S&P Global Ratings

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Maryland; Appropriations; General Obligation

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Credit Profile		
US$540.0 mil GO st & local facs loan of 2020, (Tax-Exempt) (Competitive ser SECOND A		
Long Term Rating	AAA/Stable	New
US$345.76 mil GO st & local facs loan of 2020, (Taxable) Rfdg Competitive ser SECOND C		
Long Term Rating	AAA/Stable	New
US$117.34 mil GO st & local facs loan of 2020, (Tax-Ex) Rfdg Competitive ser SECOND B		
Long Term Rating	AAA/Stable	New
Maryland GO		
Long Term Rating	AAA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' rating to Maryland's state and local facilities loan of 2020, second series A (tax-exempt), current refunding series B (tax-exempt), and advance refunding series C (taxable) general obligation (GO) bonds. The outlook is stable.

At the same time, we affirmed the following ratings, including our:

- 'AAA' rating on the state's outstanding GO debt,
- 'AA+' rating on outstanding state obligations supported by lease payments subject to appropriation, (including some issues of the Maryland Stadium Authority), and our
- 'AA+' rating on Maryland Department of Transportation's (MDOT) county transportation revenue bonds supported by capital grants appropriated from MDOT's transportation trust fund.

We also affirmed our '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. The outlook on all outstanding debt is stable.

The second-series 2020 bonds are GOs of the state to which it has pledged its full faith and credit. The second series A bonds of up to $540 million will be used for construction of state facilities; capital grants to local governments for various purposes; and matching fund loans and grants to local governments, nonprofit institutions, and other entities. The second series B and C bonds will be used toward the refunding of certain outstanding GO bonds of the state.

Credit overview

In our opinion, the state has demonstrated proactive action to date to alleviate fiscal pressures as revenues decline during the onset of the sudden-stop recession. Fiscal 2020's budget shortfall was closed with a combination of expenditure reductions and reserve use. Similar action has already been taken to address a potential $2.1 billion or 11% revenue shortfall in fiscal 2021, but more action will likely be needed.

Fiscal 2021 is expected to be a particularly difficult budget year for the state as it faces a $2.1 billion or 11% revenue shortfall from what was enacted. A formal revenue revision is not expected until the next meeting on the Bureau of Revenue Estimates (BRE) in September. The estimated shortfall may improve or worsen depending on economic activity and any receipt of federal funds. Nonetheless, the informal estimate is guiding policy and proactive decision-making.

Mitigation efforts will likely require significant expenditure reductions if revenues fail to rebound or receipt of additional federal aid does not materialize. The state's current deficit mitigation plan does not include the receipt of additional federal funds, but a large portion of potential expenditure cuts are being put off until the legislature reconvenes in January 2021. While we recognize decisions on expenditure reductions are not easy or politically palatable, prolonged delay on enacting such revisions to later in the fiscal year may diminish their effectiveness.

The state expects the balance in its rainy day fund (RDF) to total a little over $1 billion dollars entering into fiscal 2021 (about 5% of budgeted revenues) after using $144 million to balance its fiscal 2020 budget. Other budget balancing tools include implementing a hiring freeze in April 2020, enacting $120.7 million in budget cuts through the Board of Public Works (BPW), and maximizing use of Coronavirus Relief Funds from the CARES Act.

Consistent with Maryland's strong management practices, we expect the state will actively manage its budget in fiscal 2021 to address the shortfall. To manage the fiscal 2021 shortfall, the state continues with its hiring freeze, identified expenditure reductions to be brought before the BPW, and other balancing actions totaling $845 million (most which will require legislative approval). However, these measures are not sufficient to completely close the gap.

In our opinion, given the severity of the budget gap, the state is unlikely to implement broad sweeping budget cuts to mitigate the shortfall. Based on its current deficit mitigation plan, it may need to draw an additional $670 million from the RDF. If used, the state's reserve position would further decline to approximately 2% of budgeted expenditures. We consider there to be a high level of risk surrounding Maryland's ability to effectuate budget cuts and prevent steeper declines of reserve use. Drawing the reserve positon down to a level below 5% is atypical for the state, as even during the last recession it maintained reserves at or above that level.

By statute, if the fund balance is between 3% and 7.5% of projected general fund revenues, annual appropriations of at least $50 million must be made until the account balance reaches 7.5%. If the account balance is below 3%, statute requires an appropriation of at least $100 million. A portion of any annual general fund surplus would also be transferred to reserves. While the statute provides some direction on how reserves may be replenished, they are only statutory guidelines that may be amended from one budget to the next. Over the long term, the likelihood of restoring reserve balances may be difficult if economic recovery is prolonged or if revenues fail to return to pre-pandemic levels in a timely manner.

We consider the state's government framework a credit strength in responding to fiscal stress. It has a fair amount of budgetary flexibility regarding its expenditures, although this does not extend to all program areas. By law, the governor has the power, with the approval of the BPW, to reduce by not more than 25% any appropriation that he or she might consider unnecessary, except appropriations for the payment of interest and the retirement of state debt, the legislature, the public schools, the judiciary, and the salaries of public officers. A balanced approach toward managing the state's fiscal pressures will be a key credit consideration. The size of the potential revenue shortfall elevates political uncertainty surrounding expenditure reductions and whether the legislature would agree to all of the governor's cuts. The legislature has previously passed bills, vetoed by the governor, to raise revenue to fund additional education appropriations recommended by the Kirwan Commission.

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" (published Nov. 19, 2013 on RatingsDirect), 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 anchor rating of 'AA+'. We have notched up to 'AAA' as allowed per our state rating methodology due to Maryland's relatively strong economic, rapid debt amortization, and financial management profile, which we believe currently supports credit characteristics in line with those of comparable 'AAA' rated peers.

Environmental, social, and governance factors

We consider the state's social and governance risks in line with that of the sector. While we view the state's environmental risk as elevated, it has taken proactive steps to manage these risks. Located along the Atlantic Ocean and home to Chesapeake Bay, Maryland faces risk from rising sea levels. It actively manages the Chesapeake watershed and runoff, has enacted fees to provide funding for state and local resilience projects, and has adopted legislation with the goal of reducing greenhouse gas emissions.

We view the risks posed by the COVID-19 pandemic to public health and safety as a social risk, which, if sustained, could weaken the state's economy, liquidity, and budgetary performance. For more information on the potential effects of the COVID-19 pandemic on state credit conditions, see "The COVID-19 Outbreak Weakens U.S. State And Local Government Credit Conditions" (published on April 2, 2020) and "All U.S. Public Finance Sector Outlooks Are Now Negative" (published on April 1, 2020).

Stable Outlook

Generally, our rating outlook timeframe is up to two years. Given the current uncertainty around the pandemic, our view of the credit risks to Maryland and its obligations centers on the more immediate budget effects in fiscal 2021 is subject to change.

The state's fiscal 2021 budget is expected to be pressured as revenue shortfalls may require significant expenditure cuts and use of reserves. However, Maryland has a long history of proactive budget management to maintain adequate reserves levels, enact expenditure reductions when needed, and manage through periods of fiscal stress, trends that are likely to continue.

We expect economic deceleration to persist, but very strong wealth levels and a diversified economic base may allow the state to fare better during the recession than others in the sector. Fiscal pressures beyond the current year are also expected as the state grapples with increased expenditure demands for public education and health and social services. Its ability to manage these costs in a structurally balanced way will be a key credit consideration. Prior to the recession, Maryland's credit profile was already experiencing some pressures from outyear budget gaps and softening economic growth. In our opinion, the nature of the current sudden-stop recession augments these credit risks and may weaken the state's credit profile if proactive and timely corrective action is not taken.

Should the state significantly rely on nonrecurring resources to balance its budget, prove unable to enact budget cuts or make other timely corrective action, or draw down reserves to a level that is unlikely to be meaningful replenished, we may revise our outlook or lower the rating.

Credit Opinion

Update on Purple Line Project P3

The state entered into a P3 agreement for a light-rail transportation project (the Purple Line) in 2016 that has experienced significant delays. We estimate the net present value of milestone payments for the project through fiscal 2021 at about $323 million. While original projections had the project operating by March 2022, construction delay has pushed back scheduled completion.

Currently, MDOT has served the Purple Line Transit Partners LLC (PLTP) a default notice, alleging that the termination notice PLTP previously filed is invalid and the construction contractor has caused the delay, dismissing the claim that the delay was caused by events beyond the contractor's control. If MDOT succeeds with its argument and terminates the agreement because of the concessionaire's default, the termination compensation will be decided through a complex formula. A lengthy legal dispute is expected. The state may be responsible for servicing $313 million of outstanding private activity bonds tied to the project. There is an $875 million TIFIA loan outstanding as well, but none of those proceeds have been used.

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.

Strong Economy Underpinned By Strong Wealth Indicators And Diversified Base

Overall, the state continues to benefit from very strong wealth and income indicators and a relatively diversified economic base. In 2019, per capital personal income was $65,683 per capita and 116% of the nation. Gross domestic product is also strong at $70,850 per capita, or 109% of the nation.

Its proximity to Washington, D.C. and participation in the broader metropolitan area may leave the area somewhat more insulated from the recession if federal payrolls remain unchanged or increase. From February to May, the state reported federal government employment increased 0.75% while all other employment sectors underwent some level of contraction. Since the later part of 2017, federal employment in the state has been on the decline and has only recently started to increase.

Professional and business services employment makes up 17% of state jobs in 2019, compared with 14% nationally, which correlates with state incomes and wages that are higher than the national average. Professional and business services job growth has mitigated weaker government sector hiring, albeit hiring in this sector was fairly volatile in 2019, according to IHS Markit, while education and health services grew steadily. The professional, business, education, and health services sectors, combined, continue to make up the single largest job segment, accounting for about one-third of Maryland's total nonfarm employment in 2018.

Just as fast as the U.S. economy entered recession, it may have already reached bottom in May. S&P Global Economics now sees full-year national GDP contracting 5.0% (it was down 5.2% in our April forecast). However, the recovery will be slow, as the lingering effects of COVID-19 severely limit growth. We expect a modest rebound of 5.2% in 2021, a full percentage point weaker than previous estimate of 6.2% (see "The U.S. Faces a Longer and Slower Climb From The Bottom," published on June 25, 2020). In our opinion, the national economic forecasts increase downside risk for the state as a prolonged recovery is likely to soften revenue forecasts for years to come.

On a scale ranging from '1.0' (strongest) to '4.0' (weakest), we have assigned a score of '1.4' to Maryland's economy.

A Trend of Strong Budgetary Performance May Be Upended By the Pandemic

The state's pre-recession enacted fiscal 2021 budget would have resulted in $1.4 billion of cash resources preserved in the RDF ($1.2 billion) and its general fund balance ($225 million) or a combined 7.2% of estimated general fund revenues. The onset of the sudden-stop recession is now likely to result in the state using a significant portion of reserve to balance its budget.

The state's fiscal 2020 year-end may show a shortfall of $900 million to $1 billion (approximately 5% of revenues) depending on final receipts, federal reimbursements, and the effectiveness of expenditure reductions. To manage the budget, it implemented a hiring freeze beginning in April, enacted executive agency revisions of $350 million, and enacted $121 million of general fund expenditure reductions. Despite increases in the Medicaid program, management expects to achieve budgetary savings tied to the enhanced federal match for the program. Additional flexibility provided for use of Coronavirus Relief Funds from the CARES Act to offset police and other health-related expenditures should also offset some budget pressures.

Currently, the state projects using $144 million of its RDF balance in fiscal 2020, bringing the balance to approximately $1 billion at fiscal year-end, or about 5% of fiscal 2021 appropriations. The state has not formally revised its March 2020 revenue estimates of $19.2 billion for fiscal 2021, but expects a significant revision in September at the next formal meeting. Absent a formal revision, the BRE informally anticipates a potential decline in revenue of $2.1 billion, or an 11% decline from its original estimate. Over time, the shortfall may rise as entitlement programs, such as Medicaid, increase in utilization without additional federal funds.

Similar to fiscal 2020, Maryland is proactively managing its estimated revenue shortfall and will seek general fund expenditure reductions from the BPW, continue its hiring freeze along with executive agency reductions, and maximize use of available federal funds ($175 million). Other budget-balancing actions of $845 million include a $200 million reduction in K-12 education aid, eliminating pay-as-you-go capital expenditures of $143.6 million, using $139 million of existing balances to support health-related expenditures, and a $130 million reduction in local aid. A majority of these actions would require legislative approval. The legislature is not slated to meet again until January 2021, but a special session could be called before then. In our opinion, the magnitude of the shortfall relative to the state's reserve position could leave it in a weaker fiscal position if not sufficiently remedied. Any gap between budget savings and the remaining revenue shortfall would likely fall to the RDF balance to cover. Based on the state's current deficit mitigation plan, it may need to draw an additional $670 million from the fund.

In terms of education spending, the governor's 2021 budget proposal fully funds the beginning of the 10-year phase-in of the Kirwan Education Commission's recommendations and uses bond financing to ensure every jurisdiction's school construction needs are fully met. Initial funding for the plan includes dedicated video lottery terminal revenue, but outyear gaps remain. Initial funding of the plan includes $255 million in fiscal 2020 and $355 million in fiscal 2021. In our opinion, long-term funding of the state's education initiatives will likely weigh on future budgets. The legislature has previously passed bills, vetoed by the governor, to raise revenue to fund additional education appropriations recommended by the commission. Future funding of the initiatives is expected to be a continued point of contention in future budget negotiations.

We have assigned a score of '1.3' to Maryland's budgetary performance, on a scale where '1.0' is the strongest and '4.0' the weakest.

Government Framework

The Maryland Constitution requires the state to approve balanced budgets each fiscal year and for its budgets to remain balanced. To help manage the budget and maintain adequate fund balances despite revenue declines, the governor is empowered by statute to adjust spending as needed if the Maryland BRE, which meets three times per year, reduces its initial revenue estimate on which the budget is formulated. Such adjustments can only be made after first providing adequate provision for the payment of the principal and interest on state bonds and notes according to their terms. Maryland has considerable revenue-raising ability and can increase its income and sales tax rates and approve new revenues without voter approval. It also has a fair amount of budgetary flexibility regarding its expenditures, although this does not extend to all program areas. By law, the governor has the power, with the approval of the BPW, to reduce by not more than 25%, any appropriation that he might consider unnecessary, except appropriations for the payment of interest and the retirement of state debt, the legislature, the public schools, the judiciary, and the salaries of public officers. When needed, the state has adjusted agency spending accordingly. Education, including public and higher education, is Maryland's largest expenditure item and accounted for about 44% of budgeted general fund operating expenditures in fiscal 2019.

We have assigned a score of '1.4' to Maryland's government framework, on a scale where '1.0' is the strongest score and '4.0' the weakest.

Financial Management: Strong

We consider Maryland'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.

Maryland has instituted strong financial management practices. Its use of a five-year financial plan, which is updated annually with the adopted budget, provides the basis for future fiscal decisions, and recognizes future fiscal-year gaps. Monthly monitoring and reporting of key revenues allow the state to make midyear financial adjustments, if necessary, to maintain balance. Maryland has consistently maintained its statutory rainy day fund (RDF) balance at or above its legal minimum of 5% of revenues. Under current law, the governor is required to include an appropriation of at least $50 million, or an amount to bring the account balance to 7.5% of estimated general fund revenue, although the governor is also subsequently authorized to expend RDF balances equal to a minimum 5.0% of revenue. In addition, to mitigate revenue volatility in the general fund budget, the state legislature passed a mechanism that designates a portion of non-withholding income tax revenue above certain thresholds for nonrecurring purposes or to build reserves. The state has a formal debt-management policy based on defined measurements, including debt as a percentage of personal income and debt service as a percentage of revenues, along with a statutory debt amortization schedule. Maryland produces a five-year capital improvement plan that outlines expected capital requirements and identifies funding sources. The treasurer provides monthly investment inventory reports on its website and is required to report general fund investments to the general assembly in January of each year.

Once the budget is approved, the state monitors both revenue and expenditure performance on a regular basis and reports results in addition to an economic update. Budget adjustments have historically been implemented regularly on a timely basis. The governor has the authority to make adjustments to the budget and has a track record of doing so. Deficits can't be carried forward into the next fiscal year.

On a scale ranging of '1.0' (strongest) to '4.0' (weakest), we have assigned a score of '1.0' to Maryland's financial management.

Increasing Debt, Pension, And OPEB Liability Burden Creates Fiscal Pressures, But Is Well Managed

In our view, the state's tax-supported debt burden is still moderate at about 3.7% of personal income and 3.4% of gross state product. However, we estimate certain debt ratios are approaching moderately high levels. Debt per capita at the end of fiscal 2019 represented about $2,350, including the net present value of P3 milestone payments, which we consider moderately high. Tax-supported debt includes GO bonds, capital lease and appropriation-supported debt, and bay restoration bonds, as well as MDOT consolidated transportation bonds, county transportation bonds, and grant anticipation revenue vehicle bonds partially secured by transportation tax revenue. Annual debt service in fiscal 2019 represented 6% of general government spending, which we also consider moderately high. We believe the carrying charge is somewhat tempered by rapid amortization, with about 82% of tax-supported principal retired in the next 10 years, including all GO bonds retired in the next 15 as required by the Maryland Constitution.

Despite the state's moderate-to-moderately high debt and liability burden, it does present several strengths. Annual debt service in fiscal 2019 represented 6% of general government spending, tempered by rapid amortization. About 82% of tax-supported principal will be retired in the next 10 years, including all GO bonds retired in the next 15 as required by the constitution. We believe debt management is relatively strong based on the state's debt affordability study that defines certain affordability ratios (including maximum tax-supported debt as a percentage of personal income and debt service as a percentage of revenues), along with a statutory debt amortization schedule. However, debt issuance that outpaces economic growth based on substantial capital needs could pressure our view of the state's debt profile.

Maryland maintains its commitment to adequately fund its pension liabilities. Since fiscal 2018, the state has funded its pension systems based on an actuarially determined contribution. The current funding policy also requires supplemental contributions of $75 million until the system is 85% funded and directs half of the annual unappropriated general fund balance in excess of $10 million, up to $50 million annually, to pension contributions. However, current budgetary pressures may prevent these additional payments. As of June 30, 2019, the state's overall average pension funded ratio across all plans improved to 72%, which we still consider below adequate.

As of June 30, 2019, the state's applicable net other postemployment benefit (OPEB) liability was $15 billion, or about $2,500 per capita and approximately 4% of personal income, which is above medians. The liability increased over the prior year due to a lowering of the discount rate used to measure liabilities. While Maryland also established an irrevocable trust, it has not regularly appropriated funds to prefund it. In the 2018 legislative session, the state changed the pension sweeper to apply to OPEB liabilities as well. The state employee and retiree health and welfare benefits program trust was only 2.4% funded at the end of the fiscal year.

We have assigned a score of '2.7' to Maryland's debt and liability profile, on a scale where '1.0' is the strongest and '4.0' the weakest.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of July 14, 2020)		
Maryland Dept of Transp APPROP		
Long Term Rating	AA+/Stable	Affirmed
Maryland Dept of Transp APPROP		
Long Term Rating	AA+/Stable	Affirmed
Maryland Dept of Transp APPROP		
Long Term Rating	AA+/Stable	Affirmed
Maryland Dept of Transp APPROP		
Long Term Rating	AA+/Stable	Affirmed

Ratings Detail (As Of July 14, 2020) (cont.)		
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 (Hippodrome Performing Arts Center)		
Long Term Rating	AA+/Stable	Affirmed
Maryland Stad Auth (Montgomery County Conf Ctr Proj)		
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) certs of part (Baltimore Washington Intl Thurgood Marshall Arpt Shuttle Bus Fleet Acqu)		
Long Term Rating	AA+/Stable	Affirmed
Maryland Dept of Transp (Maryland) (Aviation Admin Fac) certs APPROP		
Long Term Rating	AA+/Stable	Affirmed
Maryland Dept of Transp (Maryland) (Port Admin Fac Proj) certs APPROP		
Long Term Rating	AA+/Stable	Affirmed
Maryland Dept of Transp (Maryland) (Transit Admin Proj) certs 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		
Maryland Stad Auth (Maryland) sports facs taxable lse rev bnds		
Long Term Rating	AA+/Stable	Affirmed
Maryland Stad Auth (Maryland) sports facs tax-exempt lse rev bnds		
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