MOODY'S ASSIGNS Aaa RATING TO $485 MILLION OF MARYLAND G.O. BONDS

$6.8 BILLION OF G.O. DEBT OUTSTANDING; OUTLOOK IS STABLE

Maryland (State of)
State
Maryland

Moody's Rating

Issue		Rating
General Obligation Bonds, State and Local Facilities Loan of 2011, First Series A (tax exempt)		Aaa
Sale Amount	$125,000,000	
Expected Sale Date	03/09/11	
Rating Description	General Obligation	
General Obligation Bonds, State and Local Facilities Loan of 2011, First Series B (tax exempt)		Aaa
Sale Amount	$353,480,000	
Expected Sale Date	03/09/11	
Rating Description	General Obligation	
General Obligation Bonds, State and Local Facilities Loan of 2011, First Series C (taxable QECBs)		Aaa
Sale Amount	$6,520,000	
Expected Sale Date	03/09/11	
Rating Description	General Obligation	

NEW YORK, February 18, 2011 -- Moody's Investors Service has assigned a Aaa rating and a stable outlook to the State of Maryland's $485 million General Obligation Bonds State and Local Facilities Loan of 2011, First Series A Tax-Exempt Bonds (Negotiated); First Series B Tax-Exempt Bonds (Competitive) and First Series C Taxable Qualified Energy Conservation Bonds (Competitive).

The proceeds of the First Series A and B bonds will be used for capital purposes of a variety of state facilities, capital grants for local governments and matching fund loans and grants for local government and various nonprofits, hospitals and other entities. Proceeds from the First Series C QEC Bonds will assist local education agencies to undertake energy conservation projects in schools.

SUMMARY RATING RATIONALE

The highest quality rating reflects Maryland's strong financial management policies, stable economy with high personal income levels, and ability to maintain positive available reserves despite sustained pressure on its budget.

The rating also acknowledges the state's above average debt burden and low retirement system funding levels. The outlook is stable.

Credit Strengths:

-History of strong financial management

-Strong economy with high personal income levels

-Adequate reserve levels despite recent draws

Credit Challenges:

-Continuing budget pressure in the current fiscal year and out-years

-Low retirement system funded levels

-Above average debt burden

DETAILED CREDIT DISCUSSION

MARYLAND'S CONSIDERABLE RESOURCES TAPPED TO BALANCE BUDGETS

Since the onset of the recession, Maryland has closed large budget gaps with a mix of spending reductions and the use of formal and informal reserves. Income and sales tax revenue underperformance led to fiscal 2009 revenue estimates being revised downward by $1.3 billion. As a result, the state was forced to deal with a sizable mid-year budget gap (after enacting a fiscal 2009 budget that dealt with an initially projected gap of $1.7 billion) and planned for an estimated fiscal 2010 budget gap of $2.9 billion. The state relied on spending cuts, fund transfers (including reserve transfers of $170 million in fiscal 2009 and $210 million in fiscal 2010), available ending balances, and American Recovery and Reinvestment Act (ARRA) funding to deal with these gaps.

Budget gaps reopened soon after fiscal 2010 began amid ongoing revenue weakness. In response, the Board of Public Works approved three rounds of general fund budget reductions totaling more than $1 billion. In addition to spending cuts and headcount reduction, these adjustments included the use of
$25 million in rainy day fund moneys. Approximately $200 million in fiscal 2010 needs also was addressed as part of budget planning for fiscal 2011.

The fiscal 2011 budget closed a gap of more than $2 billion. This was addressed through more than $1 billion in budget reductions, including local aid and higher education reductions, savings related to state employee wage decreases and employee furloughs. The solutions relied on more than $800 million in fund transfers, including a $350 million Local Income Tax Reserve transfer and $442 million in transfers (for fiscal 2010 and fiscal 2011) from pay-go capital funds, to be replaced with bonding. The state also accessed $200 million in additional fund transfers to address a shortfall created by less federal Medicaid matching assistance than it had planned on, and to bolster its projected year-end reserves. The fiscal 2011 budget relies on more than $1 billion in ARRA funding.

The most recent report of the Maryland Board of Revenue projects a 4.6% increase in general fund revenues for fiscal year 2011, based on stronger-than-expected tax revenue collections for the first several months of the fiscal year. This would be the first annual increase in general fund revenues since 2008.

GOVERNOR'S PROPOSED FISCAL 2012 BUDGET RELIES ON A MIX OF RECURRING AND NON-RECURRING RESOURCES TO CLOSE $1.4 BILLION GAP

The governor's proposed budget for fiscal 2012 projects a $1.4 billion budget gap despite projected general fund revenue growth of more than 3%. The governor also estimates that the state has a longer-term structural gap between recurring revenues and expenditures of about $2 billion annually. To address these issues, the governor's proposed balancing plan includes about $100 million in recurring revenue items and $950 million in spending reductions, of which $730 million have been identified as recurring cuts. , This latter amount represents the first stage of a plan to reduce the structural gap by one-third in fiscal 2012 and to further reduce it in fiscal
2013 and 2014.

The proposals include an additional $191 million in transfers from pay-go amounts held in the capital accounts of several state entities to bonding. The entities include the Maryland Water Finance Authority Bay Restoration Fund and the transfer tax. To make whole the entities' capital programs, the state will postpone some of its own bond-financed capital projects to accommodate funding the other projects within the state's borrowing cap.

Finally, the proposed budget includes a pension reform plan that, if enacted, would allow the state to realize $104 million in general fund savings in fiscal 2012 and $52 million in fiscal 2013. Most of the benefits of the reform plan (discussed more below) would flow to the general fund in the first two years.

FISCAL 2010 AND 2011 RESERVE BALANCES MAINTAINED AT 5% OF REVENUES

While the Revenue Stabilization Account (RSA) balance had grown to $1.4 billion (11% of revenues) in fiscal 2007, roughly half of that was used to address the fiscal 2008 budget gap. Since then, actual and projected balances have been maintained at 5% of general fund revenues. Current projections place RSA balances at $623 million in fiscal 2011 and $682 million in fiscal 2012.
Based on audited fiscal 2010 financial results, the state's available fund balance was $274 million, representing the net of $615 million in the RSA and a $341 million deficit in the state's "unassigned" balances. The available fund balance was about 2% of revenues in fiscal 2010. Maryland is an early adopter of new standards promulgated by the Governmental Accounting Standards Board (GASB) for reporting fund balances.

EMPLOYMENT BEGINS REBOUND IN 2010

Maryland's economy grew more strongly than the nation for much of the last decade, but like every other state, lost jobs in the recession. In 2008, employment declined by 0.3%, similar to the national jobs decline. Employment declined 3% in 2009, compared to decline of 4.3% for the nation. During 2010, the state's employment trend shifted from losses to growth and by December, the state had gained 26,000 jobs from December 2009. Throughout the recession, state unemployment rates have remained lower than the nation's, peaking at 7.7% compared to the nation-wide peak of 10.1%. Maryland's average unemployment rate was 7.4% in calendar year 2010, compared to 9.6% in the nation.

Maryland's economy has diversified in recent years, but continues to be proportionally more affected by the activities of the federal government than almost any other state. This connection has historically been both a benefit and a weakness. During the early 1990s, the federal government's downsizing hurt Maryland's economy, but the ongoing Base Realignment and Closure Commission (BRAC) reorganization is expected to result in a significant increase in new jobs. The state projects a direct employment increase of about 21,000 new federal jobs as a result of the BRAC reorganization by the end of calendar 2011. While the BRAC-related increase in jobs and state residents is expected to impact the state's economy and finances positively, the timing and degree of the impact is uncertain. However, Maryland will be impacted more heavily than many states by federal budget cuts going forward.

Maryland's personal income levels are high, with annual growth that has exceeded national levels in recent years. In 2009, the state's personal income per capita was 122% of the U.S. average, an increase from 115% in 2000 and the fifth highest in the nation.

DEBT BURDEN REMAINS ABOVE AVERAGE; RETIREMENT SYSTEM UNDERFUNDED

State debt levels relative to 50-state medians are high. Moody's 2010 State Debt Medians ranks Maryland fourteenth for debt per capita. For debt as a percentage of personal income, the state is ranked eighteenth. The state's debt burden has historically remained within the recommendations of its Capital Debt Affordability Committee, which advises limiting total debt to within 4.0% of personal income and debt service to within 8% of revenues.

Somewhat offsetting the high debt burden, Maryland's constitution requires a rapid 15-year amortization of tax-supported debt. This policy increases debt service as a percentage of revenues, but also quickly replenishes the state's debt capacity and helps restrain growth in the outstanding balance.

The state's retirement system funded levels represent a credit challenge for the state. The current funded level is low at about 63% as of June 30, 2010.
This represents a decline from 87.8% as of June 30, 2005 and is at a level lower than most similarly rated states.

The governor's fiscal 2012 budget presents proposed reforms to the Employees' and Teachers' Retirement Systems, subsequent to recommendations of the Public Employees' and Retirees' Benefits Sustainability Commission made in December 2010. The proposals include increasing the vesting period from 5 to 10 years, larger contributions from employees, increasing the early retirement age and implementing other formula changes. Pension savings would be used for general fund relief in the first two years of implementation, but would then be used to increase the systems' assets and increase the funded ratio to 80% by 2023.

The governor's proposals did not address the "corridor funding method" enacted in 2002, which has led the state to consistently contribute less than its actuarially required contribution (ARC). The recommendation by the state retirement system's board of trustees to phase out this funding method has been reported to the General Assembly's Joint Committee on Pensions but no legislation to change it has been enacted.

The state has begun to address its significant retiree health care cost liability (OPEB). Based on the most recent actuarial valuation, the actuarial accrued liability was estimated at about $16.1 billion. The state has created a Postretirement Health Benefits Trust Fund as an irrevocable trust, which thus far holds $183 million. The governor's proposals would also reduce OPEB liability by shifting retirees onto Medicare Part D, among other changes.

OUTLOOK:

The outlook for Maryland's general obligation debt is stable. The state faces significant budget pressure, including the need to address the declines in retirement system funded levels. The stable outlook reflects Moody's expectation that the state, consistent with its history of strong financial management, will appropriately address its structural budget gap and pension funding concerns.

What could change the rating - DOWN

-Inability to stabilize finances and return to budgets where revenue performance accommodates spending needs

-Economic and financial deterioration that results in deficits and continued draw downs of reserves without a plan for near-term replenishment

-Failure to adhere to the state's tradition of conservative fiscal management

-A state economy that does not rebound in tandem with the rest of the country

-Failure to address declining pension system funded levels

The principal methodology used in this rating was Moody's State Rating Methodology published in November 2004.

REGULATORY DISCLOSURES

Information sources used to prepare the credit rating are the following: parties involved in the ratings, public information, confidential and proprietary Moody's Investors Service information, and confidential and proprietary Moody's Analytics information.

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