

17 FEB 2021

Fitch Rates Maryland's \$475MM GOs 'AAA'; Outlook Stable

Fitch Ratings - New York - 17 Feb 2021: Fitch Ratings has assigned a 'AAA' rating to the following State of Maryland general obligation (GO) bonds, state and local facilities loan of 2021, first series:

--\$425 million first series A, tax-exempt bonds (competitive);

--\$50 million first series B, taxable bonds (competitive).

The bonds are expected to be offered by competitive sale on or about Feb. 24, 2021.

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 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 benefits from proximity to the nation's capital, although exposure to federal budget changes

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. Fitch's D-Trend indicates Maryland's currently robust economic levels, coupled with mid-range growth trends relative to other U.S. states. Several years of federal sequestration did drag on economic growth through the national expansion that followed the Great Recession.

The state reported a sharp and severe downturn driven by the coronavirus pandemic but with the deepest effects largely limited to leisure and hospitality and certain other service industries. As with much of the nation, federal stimulus played a key role in supporting a relatively quick rebound in most economic activity beginning in mid-2020, though trends remain below pre-pandemic expectations and subject to considerable uncertainty.

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 coronavirus-driven dislocation. 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 a 'AAA' rating.

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

--Failure to implement available policy measures that offset risks associated with a return to economic contraction consistent with Fitch's coronavirus downside scenario, resulting in an erosion of the state's superior gap-closing capacity.

--More severe economic weakness than envisioned in Fitch's coronavirus downside scenario, without evidence that available measures are adequate to counteract associated budgetary risks.

--Material increases in expenditure demands or long-term liabilities associated with ongoing developments including OPEB and education funding, that Maryland fails to mitigate with budget and policy actions.

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 outbreak of coronavirus and related government containment measures worldwide has created an uncertain global environment for U.S. state and local governments and related entities. Fitch's ratings are forward-looking in nature, and Fitch will monitor the severity and duration of the budgetary impact on state and local governments and incorporate revised expectations for future performance and assessment of key risks.

While the initial phase of economic recovery has been faster than expected, GDP in the U.S. is projected to remain below its 4Q19 level until at least 3Q21. In its baseline scenario, Fitch anticipates a slower recovery in early 2021 with vaccine rollout to vulnerable, key workers and older individuals in 1H21, but limited for most of the population until late 2021. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the report "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update", published on Dec. 7, 2020, and "Fitch Ratings Updates Coronavirus Scenarios for U.S. State and Local Government", published on Dec. 16, 2020 on www.fitchratings.com.

Federal Relief Provides Critical Support

Federal aid measures enacted in 2020 provided direct fiscal support and boosted economic activity in Maryland, and throughout the country. Direct fiscal aid included a 6.2 percentage point (pp) increase in the Federal Medical Assistance Percentage (FMAP) for Medicaid worth an estimated \$140 - \$150 million per quarter according to the state, and \$1.7 billion from the Coronavirus Relief Fund included in the Coronavirus Aid, Relief and Economic Security (CARES) Act.

The states Bureau of Revenue Estimates reports that Maryland's residents, business, and healthcare providers received more than \$20 billion in additional federal funding from the CARES Act in second quarter of 2020 alone, equal to nearly 5% of the state's entire 2019 GDP. This significant influx of federal funding played a key role in supporting a rebound in economic activity. Through December 2020, Fitch's analysis of BLS data indicates the state had recovered nearly two-thirds of the 14% pandemic-driven decline in non-farm payrolls. Maryland's performance has been in line with national trends.

Revenue Outlook Improved But Still Weakened

Maryland's current revenue and economic forecast anticipates growth well ahead of early pandemic estimates, but still short of pre-pandemic expectations. In May 2020, the state's Bureau of Revenue Estimates provided unofficial guidance to the state's Board of Revenue Estimate (the official revenue forecasting body for the state) of revenue declines across fiscal 2020 to 2022 versus the pre-pandemic March 2020 Board forecast. The board enacted more optimistic revenue forecasts in September and then again in December, which incorporated actual revenue collections and an updated economic outlook. Importantly, while improved, estimates remain below the pre-pandemic March 2020 estimates by approximately \$1 billion over this three-year span.

Fitch considers the state's revenue forecasts realistic but subject to pandemic-driven uncertainty. Fiscal

2020 general fund collections of \$18.6 billion were \$100 million below the March 2020 pre-pandemic estimate and up \$435 million (2.4%) from fiscal 2019. For fiscal 2021, the December 2020 board estimate anticipates modest growth of less than 1% to \$18.8 billion, followed by a robust 5.9% gain in fiscal 2022 (\$19.8 billion) spurred by widespread vaccination. Individual income and sales and use taxes, the largest components of the state's revenue profile drive these revenue trends and forecasts, with vaccine rollout problems or delays the key downside risk.

Mix of Actions to Balance the Budget

To address the shortfalls relative to pre-pandemic expectations and fund certain policy priorities, 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. In May, the state's Board of Public Works (BPW, consisting of the governor, treasurer and comptroller) implemented \$120.7 million in spending cuts on fiscal 2020 spending, and then another \$413 million in July. Under statute, the BPW can reduce appropriations up to 25% without legislative approval.

Maryland received approximately \$250 million from the Medicaid FMAP increase in fiscal 2020 and utilized federal CARES Act Coronavirus Relief Fund (CRF) monies to cover public safety and public health expenses. The combination of these budget management measures and better revenue performance led to a \$585.8 million general fund surplus in fiscal 2020.

For fiscal 2021, in addition to the July BPW cuts, the state has continued benefitting from federal aid including the ongoing FMAP enhancement and additional use of CRF monies to cover eligible expenses. The state made two draws on its reserves this year, totaling \$250 million, to provide economic relief primarily to Maryland small businesses, and drew on the fiscal 2020 general fund surplus.

Reserves on Track to Remain Adequately Funded

The state ended fiscal 2020 with \$1.2 billion in various reserve funds, mostly its Revenue Stabilization Account (RSA), or 6.6% of fiscal 2020 general fund revenues. The combined reserve funds (collectively, the state reserve account) and general fund balance at fiscal year-end 2020 was \$1.6 billion, or nearly 9% of general fund revenues. The state estimates ending fiscal 2021 with a \$889 million balance in the state reserve account (4.7% of fiscal 2021 estimated general fund revenues) and \$1.2 billion when combined with the general fund ending balance (6.1%). For fiscal 2022, the state estimates ending the year with \$994.4 million in the state reserve account (5% of fiscal 2022 general fund revenues) and \$1.2 billion when combined with the general fund ending balance (6%). Fitch considers these levels adequate to support Maryland's robust financial resilience.

Busy Legislative Session to Consider Fiscal 2022 Budget

In the spring 2020 session the legislature passed House Bill 1300 (HB1300) 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 plan calls for gradual increases in state and local education aid reaching \$4 billion in new

spending by 2030, with \$2.8 billion from the state, primarily through the Blueprint for Maryland's Future Fund. The legislature also passed revenue bills levying new taxes on digital downloads and digital advertising, which would be the first U.S. tax on digital advertising, with revenues going to the Blueprint Fund to support Kirwan Commission recommendations.

The governor vetoed HB1300 and the revenue measures, but both chambers of the General Assembly overrode the vetoes earlier this month. The veto overrides also made effective the 2020 Built to Learn Act, which authorizes up to \$2.2 billion in new bonding, supported by gaming revenues already dedicated to education funding.

The fiscal 2022 budget proposal and BRFA include a range of spending and policy measures that result in estimated fiscal 2022 reserve and general fund ending balances roughly in line with projected fiscal 2020 levels. The executive budget and BRFA incorporate the governor's proposed \$1 billion Relief Act to provide economic stimulus and tax cuts in response to the pandemic's economic effects. The Senate and House approved an amended version of the Relief Act which the governor signed into law earlier this week. The general assembly will consider the broader fiscal 2022 budget plan over the next several weeks.

REVENUE FRAMEWORK

Maryland's revenue framework includes a broad range of tax revenues, with PIT making up the majority of the state's annual general fund revenues. Sales and use taxes are also significant, at approximately one-fourth of general fund revenue. Gaming revenues (approximately \$500 million) provide an important source of support for K-12 education spending, and flow through the state's Education Trust Fund. Transportation receipts, most significantly motor fuel taxes, have been reallocated by the legislature at times for general spending, but statutory changes tightened the dedication for transportation needs. The state also levies a small statewide property tax to support general obligation debt that flows through the annuity bond fund.

Maryland's wealthy, service-oriented economy is the basis for a revenue growth profile that, while subject to economic cyclicity and federal policy actions, is likely to grow ahead of, or in line with, national economic growth over time.

The state has an unlimited legal ability to raise revenues through rate increases or base broadenings.

EXPENDITURE FRAMEWORK

Education and social services represent Maryland's largest spending commitments. K-12 education

spending, provided via transfers to counties, remains the most significant expenditure item for the state. Education spending also includes amortization contributions for local teacher retirement liabilities, capital support and a large network of higher education institutions. Social services, primarily for Medicaid, are also a substantial and growing component of the state's budget.

Kirwan Commission Implementation Will be Key Budget Driver

Education funding demands will escalate over the next several years based on enactment of HB1300, and Fitch anticipates the state will consider alternative revenue measures or adjustments to planned spending to minimize general fund support. In 2019, the state established the Blueprint for Maryland's Future Fund as a tool to manage and track related funding needs.

The legislature directed all sales and use tax revenues above \$100 million received annually from remote sellers and marketplace facilitators (currently estimated at \$400 million-\$500 million annually), as well as gaming revenues going to the education trust fund (estimated at \$500 million-\$600 million annually by 2023) to the Blueprint Fund. Under current estimates, through 2030, state education spending from the Blueprint Fund will reach \$2.77 billion annually, while local government spending will reach \$1.23 billion annually. Following the veto overrides, the state's Department of Legislative Services estimates the Blueprint Fund could fully fund Kirwan Commission costs through at least fiscal 2025, before potentially requiring general fund support.

Consistent with most states, Maryland's spending will likely be in line with to marginally above expected revenue growth, absent offsetting policy action, driven by both education and Medicaid. The fiscal challenge of Medicaid is common to all U.S. states and the nature of the program as well as federal government rules limit the states' options in managing the pace of spending growth. Federal action to revise Medicaid's fundamental programmatic and financial structure does not appear to be a near-term priority of the current federal administration or Congressional leadership. As with all federal programs, Medicaid remains subject to regulatory changes that could affect various aspects.

Maryland's carrying costs for liabilities are higher than the median for states (10.3% vs. 5.1% in fiscal 2019 and 10.2% for fiscal 2020) but remain well within the state's ability to control given its fiscal and economic resource base. Debt service is elevated due partially to a constitutional requirement to amortize most tax-supported borrowing within 15 years. Carrying costs also include those for accrued pension liabilities of local teachers, although newly earned benefits are the responsibility of local governments.

The state regularly contributes additional resources to pensions to accelerate funding progress, including supplemental contributions. A "sweeper" provision to divert a portion of unappropriated surpluses was originally scheduled to sunset in 2021. The state waived the sweeper provision for the fiscal 2018 and 2019 budgets but also lifted the 2021 sunset and extended the sweeper indefinitely, tied to pension system funding levels, and split the sweeper between pension and OPEB payments.

Since these contributions are beyond the actuarially determined contributions, Fitch does not incorporate them into the carrying cost metric. The fiscal 2021 budget waived the sweeper provisions (\$25 million each), but maintained \$75 million in supplemental pension system contributions. For fiscal 2022, the governor proposes the same approach.

LONG-TERM LIABILITY BURDEN

On a combined basis, debt and net pension liabilities attributable to the state as of Fitch's 2020 state pension update are above average, measuring 13.3% of 2019 personal income, compared with the U.S. states median of 5.7%. Based on a state debt statement as of Dec. 31, 2020 and pension data from the state's fiscal 2020 comprehensive annual financial report (CAFR), Fitch anticipates the long-term liability burden remains largely unchanged.

Fitch's calculations incorporate project debt associated with the Purple Line availability payment-based PPP entered into by the state's department of transportation (total \$1.2 billion, of which \$875 million is an untapped construction loan from the federal government), and Maryland Stadium Authority bonds issued for Baltimore City Public Schools (approximately \$1 billion) that partially benefit from state revenue support. The state's debt affordability guidelines include holding tax-supported debt as defined by the state (which excludes the PPP and Baltimore school obligations) at or below 4% of personal income.

The veto override of HB1300 also made effective the Built to Learn Act. The Built to Learn Act authorizes the Maryland Stadium Authority (MSA) to issue up to \$2.2 billion in gaming revenue-backed bonds for school construction projects. Fitch's analysis indicates the additional issuance would not change the 'aa' assessment of Maryland's long-term liability burden, nor the 'aaa' assessment of the state's expenditure framework, even if issued immediately in a single tranche. Fitch anticipates issuance would likely be spread over multiple issuances and years.

Pensions are a comparative credit weakness in Maryland, although the state has taken repeated action since 2011 to revise benefits and contribution practices to improve sustainability. Specific measures include lower benefit accruals, longer service requirements, a phased-in decline in the discount rate, revising the contribution methodology to achieve full actuarial contributions, and appropriating supplemental contributions.

Most of the state's net pension liability (NPL) consists of obligations for state employees and local teachers in the State Retirement and Pension System, which calculates its liabilities based on a 7.4% investment return assumption. Fitch calculates the consolidated ratio of the state's pension assets to liabilities as reported in its comprehensive annual financial report is approximately 70%. The Fitch-adjusted ratio, based on the standard 6% investment return assumption we apply to all U.S. public sector pension systems, is approximately 60%.

OPEB Litigation and Related Legislation Shifts Liability Estimate

Other post-employment benefits (OPEB) liabilities are sizable, but not exceptionally large, roughly equivalent to Fitch's estimate of the state's debt liabilities. Maryland's reported total net OPEB liability as of June 30, 2020 is \$17.6 billion, or 4.4% of personal income. This is up from \$12 billion in 2018 reflecting the effects of litigation originally challenging a 2011 law reducing OPEB prescription drug benefits, and legislation (SB 946 of 2019) enacted following filing of the litigation. The 2011 changes reduced the state's OPEB liability by approximately 40% as measured at the time.

The OPEB liability could shift further as the litigation progresses. An unexpectedly large increase in the OPEB liability, to make it much closer to the level of net pension liabilities (Fitch-adjusted \$32.8 billion at June 30, 2020), and indications that the state's capacity to make benefit changes is significantly limited, could lead Fitch to consider the OPEB liability as a negative asymmetric rating factor consideration.

OPERATING PERFORMANCE

Maryland's financial resilience is extremely strong. Historically the state has relied on spending cuts, revenue increases and the use of non-recurring resources, including drawdowns of general fund balance and from the RSA when confronted with budgetary weakness.

2017 legislation addressed revenue volatility and reserve balances to provide additional financial resilience. Beginning in fiscal 2020, personal income tax revenues from non-withholding components that exceed a 10-year average were to be diverted from routine spending and instead be directed first to address any deficit in general fund revenues versus the last estimate, and then to build the RSA up to 10% of general fund revenues and cover pay-go project needs for K-12 and higher education. Pandemic-driven declines led to a revenue deficit of \$243 million in fiscal 2020 for revenues other than non-withholding components, greater than the excess non-withholding revenues of \$141 million and eliminating any RSA contribution. The December 2020 BRE report projects approximately \$80 million from this revenue volatility cap in 2022, but the governor's fiscal 2022 executive budget proposes using that \$80 million for budget balancing.

Updated FAST Scenario Analysis for Maryland

Fitch adjusted 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, to reflect GDP parameters consistent with Fitch's global coronavirus scenarios. FAST is not a forecast, but it provides a relative sense of the risk exposure of a particular state to economic declines 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 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 5% first-year decline in Maryland's revenues, followed by a 7% increase in year two and a cumulative 7% increase over the three-year scenario. This compares to the states' median decline of 12% in the first year and 2% growth 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 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 6%, followed by a rebound of 1% decline in the second year. The cumulative three-year decline of 1% is stronger than the median 11% decline for all states reflecting the state's lower revenue sensitivity to national economic downturns.

Maryland's disciplined approach to budget management during expansions leaves it well-positioned to address downturns. Regular consensus revenue forecasting identifies material changes in economic and revenue performance. The BPW regularly exercises its ability to reduce spending to manage projected revenue shortfalls, including at the onset of the pandemic.

The state routinely budgets to maintain flexibility both in the form of a general fund unencumbered balance and the separate RSA balance. The latter has been consistently funded at 5% of general fund revenues, including through most of the last downturn.

Recent improvements to the state's budgetary management practices include the transition to full actuarial funding of pensions, implementation of the revenue volatility cap and a planned increase in the RSA. While the governor's fiscal 2022 executive budget proposes waiving the RSA increase as a budget balancing measure given pandemic-driven economic uncertainty, Fitch anticipates the state will resume progressing towards the statutory 10% goal once economic recovery takes hold.

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.

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
Maryland, State of (MD) [General Government]	LT IDR	AAA ●	Affirmed	AAA ●
<ul style="list-style-type: none"> Maryland, State of (MD) /General Obligation - Unlimited Tax/ 1 LT 	LT	AAA ●	Affirmed	AAA ●
<ul style="list-style-type: none"> Maryland, State of (MD) /Stadium Revenues/ 1 LT 	LT	AA+ ●	Affirmed	AA+ ●
<ul style="list-style-type: none"> Maryland, State of (MD) /State Appropriation - 	LT	AA+ ●	Affirmed	AA+ ●

ENTITY/DEBT	RATING	RECOVERY	PRIOR
Transportation/ 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 States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

Additional Disclosures

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