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Ratings

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Summary:

Maryland; Appropriations; Gas Tax; General Obligation

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Credit Profile		
US$510.0 mil GO bnds st and local facs loan of 2018, second series (Tax-exempt (competitive)) due 08/01/2033		
Long Term Rating	AAA/Stable	New
Maryland GO		
Long Term Rating	AAA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AAA' long-term rating to the State of Maryland's state and local facilities loan of 2018, Second series tax-exempt general obligation (GO) bonds.

At the same time, S&P Global Ratings affirmed its 'AAA' rating on the state's GO debt outstanding and its 'AA+' rating on state obligations outstanding supported by lease payments under a master lease, subject to appropriation. S&P Global Ratings also affirmed its 'AA+/A-1' rating on the Maryland Stadium Authority's series 2007 sports facilities lease revenue refunding bonds secured by lease rental payments subject to annual appropriation by the state. S&P Global Ratings also affirmed its 'AA+' rating on Maryland Department of Transportation's (MDOT) county transportation revenue bonds supported by capital grants appropriated from MDOT's Transportation Trust Fund (see report published May 18, 2018, on RatingsDirect).The outlook on all long-term ratings is stable.

The 'AAA' GO rating reflects what we view as Maryland's:

- Broad and diverse economy, which continues to post slow growth;
- Strong wealth and income levels relative to those of the nation;
- Long history of proactive financial and budget management, including implementation of frequent and timely budget adjustments to align revenues and expenditures and long-term financial planning that should continue to be helpful in addressing future budget challenges; and
- Well-developed debt management practices with a moderate debt burden for most measures and rapid amortization, although long-term pension and other postemployment benefits (OPEB) liabilities remain moderately high, in our opinion.

In March 2018, Maryland finalized its general fund budget for fiscal 2019 totaling $17.9 billion, which is 4% higher than the current fiscal 2018 working general fund budget, primarily due to growth in education and public health spending. The budget solved for an initial projected gap of $298 million (about 2% of budget) by suspending various mandated spending measures, reducing prescription drug costs for state retirees among other cost savings, and incorporating revised Board of Revenue Estimates (BRE) revenue forecasts reflecting higher state income taxes linked to the federal tax cut and jobs act, despite slight weakness in underlying revenue trends. Because state tax law couples state exemptions and deductions with the federal tax framework, Maryland initially estimated the federal tax reform would result in an estimated $512 million in additional revenue in fiscal 2019. However, legislators raised the standard deduction for individuals and married couples, which reduced this estimated revenue growth by $78 million. Lawmakers also distributed $200 million of the estimated revenue to a special fund outside of the general fund for future anticipated spending on early childhood and primary and secondary education. The state is likely to face higher future education costs related to pending recommendations from the Kirwan Commission for improved equity and adequacy of state education funding formulas. Furthermore, in November 2018, voters will decide on a referendum to mandate annual appropriation of commercial gaming revenues in the Education Trust Fund for supplemental public education funding beginning in fiscal 2020. If this referendum passes, the general fund would no longer be able to use these gaming revenues to support a portion of the education funding formula. The current general fund budget outlook incorporates phased increases to annual general fund expenditures between fiscal 2020 and fiscal 2023, which exacerbates projected future general fund budgetary gaps. The fiscal 2019 budget maintains $883 million in the rainy day reserve and about $106 million in unappropriated general fund reserves for a combined reserve equal to $988 million, or about 5.5% of spending. Maryland currently estimates it ended fiscal 2018 with $1.05 billion, or about 6% of spending, in rainy day reserves and unappropriated general fund balance, which we consider good.

Montgomery County, Md. is one of the 20 bids selected as finalists in Amazon's HQ2 search. Four sites were proposed in Alexandria and Arlington County's joint bid, two of which are in Alexandria. However, finalists also include three sites in the region; two sites in Virginia and one in Washington, DC. The 2018 legislature also passed the PRIME Act, which offers $5.5 billion in various tax credits and infrastructure investment incentives to Amazon's HQ2 if it locates in Montgomery County. The company intends to create 50,000 high-paying, full-time jobs upon build out. A state-commissioned analysis projected the state could gain 101,000 direct and indirect jobs and $17 billion in increased economic activity upon build out if the facility located in the county. Although it is still early to speculate on Amazon's final decision, if any of the regional bids were selected, we believe the state would likely still see some benefit from regional economic growth.

Overall state revenue estimates are based on state economic growth forecasts that we believe are reasonable and that are in line with IHS Markit's projections. The BRE's official March 2018 forecast estimates about $17 billion in fiscal 2018 of general fund revenue, reflecting 2.2% year-over-year growth, at the end of fiscal 2018. State officials expect actual fiscal 2018 general fund revenues through June 2018 to track above estimates after accruals. For fiscal 2019, The March 2018 BRE projected 6.5% general fund revenue growth compared with estimated fiscal 2018; however, revised projected general fund revenue after legislative adjustments totals $17.8 billion, or 4.3% year-over-year growth. March BRE forecasts do not incorporate any expected additional revenue from the recent U.S. Supreme Court South Dakota v. Wayfair ruling on internet sales; however, state officials estimate potential additional revenue would likely be minimal and contingent on interpretation or additional legislative changes to current statute. About 27% of the state's current general fund revenue comes from sales taxes.

Maryland's fundamental economic strengths include strong wealth and income indicators and a relatively diversified base. The population totals 6 million, although population growth has slowed slightly when compared with that of the nation in the past three years. International immigration into the state has boosted population growth historically as has federal spending, and changes in federal policy could also affect demographic trends in the state. After a period of federal sequestration and the loss of government jobs, which dampened historical growth in state employment and income, recent state personal income growth has aligned with national trends and forecasts reflect anticipated wage growth spurred by low unemployment rates and higher projected inflation. The BRE's current economic forecast projects 0.8% and 0.5% employment growth in 2018 and 2019, respectively, which is less optimistic on average than IHS Markit's corresponding projections of about 0.7% and 1.3%, respectively. Although the BRE's economic forecast projected annual personal income growth of 3.8% in calendar 2018, in line with IHS Markit's current forecast, BRE's projected 4.2% growth in 2019 personal income is more conservative than IHS Markit's forecast 4.8% in 2019. The state's general fund budget outlook for fiscal 2020 through fiscal 2023 reflects anticipated future spending growth with rising state Medicaid and mandated education costs that outpace persistent projected slow economic and revenue growth, which will need to be continually addressed. Risks to the revenue estimate include continued federal policy uncertainty and soft economic growth or financial market volatility.

We consider the state's management practices "strong" under our financial management assessment (FMA) methodology. In our framework, an FMA of "strong" indicates that practices are strong, well embedded, and likely sustainable. Although Maryland's economic growth is slow, we believe the state continues to demonstrate strong revenue and budget monitoring practices with a track record of making proactive expenditure adjustments midyear when required.

Maryland's debt burden per capita, including public-private partnership (P3) obligations, totals $2,300, which we consider moderately high. The state entered into a P3 agreement for a light rail transportation project (the purple line). We estimate the net present value of milestone payments for the project at about $534 million. As described in our commentary, "How Standard & Poor's Treats Public-Private Partnerships In U.S. State And Local Government Debt Analysis" (published Sept. 17, 2015), on financial close of the project, we incorporated the net present value of the milestone payments into the state's net tax-supported debt ratios through the period before Maryland starts making availability payments for the P3 project. Once P3 project construction is complete and operational, we will incorporate availability payments that are not supported by project revenue into our estimates of the state's net tax-supported debt ratios. We estimate the net present value of the availability payments at about $2.4 billion, assuming no self-support. To the extent project revenue is not sufficient to cover the majority of future availability payments, we believe net tax-supported debt compared to gross state product (GSP) and personal income could rise to what we consider moderately high levels.

The state's debt burden compared to personal income and annual debt service relative to the budget remains moderate, although per capita debt has grown to moderately high levels in our opinion. Debt amortization remains very rapid, with about 80% of tax-supported debt retired in 10 year. All GO bonds mature in the next 15 years, as required by the Maryland Constitution; However, we note amortization of debt outstanding has slowed in the past few years. The state produces a debt affordability study that defines certain affordability ratios including maximum tax-supported debt as a percent of personal income and debt service as a percent of revenues, along with a statutory debt amortization schedule. The 2018 legislature approved $1.075 billion in GO bond authorization in fiscal 2019 for public school improvements and construction and improvement of state owned facilities. The authorized annual GO bond level aligns with the Spending Affordability Committee's recommendation and although it is slightly above the

Capital Debt Affordability Committee recommended level of $995 million, we understand the state remains below its defined affordability ratio parameters. The state levies a property tax with receipts credited to a special fund used to help support GO debt service. Its Board of Public Works fixes the property tax rate each year, which has been set at 11.2 cents per $100 of assessed value (AV) since 2007. Statewide AV has grown a cumulative 16% since fiscal 2014 to almost $746 billion in fiscal 2018, with property tax receipts generating almost 65% of the revenues available for GO debt service in fiscal 2018. General funds and bond premiums represent most of the balance of revenues used for debt service.

We consider the state's overall reported three-year average pension funded ratio relatively low at 68%. The system estimates a preliminary 7.7% return on investments at June 30, 2018, which remains above the actuarial assumed long-term rate. However, we believe long-term future pension costs are likely to grow due to scheduled reductions in the system's actuarial assumed long-term rate of return to 7.45% from 7.55% as well as "level percentage of pay" amortization methods, which assume rising future payroll and results in escalating pension contributions over time. The state has made its actuarially determined pension contribution as well as a supplemental annual pension payment in recent years. As of June 30, 2017, the state employee and retiree health and welfare benefits program net OPEB liability was $11 billion, or about $1,840 per capita, which we consider above average. While the state also previously established an irrevocable trust, it has not regularly appropriated funds to prefund the trust. In the 2018 legislative session, Maryland changed a law that previously directed a portion of unappropriated general fund surplus toward higher pension contributions (pension sweeper) to also apply to OPEB liabilities effective in fiscal 2021. Recent state budgets have exempted the pension sweeper due to projected structural gaps. We expect to monitor the state's future adherence to its revised pension funding policy to budget for actuarially based pension contributions and demonstrate commitment to funding its long-term liabilities.

Maryland's GO bonds are eligible to be rated above the sovereign because we believe the state can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions," Nov. 19, 2013, U.S. states are considered to have moderate sensitivity to country risk. State-derived revenues are the sole source of security on the bonds, and the institutional framework in the U.S. is predictable with significant state autonomy and flexibility.

Based on the analytic factors evaluated for Maryland, on a scale of '1.0' (as the strongest) to '4.0' (as the weakest), S&P Global Ratings has assigned a composite score of '1.6' to the state, which reflects an indicative rating of 'AA+'. We have notched up to 'AAA' as allowed as per our state rating methodology due to the state's relatively strong economic and financial management profile, which we believe supports credit characteristics in line with those of comparable 'AAA' rated peers.

Outlook

The stable outlook reflects Maryland's continued focus on structural budget alignment and maintenance of minimum state reserves at levels we consider good, despite continued slow economic growth. The state's continued practice of making proactive midyear adjustments to align the budget in case of slower-than-anticipated revenue growth will remain an important credit factor over the two-year outlook horizon, given Maryland's above-average economic dependence on federal government employment and spending. Cost pressures related to health and human services spending as well as education funding could exacerbate future budget gaps. Should the state fail to make proactive budget adjustments or rely significantly on reserves and other one-time sources, we could lower the rating. Further slowing of economic growth compared with that of the nation, withdrawal of federal fiscal aid or changes to tax policy that strain the state's economy and budget, material growth in debt and liability burdens, or the state's failure to demonstrate a consistent commitment to fully funding pensions and OPEB obligations could also pressure the rating.

Ratings Detail (As Of July 20, 2018)		
Maryland Dept of Transp		
Long Term Rating	AA+/Stable	Affirmed
Maryland Dept of Transp Gas Tax		
Long Term Rating	AA+/Stable	Affirmed
Maryland Dept of Transp Gax Tax		
Long Term Rating	AA+/Stable	Affirmed
Maryland Econ Dev Corp APPROP		
Long Term Rating	AA+/Stable	Affirmed
Maryland Econ Dev Corp APPROP		
Long Term Rating	AA+/Stable	Affirmed
Maryland Stad Auth lease rev rfdg bnds (Montgomery County Conf Ctr Proj)		
Long Term Rating	AA+/Stable	Affirmed
Maryland Stad Auth taxable lse rev rfdg bnds (Hippodrome Performing Arts Center)		
Long Term Rating	AA+/Stable	Affirmed
Maryland GO		
Long Term Rating	AAA/Stable	Affirmed
Maryland GO		
Long Term Rating	AAA/Stable	Affirmed
Maryland GO		
Long Term Rating	AAA/Stable	Affirmed
Maryland Dept of Transp, Maryland		
Maryland		
Maryland Dept of Transp (Maryland) (Aviation Admin Fac) APPROP		
Long Term Rating	AA+/Stable	Affirmed
Maryland Dept of Transp (Maryland) (Port Admin Fac Proj) APPROP		
Long Term Rating	AA+/Stable	Affirmed
Maryland Dept of Transp (Maryland) (Transit Admin Proj) APPROP		
Long Term Rating	AA+/Stable	Affirmed
Maryland Econ Dev Corp, Maryland		
Maryland		
Maryland Econ Dev Corp (Maryland) lse rev (Maryland) (Mayland Dept Of Transp Headquarters Fac)		
Long Term Rating	AA+/Stable	Affirmed
Maryland Stad Auth, Maryland		
Maryland		

Ratings Detail (As Of July 20, 2018) (cont.)		
Maryland Stad Auth (Maryland) sports facs lse rev rfdg bnds (ATM) (Baseball Stadium Issue)		
Long Term Rating	AA+/Stable	Affirmed
Maryland Stad Auth (Maryland) taxable sports facs lse rev rfdg bnds (Baseball Stadium Issue)		
Long Term Rating	AA+/Stable	Affirmed
Maryland Stad Auth (Maryland) (Camden Station Proj)		
Long Term Rating	AA+/Stable	Affirmed
Maryland Stad Auth (Maryland) (Conference Ctr Facs)		
Long Term Rating	AA+/Stable	Affirmed
Maryland Stad Auth (Maryland) (Football Stadium)		
Long Term Rating	AA+/A-1/Stable	Affirmed

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.