

## **FITCH RATES \$718MM STATE OF MARYLAND GOS 'AAA'; OUTLOOK STABLE**

Fitch Ratings-New York-13 July 2011: Fitch Ratings assigns an 'AAA' rating to the following State of Maryland (state) general obligation (GO) bonds, state and local facilities loan of 2011, second series, consisting of:

- \$100 million second series A tax-exempt bonds (negotiated);
- \$390 million second series B tax-exempt bonds (competitive);
- \$15.9 million second series C taxable qualified zone academy bonds (competitive);
- \$6.515 million second series D taxable qualified energy conservation bonds (competitive);
- \$206.04 million second series E tax-exempt refunding bonds (competitive).

Series A and series B par amounts will be finalized upon sale. The series A bonds are expected to sell via negotiated sale on July 22 and July 25, 2011; the series B through series E bonds are expected to sell via competitive sale on July 27, 2011.

In addition, Fitch affirms the following ratings:

- Approximately \$7 billion state GO bonds, at 'AAA'.

The Rating Outlook is Stable.

### **RATING RATIONALE:**

- Debt oversight is strong and centralized, and the debt burden is moderate. The state has policies to maintain debt affordability, and the constitution requires GO and transportation bonds to amortize within 15 years. Pension funding levels have deteriorated, although the state is undertaking extensive pension and other post-employment benefit (OPEB) reforms.
- The state has a diverse, wealthy economy, benefiting from its proximity to the nation's capital.
- Financial operations are conservative, and the state maintains a rainy day fund to manage revenue cyclicality. The state took repeated action during the course of the recession to address projected budget gaps, including raising tax revenues, cutting spending, and using rainy day and other balances.

### **KEY RATING DRIVERS:**

- Continued maintenance of sound financial operations and conservative debt management practices.

### **SECURITY:**

General obligations to which the state's full faith and credit are pledged.

### **CREDIT SUMMARY:**

The 'AAA' rating on the state's GO bonds reflects its sound financial operations, a wealthy, diversified economy and strong management of debt. The state's economy is experiencing a slow return to growth after the recession, during which widespread job losses and a deep housing market downturn affected state revenue collections. Severe revenue declines required the state to take repeated balancing actions, including implementing cuts and fund transfers and relying on federal stimulus. Revenues have begun to stabilize, with fiscal 2011 year-to-date receipts through May exceeding forecast expectations. The state forecasts a solid fund balance as of June 30, 2011 (the fiscal year-end) at \$646 million, or 4.9% of general fund revenues and a rainy day fund (RDF) balance at \$624 million, or 4.7% of general fund revenues. The fiscal 2012 adopted budget implemented broad cuts, reformed employee and retiree benefits, and shifted revenues to achieve balance, leaving the RDF untapped.

The state is wealthy, and its diverse economy benefits from proximity to the nation's capital.

Despite recent improvement from recessionary weakness, economic performance has been mixed in recent months. May 2011 employment fell 0.7% year-over-year, the second consecutive monthly decline after nearly a year of post-recession employment gains. Unemployment fell to 6.8% in May 2011, from 7.4% in May 2010, and remains well below the nation's 9.1% rate reported in May 2011.

The likelihood of additional federal spending constraints may weigh on the state's economy going forward; government sector employment fell 1.8% in May 2011 compared to the prior year. Nonetheless, the state continues to benefit from employment shifts associated with the 2005 military base realignment process. Personal income in the state continued to grow through the downturn, unlike much of the country; first quarter 2011 was up 4.4% from the first quarter of 2010, compared to 4.7% nationally in the same period. The state anticipates 3.5% growth in 2011. Measured on a per capita basis, Maryland's 2010 preliminary personal income ranks 4th among the states, at 121% of the U.S. level.

Financial operations are conservative, with the state consistently demonstrating a strong commitment to maintaining budgetary balance through the downturn, including through repeated spending cuts, fund balance transfers and revenue increases. The state has also maintained flexibility in the form of the RDF, which has remained funded at or near 5% of general fund revenues in recent years. At enactment of the fiscal 2011 budget, the state forecasted that the year would close with a \$204 million fund balance (1.6% of general fund revenues), and an RDF balance at \$631 million (5% of general fund revenues). The state raised its revenue expectations modestly in the course of the year; fiscal 2011 revenues now are estimated to have grown 4.6%, or 2.7% net of the impact of highway user tax measures enacted with the fiscal 2011 budget and certain one-time corporate income tax receipts. The general fund balance is expected to end at \$646 million (4.9% of revenues). Actual revenues through May 2011 are running about 1% ahead of forecast, largely due to strength in individual income tax receipts.

The fiscal 2012 adopted budget addressed a budget gap estimated at \$1.35 billion, including from the phase-out of federal stimulus funds. The gap was closed through spending cuts, largely to state programs and agencies (\$516 million), but also from reforms to employee and retiree fringe benefits (\$124 million). In addition, the state shifted certain revenue streams and fund balances to the general fund (\$122 million) and replaced planned pay-go spending with bonding (\$197 million). Fiscal 2012 is expected to close with a \$56 million fund balance (0.4% of general fund revenues); the RDF would remain fully funded at \$682 million (5% of general fund revenues).

The burden of total tax-supported debt is moderate, and the state's strong and centralized debt management remains a credit strength. Net tax-supported debt equals approximately \$9.8 billion, or 3.5% of 2010 preliminary personal income. More than two-thirds of tax-supported debt is GO bonds. GO and transportation bonds are constitutionally required to mature within 15 years, ensuring rapid amortization. Debt affordability guidelines include holding tax-supported debt at or below 4% of personal income.

The funding of the state's pensions has deteriorated in recent years, with June 30, 2010 funding for the state employees 59.7%, a weak level, and teachers at 65.4%. Using Fitch's more conservative 7% discount rate assumption, the state employees and teachers' plans would be 55.2% and 60.4%, respectively (see Fitch's report dated 17 February 2011, 'Enhancing the Analysis of U.S. State and Local Government Pension Obligations' available on Fitch's website at [www.fitchratings.com](http://www.fitchratings.com)). The pension and health care reforms enacted with the budget are expected to slow the growth of the state's pension liability and direct additional contributions to the pension system over time to improve funding ratios. Moreover, benefit changes to other post-employment benefits (OPEB) are estimated to reduce the state's OPEB liability to \$9.2 billion, from \$15.9 billion. The state is continuing to pursue pension system reforms.

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In addition to the sources of information identified in the Tax-Supported Rating Criteria, this action was additionally informed by information from IHS Global Insight.

Applicable Criteria and Related Research:

--'Tax-Supported Rating Criteria' (Aug. 16, 2010).

--'U.S. State Government Tax-Supported Rating Criteria' (Oct. 08, 2010).

Applicable Criteria and Related Research:

Tax-Supported Rating Criteria

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=548605](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=548605)

U.S. State Government Tax-Supported Rating Criteria

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=564546](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=564546)

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