MOODY'S ASSIGNS Aaa RATINGS TO $718 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 State and Local Facilities Loan of 2011, Second Series A Tax-Exempt Bonds (Negotiated)	Aaa
Sale Amount $100,000,000	
Expected Sale Date 07/22/11	
Rating Description General Obligation	
General Obligation State and Local Facilities Loan of 2011, Second Series B Tax-Exempt Bonds (Competitive)	Aaa
Sale Amount $390,000,000	
Expected Sale Date 07/27/11	
Rating Description General Obligation	
General Obligation State and Local Facilities Loan of 2011, Second Series C Taxable Qualified Zone Academy Bonds (Competitive)	Aaa
Sale Amount $15,900,000	
Expected Sale Date 07/27/11	
Rating Description General Obligation	
General Obligation State and Local Facilities Loan of 2011, Second Series D Taxable Qualified Energy Conservation Bonds (Competitive)	Aaa
Sale Amount $6,515,000	
Expected Sale Date 07/27/11	
Rating Description General Obligation	
General Obligation State and Local Facilities Loan of 2011, Second Series E Tax-Exempt Refunding Bonds (Competitive)	Aaa
Sale Amount $206,040,000	
Expected Sale Date 07/27/11	
Rating Description General Obligation	

NEW YORK, July 14, 2011 -- Moody's Investors Service has assigned Aaa ratings to the State of Maryland's $718 million General Obligation Bonds State and Local Facilities Loan of 2011, Second Series, consisting of $100 million Second Series A Tax-Exempt (Negotiated), $390 million Second Series B (Competitive), $15.9 million Second Series C Taxable Qualified Zone Academy Bonds (Competitive), $6.5 million Second Series D Taxable Qualified Energy Conservation Bonds (Competitive), and $206 million Second Series E Tax-Exempt Refunding Bonds (Competitive). Proceeds of the Series A bonds and the Series B through D bonds will be used to finance state capital projects. Proceeds of the Series E bonds will advance refund certain outstanding general obligation bonds. The Series A bonds are scheduled to price on July 22, the Series B bonds are scheduled to price on July 27.

On July 13, 2011, Moody's placed the U.S. government's Aaa bond rating on review for possible downgrade, and published a Special Comment, "Implications of a U.S. Government Downgrade for Aaa-rated Municipal Issuers". The report, which is available at www.moodys.com, states that we will review all Aaa-rated municipal issuers in the states sector during the week of July 18 to determine whether their ratings should also go on review for possible downgrade in light of the sovereign rating action. Any review for downgrade of Maryland's rating will be announced at that time.

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.

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

-Low retirement system funded levels

-Above average debt burden

-Reliance on federal jobs in era of retrenchment

DETAILED CREDIT DISCUSSION

MARYLAND'S CONSIDERABLE RESOURCES TAPPED TO BALANCE BUDGETS

Since the onset of the 2008 recession, Maryland has closed large budget gaps with a mix of spending reductions, tax increases and the use of formal and informal reserves. In fiscal 2011, a $2 billion initial budget gap and additional mid-year shortfalls were addressed through more than $1 billion in budget reductions, including cuts to local aid and higher education. The solutions also relied on more than $800 million in fund transfers, which included $550 million transferred from the local income tax reserve fund, of which $350 million was directed to the education trust fund.

The enacted $14.7 billion fiscal 2012 budget closes a $1.4 billion projected shortfall through nearly $900 million in spending reductions, additional transfers exceeding $300 million, and about $100 million in previously unbudgeted revenues. The state reduced agency spending $516 million and cut local aid $89 million. Fiscal 2012 spending reductions were also aided by a $124 million pre-payment of 2012 education aid in fiscal 2011 and changes in employee pension and health benefits (discussed below). These actions kept year-to-year spending growth to 2 percent.

The Maryland Board of Revenue Estimates (BRE) projected a 4.6% increase in fiscal 2011 general fund revenues. Because of better-than-expected performance of the individual income tax, fiscal 2011 revenue collections outperformed the forecast by $110 million through May. The boost is primarily due to estimated and final payments exceeding expectations, as well as lower-than-anticipated refunds; additionally, the year-to-date withholding portion of the tax is up 4.0%, in line with the forecast. Withholding is generally considered to be an indicator of current economic activity, while the other components are linked to past activity.

Fiscal 2012 general fund revenues will grow 5.7% according to the state's forecast. The increase in revenue includes the impacts of a sales tax increase on alcoholic beverages enacted in the 2011 legislative session. Recent weaknesses in tax collection trends may lead the BRE to lower its projections at its next meeting in September 2011.

MARYLAND BENEFITS FROM POOL OF PAY-AS-YOU-GO CAPITAL RESOURCES

Throughout the downturn, the state has benefited from its ability to convert the sizeable pay-as-you-go portion of its capital plan to bonds. In fiscal 2011, the general fund received $90 million from capital funds, bringing total capital transfers since 2008 to about $475 million. Including actions benefiting the 2012 budget, the state will have converted $611 million in pay-as-you-go capital into $591 million in general obligation bonds since the recession hit in 2008. The transfers have not impaired the capital programs most affected by the transfers, the Maryland Water Finance Authority Bay Restoration Fund and the Transfer Tax, as the state has funded their scheduled projects from its GO program.

FISCAL 2011 AND 2012 RESERVE BALANCES MAINTAINED AT 5% OF REVENUES

Maryland's 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 about 5% of general fund revenues, which is the state's current target. The state's projections place RSA balances at $623 million in fiscal 2011 and $682 million in fiscal 2012. The state's multi-year plan assumes that it will rebuild the RSA starting in fiscal 2013 with annual transfers of $50 million.

RECOVERY ELUSIVE AS JOB GAINS ERODE IN FIRST HALF OF 2011

Maryland's recovery from the national recession has been halting. The state weathered the downturn better than many of its peers, with unemployment peaking at 7.7 percent in January of 2010. Nationwide, the unemployment rate peaked at 10.1 percent in October 2009. However, job gains for the state have been elusive. From December 2009 to December 2010, the state's payroll jobs grew just 0.4%, or about11,000 jobs. From December to May 2011, the state's economy shed 7,000 jobs, a 0.3% decline, while the nation's payrolls grew 0.6%.

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 been 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. The relocation of military activity is also expected to attract additional employment by military contractors.

Maryland's personal income levels are high, with annual growth that has exceeded national levels in recent years. From 2000 to 2010, the state's personal income grew at a 4.4% pace, compared to 3.9% growth nationwide. The faster growth propelled Maryland's per capita income from 114% of the nation's in 2000 to 121% in 2010.

MARYLAND'S DEBT OUTSTANDING GREATER THAN MOST STATES

State debt levels relative to 50-state medians are high. Moody's 2011 State Debt Medians ranks Maryland eighteenth for debt as a percent of personal income and fifteenth on a per capita basis. 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.

STATE ENACTS REFORMS TO REDUCE HIGH PENSION AND OPEB LIABILITIES

The funded levels of Maryland's retirement system represents a credit challenge for the state. The current funded level is low at approximately 63% as of June 30, 2010. This represents a decline from 87.8% from June 30, 2005 and is at a lower level than most similarly-rated states. There are six pension plans in the Maryland State Retirement and Pension System, although there is little liability outside of the Employees' Combined System and the Teachers' Combined System. In Maryland, the state is responsible for teacher pension contributions.

The legislature enacted a number of changes to the state's pension system during the 2011 legislative session. For individuals hired on or after July 1, 2011, these changes included increasing the vesting period and retirement age, and modifications to the benefit formulas. In addition, existing employees and individuals hired on or July 1, 2011, are also subject to an increased employee contribution rate and reduced cost of living adjustments for service accrued on or after July 1, 2011. Thereafter, the state will supplement its annual pension contribution with up to $300 million per year of the savings from the reforms. With these changes, the state projects its funded ratio will reach 80% by 2023.

The legislature also enacted changes to retiree health benefits ("OPEB") that are projected to reduce the state's OPEB liability roughly by half. The 2010 actuarial valuation placed the state's actuarial accrued liability for these benefits at about $16 billion. A new actuarial valuation conducted in conjunction with the enactment of reform placed the liability at $9.2 billion. Consequently, the state's OPEB actuarially required contribution fell from $1.2 billion to about $700 million. The state has also created a Postretirement Health Benefits Trust Fund as an irrevocable trust that held $183 million as of the state's fiscal 2010 financial audit. The changes to retiree health benefits included moving Medicare-eligible retirees to Medicare Part D starting in 2020, an increase in retiree premium cost sharing, and more stringent service requirements for eligibility.

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, that will test its financial management abilities. 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

-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 adhere to plans to address low pension funded ratios

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was Moody's State Rating Methodology published in November 10, 2004. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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