FitchRatings

FITCH RATES $475 MILLION MARYLAND GOS 'AAA'; OUTLOOK STABLE

Fitch Ratings-New York-11 July 2013: Fitch Ratings assigns an 'AAA' rating to the following state of Maryland (the state) general obligation (GO) bonds, state and local facilities loan of 2013, second series, consisting of:

--$435 million second series A tax-exempt bonds (competitive);
--$40 million second series B taxable bonds (competitive).

The bonds will be sold via competitive sale on July 24.

In addition, Fitch affirms the 'AAA' rating on approximately $8 billion in outstanding state GO bonds.

The Rating Outlook is Stable.

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

KEY RATING DRIVERS

CONSERVATIVE FINANCIAL OPERATIONS: Financial operations are conservative, and the state maintains a well-funded rainy day fund. 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.

STRONG DEBT MANAGEMENT: 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 REFORMS: Pension funding levels have deteriorated, although the state has undertaken extensive pension and other post-employment benefit (OPEB) reforms.

BROAD ECONOMY: The state has a diverse, wealthy economy, benefiting from its proximity to the nation's capital.

RATING SENSITIVITIES

Sound fiscal management practices and the consistent maintenance of fiscal flexibility, including in the form of budgetary reserves, provide the state with significant ability to respond to near-term economic or fiscal conditions, such as federal budget reductions, in a manner consistent with the 'AAA' rating.

CREDIT PROFILE

The 'AAA' rating on Maryland's GO bonds reflects its sound financial operations, a wealthy, diversified economy and strong management of debt. The state's economy has long benefited from proximity to the nation's capital, although the prospect of near-term federal budget austerity poses a degree of uncertainty for the state's large federal agency presence and associated private contracting. Despite this risk and the generally slow pace of economic recovery, the state's diverse and wealthy service-oriented economy remains a source of credit strength. The state's approach to fiscal management has been consistently conservative both through the last recession and during the recovery, with the state relying on spending cuts, revenue increases and the use of non-recurring resources to maintain balance. Maryland retains ample fiscal flexibility, including a well-funded rainy day fund. Although pension funded ratios are weak, the state has undertaken multiple reforms to return to full funding over time.

ECONOMY

Maryland's economy continues to expand during 2013, albeit at the slow pace that has characterized the post-recessionary period and below the national average. May 2013 employment rose 1.3% year-over-year, compared to 1.6% nationally. Job gains were spread across multiple sectors, including in construction and professional and business services, although federal government employment slipped. The state's unemployment rate, at 6.7% in May 2013, was well under the 7.6% national average.

Measured on a per capita basis, Maryland's 2012 personal income ranks fifth among the states, at 122% of the U.S. level. Personal income grew in the first quarter of 2013 by 1.3% year-over-year, below the 2.8% national pace of growth for the same period. The state's March 2013 economic forecast, similar to previous forecasts, anticipates federal budget cuts curbing personal income and job gains near term but otherwise not derailing the state's slow recovery. The forecast estimates annual personal income growth of 2.8% in 2013 and 4.9% in 2014, with employment rising 0.9% and 1.5% in 2013 and 2014, respectively.

FINANCES

Financial operations are conservative, with the state consistently demonstrating a strong commitment to 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 its rainy day fund (RDF), which remained funded at or near 5% of general fund revenues through the downturn. As of June 30, 2013, the RDF balance is $701 million (4.7% of general fund revenues).

Fiscal 2013, which ended on June 30, is estimated to have ended with a sizable general fund balance of $558 million in addition to the RDF, well above the $200 million forecast by the state at the time the fiscal 2013 budget was adopted. The adopted budget closed a gap estimated at nearly $1.1 billion through a mix of personal income and other tax changes ($343 million) and appropriation reductions ($698 million). Reductions included the first year of a four-year phased-in shift of the normal cost of employer contributions for teacher pensions to local governments, estimated to reduce state spending by $217 million annually by fiscal 2016.

After sizable upward revenue forecast revisions in September and December 2012, particularly in personal and corporate income taxes, the state's March 2013 revenue forecast moderated expectations slightly in response to slowing sales tax collections. The March forecast assumes fiscal 2013 general fund revenues rise 4.9% to nearly $15 billion, from $14.3 billion in fiscal 2012. Fiscal 2013 year-to-date collections through May were up 6.2% from the previous year, partly due to timing factors associated with acceleration of income related to federal tax rate changes.

The adopted budget for fiscal 2014 continues to maintain the state's fiscal flexibility in the form of a well-funded RDF, forecast at $768 million (5% of general fund revenues), a projected ending balance of $294 million (1.9% of general fund revenues), and the statutory ability to redirect up to $97 million for program support in the event of continued federal sequestration cuts. General fund revenues are expected to rise 2.4%, to $15.3 billion, as of the March 2013 forecast. The forecast assumes that the partial implementation of federal sequestration cuts will affect broader economic activity and tax revenue growth. The plan also incorporates $84 million in revenue adjustments and $271 million of spending reductions. Outside the general fund, the state adopted a variety of revenue measures to increase resources for transportation capital, including applying sales taxes to gasoline and providing for inflation increases for existing levies and user fees; the plan is expected to generate nearly $668 million for transportation annually by fiscal 2018, after full phase-in.

LONG-TERM LIABILITIES

The burden of Maryland's total tax-supported debt is moderate, and its strong and centralized debt management remains a credit strength. Net tax-supported debt as of March 31, 2013, equals approximately $11.2 billion, or 3.7% of 2012 personal income, including the current sale. 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 pensions has deteriorated in recent years, with June 30, 2012 system-wide funded ratios for state employees at 62.5% and teachers at 65.8%. Using Fitch's more conservative 7% discount rate assumption, the employees and teachers' plans would be funded at 57.7% and 60.7%, respectively. On a combined basis, net tax-supported debt and the portion of pension liabilities attributable to the state are estimated by Fitch at about 11.7% of 2012 preliminary personal income, higher than the median of Fitch-rated states. Despite this comparative credit weakness, the state has taken multiple steps to reduce the burden of pensions in addition to the shift of teacher pension contributions noted earlier. These include reducing benefit accruals and requiring higher state contributions to accelerate funded ratio improvement. The state's fiscal 2014 budget also begins the phase-out of a previous contribution methodology that had resulted in annual pension contributions below an actuarially-calculated level over the last decade. Additionally, changes in 2011 to other post-employment benefits are estimated to have reduced the state's OPEB liability to $9.2 billion, from $15.9 billion as of June 30, 2011; the unfunded liability as of June 30, 2012 is $9.4 billion.

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Additional information is available at 'www.fitchratings.com'.

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', dated 14 Aug. 2012;
--'U.S. State Government Tax-Supported Rating Criteria', dated 14 Aug. 2012.

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Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. State Government Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686033