due for March, April and May. Broadly speaking the state estimates roughly \$2 billion in PIT, CIT and SUT revenues have been deferred from their original due dates, but final amounts will only be known following the new July 15 due date. Maryland will accrue all deferred revenues back into fiscal 2020 for accounting and reporting purposes.

The state consolidates all general fund revenue cash into a single portfolio which retains ample balances. As of May 31, the state treasurer reports the portfolio, which includes other state funds, held \$7.3 billion (\$6.9 billion in the general fund, of which \$4.4 billion was in cash or cash equivalents). Over the past 12 months, monthly ending balances averaged \$9.3 billion.

#### Coronavirus -Maryland Budgetary Update

Maryland is well positioned to utilize its superior gap-closing capacity to manage through the current downturn, with initial economic data implying the state's experience has largely been in line with national trends. Following a steep 13% decline in April from the prior month, Maryland's non-farm payrolls increased 1.2% in May while payrolls national declined 14% in April and increased 2.1% in May. Payrolls for Maryland, and the nation, remain well below pre-pandemic levels reflecting the deep and sustained economic dislocation. High-frequency economic data indicates similar trends. [Tracktherecovery.org](http://Tracktherecovery.org) reports consumer spending in Maryland declined

38% in mid-April from January 2020 levels, compared to a 31% to 32% trough for the U.S. As of mid-June Maryland's consumer spending was down 14% versus 9% for the U.S. And the state's insured unemployment (IU, not seasonally adjusted) rate, the ratio of continuing claims for unemployment insurance (UI) to total employment covered by the UI program, was 9.1% for the week ended June 20 versus 12.3% nationally. The weekly IU rate is different from the more commonly used monthly unemployment rate, but it provides a useful forward look given its timeliness.

#### Revenues Down Sharply But Extent Remains Unclear

Recent revenue estimates from the state indicate sharp declines, but with significant uncertainty as to the level. On May 14, Maryland's Board of Revenue Estimates (BRE) adopted unofficial revenue guidance with a revenue decline in fiscal 2020 ranging from \$925 million to \$1.1 billion (4.9% - 6%) of the pre-pandemic March 2020 official BRE revenue forecast. This unofficial forecast for between \$17.6 billion and \$17.8 billion in total general fund revenues in fiscal 2020 is down between \$403 million and \$603 million (2.2% to 3.3%) from fiscal 2019 actuals. Through May 31, the state's actual collections revenues trailed the prior year by \$590 million, or 3.9%. As noted above, fiscal 2020 final results will include deferred tax revenues, creating some uncertainty as those levels are unknown until collected. After evaluating May collections, the state's Bureau of Revenue Estimates, which develops the revenue estimates reviewed by BRE, anticipates final results for fiscal 2020 will fall within the range estimated on May 14. Maryland's BRE anticipates adopting its next official forecast in September.

#### Mix of Actions to Balance the Budget

To address the revenue declines, the state is utilizing a mix of spending cuts, federal aid and limited draws on its reserve funds which Fitch considers achievable and prudent. In April, the governor implemented a hiring freeze and other limits on state spending. Just after release of the May 14 unofficial revenue guidance, the state's Board of Public Works (BPW, consisting of the governor, treasurer and comptroller) implemented \$120.7 million in spending cuts. Under statute, the BPW can reduce appropriations up to 25% without legislative approval. The state made considerable use of this powerful budget management tool during the Great Recession and has done so several times already in this downturn.

The state estimates the freeze in state spending and all agency reversions yielded \$350 million in total fiscal 2020 savings with as much as \$250 million from the Medicaid FMAP increase offsetting state Medicaid costs. Maryland also anticipates using \$90 million in CARES Act CRF monies to cover public safety and public health expenses and to draw down between \$144 million to \$394 million of the \$1.2 billion balance in the revenue stabilization account (RSA, the primary reserve fund),

dependent on the extent of the revenue decline.

For fiscal 2021, the revenue forecast is considerably more negative and uncertain, and the state is taking reasonable measures to position itself to address the resulting fiscal challenges. The May 14 unofficial BRE revenue guidance estimates general fund revenues totaling between \$16.5 billion and \$17.1 billion. This is down sharply from the March 2020 official forecast by \$2.1 billion - \$2.6 billion (10.6% to 13.6%). On a yoy basis the unofficial guidance for fiscal 2021 is down between \$684 million and \$1 billion from the guidance for 2020.

The legislature approved a fiscal 2021 budget in the early days of the pandemic and the state has adjusted the spending plan based on the materially weakened revenue outlook. Given the considerable magnitude and uncertainty around the revenue outlook, as evidenced by the wide range in the unofficial guidance, the state will need to further revise its fiscal 2021 budget to fully mitigate the budgetary implications of the coronavirus pandemic. On July 1, the BPW implemented \$413.2 million in spending reductions (\$394.9 million in the general fund), including in aid to public and private higher education institutions (\$186.8 million) and a reduction in a grant to the Washington Metropolitan Area Transit Authority (WMATA, \$28 million, and not affecting revenues dedicated for WMATA's recently issued dedicated capital funding bonds (rated 'AA'/Negative)). The BPW deferred final action on an additional roughly \$200 million in cuts the governor had proposed with the board intending to reconvene in a month to evaluate the need for additional cuts with the context of new revenue and economic data anticipated over the next several weeks.

#### Sizable Revenues Gap Remains to be Solved

Even with these BPW actions, the state still faces a substantial roughly \$1.9 billion to \$2.4 billion gap between adjusted fiscal 2021 spending and the current unofficial revenue forecast range. To address the remaining shortfall, the governor proposed an additional \$845 million in budget actions, the majority of which would be put to the legislature (\$724.6 million) in the form of a budget reconciliation and financing act (BRFA) with the remaining portion largely at the governor's discretion. The proposed BRFA measures include a \$200 million reduction in K-12 aid versus the enacted pre-pandemic fiscal 2021 budget (essentially level-funding schools at fiscal 2020 amounts), a \$143.6 million cut in pay as you capital spending and a \$100 million reduction Medicaid spending (to be fully offset with the 6.2 percentage point FMAP enhancement if the national public health emergency is extended through fiscal 2021). While not a direct offset, the CARES Act establishes an Elementary and Secondary School Emergency Relief Fund (ESSER). The act allocates \$208 million to Maryland, with a minimum of approximately \$187 million designated for local school districts, all to be spent within one year of receipt for a fairly broad set of allowable uses.

#### Legislative Action May Wait Until January

Maryland's fiscal response to the pandemic to date has been centered around the governor and the BPW, but legislative action will play a key role later this fiscal year. The legislature is currently scheduled to convene in January 2021 although the legislature has the option of convening in a special session in the fall. Fitch notes that waiting until January 2021 to consider budget changes could limit their effectiveness as that would be more than halfway into the fiscal year.

When it meets, the legislature will consider the governor's BRFA proposals, alternative budget balancing mechanisms and potential overrides of gubernatorial vetoes. In the spring 2020 session the legislature passed legislation implementing the broad recommendations of the Commission on Innovation and Excellence (also known as the Kirwan Commission), which was statutorily-empaneled to make recommendations on education policy and funding. The legislature also passed revenue bills providing an estimated \$170 million - \$200 million annually in additional revenues, primarily to support Kirwan Commission recommendations. The governor vetoed the Kirwan Commission bill and the revenue measures. Fitch anticipates the legislature could consider overriding these vetoes, particularly the revenue measures, as a means of addressing the revenue shortfall in fiscal 2021.

#### Broad Range of Fiscal Tools

The state retains \$1.2 billion in its RSA (6%-7% of estimated fiscal 2020 general fund revenues) with a portion to be drawn down to balance fiscal 2020 operations as noted above. The remaining balance, likely to be close to \$1 billion will be available to address the fiscal 2021 shortfall. The exact levels of the RSA going forward will be dependent on the state's economic and revenue trajectory over the next several months, and executive and legislative responses. Fitch anticipates the state will maintain a reduced, though still sizable, RSA balance sufficient to provide cushion against a prolonged period of slow economic recovery. Through the Great Recession, the state kept the RSA at or near the then-statutory target of 5% of general fund revenues.

During the Great Recession, the state acted relatively timely to address revenue shortfalls through a mix of executive, BPW and statutory expenditure cuts, use of additional federal aid (including enhanced FMAP) tax increases and fund transfers. The state's actions to date generally align with that approach and Fitch anticipates a similar mix to prevail as the state continues to address the budgetary challenges. Fitch considers use of the RSA to balance fiscal 2020 as reflective of the sudden and steep nature of the economic and revenue dislocation, late in the fiscal year leaving limited time to implement alternative budget measures.

#### CREDIT PROFILE

Updated FAST Scenario Analysis for Maryland



The Fitch Analytical Stress Test (FAST) scenario analysis model, which relates historical tax revenue volatility to GDP to support the assessment of operating performance under Fitch's criteria, has now been adjusted to reflect GDP parameters consistent with Fitch's global coronavirus forecast assumptions. FAST is not a forecast, but it represents Fitch's estimate of possible revenue behavior in a downturn based on historical revenue performance. Hence, actual revenue declines will vary from FAST results. FAST does provide a relative sense of the risk exposure of a particular state compared to other states.

Maryland has robust financial resilience that should allow it to absorb the budgetary effects of Fitch's coronavirus baseline scenario and ultimately rebuild that resilience through the eventual recovery period. The state appears to be less vulnerable to cyclical revenue declines tied to economic downturns than most other states. The current coronavirus baseline scenario results in a 8% first-year decline in Maryland's revenues, followed by a 7% increase in year two and a cumulative 3% increase over the three-year scenario. This compares to the states' median decline of 17% in the first year and negative 6% over the three-year scenario.

A more severe recession of the depth and duration of Fitch's downside scenario would pose more of a challenge to the state's financial resilience but one Maryland still appears positioned to absorb without materially affecting its long-term ability to restore and then maintain robust financial resilience. Under this scenario Maryland's first-year decline would be 17%, followed by a rebound of 9% in the second year. The cumulative three-year decline of 6% is stronger than the median 22% decline for all states reflecting the state's lower revenue sensitivity to national economic downturns.

For additional information on the state of Maryland's GO bonds rating and IDR please see "Fitch Rates Maryland's \$780M GOs 'AAA'; Outlook Stable" dated Feb. 24, 2020.

#### Maryland Stadium Authority Transaction Details

Lease revenue bonds of the MSA are secured by leases between the MSA and the State of Maryland, with lease payments subject to annual legislative appropriation. The 'AA+' Long-Term rating of the bonds is thus linked to the credit quality of the State of Maryland. The MSA has funded several sports, cultural and convention venues statewide using a master lease structure, and MSA borrowing is part of state debt oversight.

Please see "Fitch Rates Maryland Stadium Auth's \$21M Lease Rev Bds 'AA+'; Outlook Stable," published on Oct. 16, 2019 for additional information on the MSA revenue bonds.

#### Maryland Department of Transportation (MDOT) Certificates of Participation (COPs) Details

MDOT's COPs are payable solely from purchase installments from MDOT pursuant to purchase agreements, subject to appropriation in each year by the Maryland General Assembly. MDOT intends to make payments from the department's Transportation Trust Fund, but the state's full resources are available for appropriation.

Please see "Fitch Rates Maryland DOT's \$30MM COPs 'AA+'; Outlook Stable," published on Feb. 20, 2019 for additional information on the MDOT COPs.

#### MDOT Purple Line PPP Counterparty Obligation Rating Details

The Purple Line is a planned 16.2-mile light rail transit line between Bethesda and New Carrollton, MD. It will include 21 stations and intersections with three existing Washington Metro Area Transit Authority (WMATA) lines, Amtrak and Maryland Area Regional Commuter (MARC) train lines. It would be owned by MDOT and the Maryland Transit Administration (MTA), the arm of MDOT that oversees various transit operations for the state.

The 'AA-' counterparty obligation rating reflects that MDOT's grantor obligations under the PPP agreement meet Fitch's expectation for a ratable PPP counterparty obligation. The commitment of the grantors, MDOT and MTA, to make construction progress payments, milestone payments, and long-term availability payments to the concessionaire, is structured to resemble the state's existing transportation COPs. All MDOT and MTA obligations under the PPP agreement benefit from MDOT's contractual commitment to seek annual legislative appropriations for all scheduled payments. This rating is an input to, and distinct from, the rating on project revenue debt noted below.

Please see "Fitch Downgrades Purple Line Transit Partners' Sr. PABs & TIFIA to 'B' on Negative Watch," published on June 25, 2020 for additional information on the project revenue bonds.

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

#### 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

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or

to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg).

Maryland, State of (MD) [General Government]; Long Term Issuer Default Rating; Affirmed; AAA;  
RO:Sta

---Maryland, State of (MD) /General Obligation - Unlimited Tax/1 LT; Long Term Rating; Affirmed;  
AAA; RO:Sta

---Maryland, State of (MD) /Stadium Revenues/1 LT; Long Term Rating; Affirmed; AA+; RO:Sta

---Maryland, State of (MD) /State Appropriation - Transportation/1 LT; Long Term Rating; Affirmed;  
AA+; RO:Sta

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**Applicable Criteria**

[U.S. Public Finance Tax-Supported Rating Criteria \(pub. 27 Mar 2020\) \(including rating assumption sensitivity\)](#)

### **Applicable Model**

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

### **Additional Disclosures**

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