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Ratings

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Summary:

Maryland; Appropriations; General Obligation

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Table Of Contents

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Credit Profile		
US$787.63 mil GO rfdg bnds (state and local fac loan of 2017) ser 2ND B due 08/01/2026		
Long Term Rating	AAA/Stable	New
US$550.0 mil GO bnds (state and local fac loan of 2017) ser 2ND A due 08/01/2032		
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 2017, which includes:

- Second series A tax-exempt general obligation (GO) bonds; and
- Second series B tax-exempt GO refunding 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 appropriation debt outstanding. 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. 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 recover slowly after weakness in recent years due to federal budget uncertainty and sequestration;
- 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 are relatively high, in our opinion.

The Board of Revenue Estimates' (BRE) official March 2017 forecast estimates 2.4% growth in fiscal 2017 general fund revenues, which is $35 million under December 2016 estimates following a cumulative $380 million downward revision to projections in September and December 2016. Maryland's BRE regularly forecasts state revenue across a diverse revenue base, with 54% of general fund budgetary revenue in fiscal 2017 coming from personal income and 28% from sales tax revenue. State officials report wage income represents the majority of the state's personal income tax revenue. Uncertainty at the federal level on hiring and tax reform might have contributed to dampened consumer

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confidence and sales and use tax collections compared with estimates. Actual receipts through June reflect only 2% year-over-year growth for fiscal 2017, although state officials believe accrued withholdings could bring final fiscal 2017 year-end revenue in line with forecast. The March 2017 BRE forecast projected fiscal 2018 current general fund revenue growth of 3.6% compared with fiscal 2017, which is in line with December BRE estimates, and incorporates about $25 million lower revenue to account for a pending federal hiring freeze. With about 15% of the state's withholding income tax revenue coming from federal civil- and defense-related accounts, state employment and state income tax revenue remains susceptible to federal budget decisions. Since March, the federal government has lifted the official hiring freeze announced in January, although federal budget uncertainty remains. 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 current economic forecast projects 1.0% and 0.8% employment growth in 2017 and 2018, respectively, which is slightly more conservative than IHS Markit's corresponding projections of about 1.5% and 0.9%, respectively. The BRE's economic forecast also projected slightly more conservative annual personal income growth of 4.0% and 4.2% in 2017 and 2018, respectively, compared with IHS Markit's current forecasts of about 4.2% and 4.4%, respectively. However, the state's outlook for fiscal 2019 through fiscal 2022 reflects continued slow economic growth contributing to persistent projected structural budget gaps under current assumptions that will need to be continually addressed.

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. Budget solutions included a combination of $183 million in expenditure reductions for fiscal 2018 and transfers from other funds, including a $170 million transfer from the Revenue Stabilization Account (RSA) in fiscal 2017.

The general assembly passed the fiscal 2018 general fund budget in late March, two weeks before the session adjourned. The final general fund budget for fiscal 2018 totaled about $17.2 billion, which was in line with Gov. Hogan's proposed budget and relatively flat compared with the current fiscal 2017 working general fund budget. The budget structurally solved for an estimated $745 million, or 2.2%, budget gap spanning fiscal 2017 and fiscal 2018. The final budget and legislation projects $91 million in year-end general fund balance and $860 million in the rainy day fund for a total $950 million, or 5.5% of budget in reserves, which we still consider good and above the 5% minimum level required by statute. 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 these reserves as long as RSA balances remain equal to a minimum 5.0% of revenue. In fiscal 2018, the budget includes $40 million the state would have otherwise transferred to the rainy day fund. The fiscal 2018 general fund budget also eliminates required additional transfers to pension contributions, although it still funds the fiscal 2018 actuarially determined pension contributions as well as a $75 million in supplemental pension contribution, and provides for a slight increase in the estimated year-end general fund balance to maintain combined reserves above the 5% minimum level. Additionally, in order to mitigate revenue volatility in the general fund budget, the 2017 general assembly passed legislation that directs future growth in non-withholding income tax revenue above certain thresholds for non-recurring purposes or to build reserves.

We favorably view the state's long history of proactive financial and budget management to align revenues and expenditures, although risks to the budget include further slowing of economic growth compared with that of the nation or federal funding reductions in the state. Risks to the budget estimate include continued soft economic growth, shortfalls in estimated revenue, and growing state Medicaid costs related to enrollment or changes in federal fiscal policy. Unanticipated enrollment in the expansion population under the Affordable Care Act contributed to $82 million in Medicaid general fund deficiencies in fiscal 2017 and state general fund costs for Medicaid are estimated to rise 5.7% in fiscal 2018 compared with fiscal 2017 to support rate increases for managed care organizations.

Federal sequestration contributed to overall employment growth that lagged the nation between 2013 and 2016. IHS Markit estimates state employment will grow by 1.5% in 2017 due to hiring in services, which is slightly above national growth projections. However, subsequent employment growth in Maryland is projected to remain slower than that of the nation between 2018 and 2020. IHS Markit projects continued expansion of professional and business payrolls over the next decade to replace the government sector as the state's largest employer. State unemployment remained below the national rate as reflected in the 4.1% preliminary unemployment rate as of June 2017 compared with the 4.4% national level. Federal sequestration also dampened recent GSP growth, which is heavily influenced by federal government purchases by the private sector; however, GSP growth has shown recent signs of improvement and IHS Markit projects levels more in line with projected national GDP growth in 2017.

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.

Maryland's debt burden, excluding public-private partnership (P3) obligations, grew about 8% to about $12.5 billion in fiscal 2016, which brings the state's debt burden to more than $2,000 per capita, which we consider moderately high. The state also has 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 $744 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 RatingsDirect), 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. With the milestone payment obligations included, the state's calculated debt burden per capita grows to $2,200, which we still consider moderately high. We understand a federal appeals court recently restored the project's environmental approval, which allows the state to request $900 million of federal aid contingent on federal budget negotiations. Once P3 project construction is complete and operational, expected to occur in 2023, 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 $2.6 billion, assuming no self-support. To the extent project revenue is not sufficient to cover the majority of future availability payments, we believe most of Maryland's debt measures will remain moderate, but net tax-supported debt compared to population 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 rapid, with about 81% of tax-supported debt retired in 10 years. All GO bonds mature in the next 15 years, as required by Maryland Constitution. 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 rose by 4.1% in fiscal 2015 and 3.9% in fiscal 2016 to $695 million, with property tax receipts generating 67% of the revenues available for GO debt service. General funds and bond premiums represent most of the balance of revenues used for debt service. We consider the state's overall three-year average pension funded ratio relatively low at 69%, which incorporates the system's 66% funded position in fiscal 2016 compared with 72% in fiscal 2014. The state's net pension liability recently grew to levels we consider relatively high after a weak 1.1% net investment return for the Maryland retirement system in fiscal 2016. We understand the system posted a near 10% return on investments at June 30, 2017, which could moderate reported liabilities in fiscal 2017. However, we believe long-term future pension costs are likely to grow due to scheduled reductions in the system's actuarial assumed rate of return in two years 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. We also believe OPEB liabilities are above average when compared with those of other states (see "Rising U.S. State Post-Employment Benefit Liabilities Signal An Unsustainable Trend," published Sept. 7, 2016). We expect to monitor the state's future adherence to its revised pension funding policy to budget for actuarially based pension contributions and demonstrate strong funding discipline and commitment to funding the long-term liability.

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.

For additional information on the state's general creditworthiness, please see full analysis published Feb. 24, 2017.

Outlook

The stable outlook reflects Maryland's continued focus on structural budget alignment and maintenance of minimum state reserve levels, 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. 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 could also pressure the rating.

Ratings Detail (As Of August 2, 2017)		
Maryland Econ Dev Corp APPROP		
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		
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