Maryland; General Obligation

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Table Of Contents

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Credit Profile		
US$435.0 mil tax-exempt bnds ser SEC SER A due 08/01/2028		
Long Term Rating	AAA/Stable	New
US$40.0 mil GO taxable bnds ser SEC SER B due 08/01/2017		
Long Term Rating	AAA/Stable	New
Maryland GO		
Long Term Rating	AAA/Stable	Affirmed
Maryland GO bnds st & local facs ln		
Long Term Rating	AAA/Stable	Affirmed
Maryland GO bnds st & local facs ln		
Long Term Rating	AAA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AAA' long-term rating, and stable outlook, to Maryland's $475 million state and local facilities loan of 2013, consisting of second series A and second series B. Standard & Poor's affirmed its 'AAA' long-term rating, and stable outlook, on Maryland's parity GO debt outstanding.

The rating reflects what we view as the state's:

- Broad and diverse economy, which has experienced steady growth. Potential federal fiscal consolidation could negatively affect near-term growth prospects, however;
- High wealth and income levels;
- Long history of proactive financial and budget management, including implementation of frequent and timely budget adjustments to align revenues and expenditures;
- Well-developed financial and debt management policies including long term financial planning which should be helpful in addressing future budget challenges; and
- Moderate debt burden, which we expect to continue due to a clearly defined debt affordability process which limits annual issuance coupled with a constitutional 15-year debt maturity schedule.

Pension funding levels have deteriorated in recent years and other postemployment benefit (OPEB) liabilities are significant but recent reform initiatives in both areas should improve the funding levels of both in future years.

The state's unemployment rate steadily declined through 2012 and has regularly been below that of the U.S. The rate through April was 6.5%, well below the peak of 7.8% in 2010. We expect that economic recovery will continue for Maryland, but the pace could slow due to potential declines in the government sector. The state's current economic forecast, upon which the fiscal 2014 budget is based, was updated in March and projects employment growth of 0.9% in 2013 and 1.5% in fiscal 2014. Total personal income growth forecasted by the state is 3.6% in 2013, and 4.5% in 2014. We believe the state's forecast is reasonable based on recent economic trends, and it is generally lower than the projections of IHS Global Insight Inc. There continues to be significant uncertainty regarding federal funding. The

Board of Revenue Estimates (BRE) notes that Maryland receives a significant amount of direct and indirect revenues from government spending with federal spending accounting for about one-third of the state's economy. Due to this dependence, the state had outlined a range of fiscal effects from potential federal tax policy and spending changes. The overall revenue forecast will be adjusted in September, and, in our view, there could be some downside risk due to sequestration. While federal fiscal consolidation remains a risk to the state's budget and long term financial plan, we believe that the state is monitoring developments and has options to mitigate this risk based on its well-developed budget policies and financial reserves.

Based on current estimates, fiscal 2013 is expected to end with a positive general fund balance of $558 million (3.7% of general fund revenue) and a revenue stabilization account (RSA) of $701 million (4.7% of general fund revenue). We believe that the aggregate reserves provide the state flexibility to manage future budget volatility. General fund revenues through May are in line with revised estimates. While there is some weakness in sales and use, as well as corporate income, taxes, personal income tax revenues are above budget estimates.

The state originally identified a structural budget gap of $383 million for fiscal 2014. The enacted budget closed the gap with minor revenue adjustments and expenditure reductions ($271 million). There are no general fund tax increases included in the enacted budget. The state projects that its combined reserves at year-end fiscal 2014 will be $1.1 billion (6.9% of general fund revenues) compared to $1.3 billion at year-end fiscal 2013, reflecting the use of some of the general fund reserves to balance the budget.

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.

The state's debt burden remains moderate on both a per capita basis and relative to personal income, and we expect ratios to remain stable given the annual debt affordability process. Annual debt service as a percentage of expenditures to the budget is moderately high relative to state peers, in our opinion, but remains below the state's debt-affordability targets. Debt amortization remains rapid, with all GO bonds to be retired in the next 15 years, as the Maryland constitution requires.

In the past four fiscal years, the state's unfunded pension liability has grown significantly, in our view, due to a combination of investment losses and less-than-full funding of the annual required contribution (ARC). Various pension reform measures were implemented during the 2011 legislative session, including increased employee contributions and decreased cost of living adjustments. In addition, the state lowered certain benefits and increased vesting periods increased to 10 years from five for new employees in order to improve funding levels.

Based on the analytic factors we evaluate for states , on a scale of '1.0' as the strongest to '4.0' as the weakest, Standard & Poor's has assigned a composite score of '1.5' to Maryland.

Outlook

The stable outlook on Maryland reflects our view of the state's proactive budget management in recent years and the steady economic recovery underway, which has stabilized revenues and allowed for continued funding of reserves. Financial reserves and the pace of economic recovery will be important credit factors during the two-year outlook horizon given the current uncertainty relating to federal funding and Maryland's above-average economic dependence on federal government employment and spending. Standard & Poor's will continue to monitor the federal consolidation efforts and will evaluate their effect on the state's finances and officials' response. The state's below-average pension funded ratios continue to represent downside risk to the rating. Although the state has implemented various reforms, it does not fully fund its ARC, which, along with weak investment returns, has significantly lowered the funded ratio.

Government Framework

Maryland's constitution requires the state to approve balanced budgets each fiscal year and for its budgets to remain balanced. To help manage its budget and maintain adequate fund balances despite revenue decline, the governor is empowered by statute to adjust spending as needed if the Maryland Board of Revenue Estimates, which meets three times per year, reduces its initial revenue estimate upon which the budget is formulated. Such adjustments can only be made after first providing adequate provision for the payment of the principal and interest on state bonds and notes according to their terms. Maryland has considerable revenue-raising ability and can increase its income and sales tax rates and approve new revenues without voter approval. It also has a fair amount of budgetary flexibility regarding its expenditures. By law, the governor has the power, with the approval of the Board of Public Works, to reduce by not more than 25%, any appropriation that he might deem unnecessary, except appropriations for the payment of interest and the retirement of state debt, the legislature, the public schools, the judiciary, and the salaries of both public officers and permanent employees. When needed, the state has adjusted agency spending accordingly. Education aid is Maryland's largest expenditure item and accounted for about 50% of general fund expenditures in 2012.

Standard & Poor's assigned a score of '1.4' out of '4.0' to Maryland's government framework, in which '1.0' is the strongest score.

Financial Management: "Strong"

We consider Maryland's management practices strong under our FMA methodology. In our framework, an FMA of strong indicates that practices are strong, well embedded, and likely sustainable. Based on a review of several key financial practices, Maryland has made continuing efforts to institutionalize sound financial management practices. In reviewing its practices and policies, it was very apparent to us that the state's use of a five-year financial plan, which is updated annually with the adopted budget, provides the basis for future fiscal decisions and recognizes future fiscal-year gaps. Monthly monitoring and reporting of key revenues allows the state to make midyear financial adjustments, if necessary, to maintain balance. Maryland has consistently maintained its statutory "rainy day" fund at or above its legal minimum of 5% of revenues. Under current law, it can be increased to 7.5%. The state has a formal debt-management policy based on defined measurements, including debt as a percentage of personal income and debt service as a percentage of revenues, along with a statutory debt amortization schedule. Maryland produces a five-year capital improvement plan that outlines expected capital requirements and identifies funding sources. Its investment practices are conservative in our opinion and actively adhered to.

Once the budget is approved, the state monitors both revenue and expenditure performance on a regular basis and reports results in addition to updating its economic forecast. The state has historically implemented budget adjustments implemented on a timely basis. The governor has the authority to make adjustments to the budget and has a track record of doing so. Deficits can't be carried forward into the next fiscal year.

On a scale ranging from '1.0' (strongest) to '4.0' (weakest), Standard & Poor's assigned a '1.0' to Maryland's financial management.

Economy

Maryland's economy enjoys several fundamental strengths in Standard & Poor's view, including a diversified employment base that historically has expanded at a healthy pace. We believe the basic underpinnings of the economy will provide for adequate growth prospects into the future, but the importance of the federal government to the overall economy will likely affect the pace of growth in the near term. Maryland has exhibited stable population growth that has been in line with the national growth average in the past five years. Its population stood at 5.9 million in 2012, up 7.1% since 2002. Wealth and income levels have consistently been well above average, with per capita person income of $51,971 in 2012 representing a strong 122% of the U.S. level and ranking the state fifth in the country. This relative income advantage should continue given the highly educated work force.

The professional, business, education, and health services sectors, combined, make up the single largest job segment, accounting for about one-third of Maryland's total nonfarm employment in 2012. The government sector makes up 20% of employment. While a majority is state and local government employment, federal government employment represents 5.7%, compared with 2.2% for the U.S overall. Federal employment in the state is relatively diverse with an emphasis on health care, the sciences, and intelligence, which may help mitigate some risks of downsizing. Trade, transportation, and utilities (17%) and leisure and hospitality are the other major sectors. Manufacturing makes up a minimal 4.4% of the employment base, which is well below the national average of 8.9%. Construction job loss led the decline through the recent recession as the housing market deteriorated, but nearly all employment sectors declined with the exception of education, health services, and the federal government. Economic recovery has been slow and steady, and the state estimates that it has recovered more than 95.3% of the jobs lost through the recession. The state has historically enjoyed an unemployment rate that is consistently below the national average.

Significant economic development in the state has centered around key federal government installations, an established higher education and research presence, and a well-educated work force. About 37% of Maryland residents have a bachelor or graduate/professional degree compared with 29% for the U.S. Following the Base Closure and Realignment Commission process, the state estimates that more than 45,000 jobs moved into Maryland through 2011. While this had a positive effect on employment, it had a proportionately higher impact on wage growth because these jobs are high paying professional and business service positions with an average salary approaching or exceeding $70,000 annually. Adding to this is the continued expansion by the National Security Agency at Fort Meade, including the newly created U.S. Cyber Command. Some of these positive developments could be offset by sequestration. The state estimates that job losses under sequestration (a 10 year, $1.2 trillion reduction in federal funding) could range from 60,000 to more than 100,000. The Board of Revenue Estimates had assumed in its economic and revenue forecast that a compromise would be reached that mitigates the required spending cuts although federal spending would still have declined relative to a no-sequestration baseline. This will be revisited in September now that sequestration has occurred.

On a scale ranging from '1.0' (strongest) to '4.0' (weakest), Standard & Poor's assigned a score of '1.3' to Maryland's economy.

Budgetary Performance

The state's budgetary performance has been relatively stable in recent years despite the revenue decline associated with the recent recession. The state has consistently maintained the revenue stabilization account and has employed a balanced approach to address budget volatility, including revenue enhancement, spending reductions, cost shifting to local governments, and use of reserves. The state's revenue base is diverse, and it has adjusted certain tax rates since 2008 in order to enhance revenue collections.

Fiscal 2012 generally accepted accounting principle (GAAP) results

The state ended fiscal 2012 with a $263 million deficit on a GAAP basis. The total fund balance declined to $1.1 billion (4.2% of expenditures). The unassigned balance was negative $681 million or 2.7% of expenditures. The total fund balance has steadily declined since peak levels recorded in fiscal 2007 of $3.3 billion.

Fiscal 2013 results

The state expects to end fiscal 2013 with a slight increase in the fund balance despite a slight downward revision in revenues in March of this year. Revenue growth for fiscal 2013 was strong through May, with growth of 6.2% above fiscal 2012. The state had anticipated a surge in revenues due to federal tax policy changes and had adjusted revenues up significantly in January of this year, followed by the slight revision in March. Despite federal sequestration, steady economic recovery continues.

The 2014 budget also includes deficiency appropriations of $115.3 million for fiscal year 2013, which includes funds for social service costs, funding for school assessments, and for other liabilities. The ending balance on a budgetary basis for the fiscal year ending on June 30, 2013 is estimated to be $558 million, which compares favorably to $551 million at June 30, 2012. Total reserve funds, including the RSA, are estimated at $1.3 billion.

Fiscal 2014 budget overview

The BRE evaluated the federal fiscal cliff and outlined various scenarios in advance of establishing the revenue forecast for fiscal 2014. The state had assumed that the full impact of sequestration would be mitigated, an assumption they will re-visit this September when updating the revenue forecast with some additional downside risk possible based on sequestration. The total revenue impact from sequestration is currently $194 million for fiscal years 2013 and 2014 with a decline of $54 million in federal funds flowing to the state.

Total general fund revenues are estimated at $15.4 billion or 2.9% above fiscal 2013 estimated revenues. Revenues and transfers support appropriations of $16 billion, which is 4% above fiscal 2013. Spending for public education increases by 3.3% under the plan. Based on the current revenue forecast and spending reductions included in the enacted proposal, the out-year gaps through fiscal 2018 are nearly eliminated. Gaps range from $270 million in fiscal 2015 and declining to $195 million in fiscal 2016 with slight surpluses now forecast for fiscal 2017 and 2018. The state will expand Medicaid as outlined by federal health care reform. The budget is also based on successful negotiation of the federal waiver relating to its hospital reimbursement, which has been in place for decades. The budget allows for $87 million of funds originally earmarked for increasing the pension funded status to mitigate any impact from federal sequestration. If not needed for this purpose, the money will be directed to fund the pension.

Standard & Poor's assigned a score of '1.2' out of '4.0' to Maryland's budgetary performance, in which '1.0' is the strongest.

Debt And Liability Profile

The state's net tax-supported debt following this issuance is estimated at about $10.7 billion (excluding $479 million of GARVEE bonds). In our view, the tax-supported debt burden is moderate by all measures at $1,813 per capita, 3.5% of personal income, and 3.4% of gross state product. Debt service represents about 6.7% of state revenues, which we consider moderately high. However, tax-supported debt is amortized rapidly, with all GO bonds to be retired in the next 15 years (76% in 10 years), as required by the Maryland constitution. The governor's proposed capital budget for fiscal years 2014 through 2018 includes $5.5 billion in general obligation bond sale revenue. The Capital Debt Affordability Committee recommended to the governor and legislature a debt authorization of $1.075 billion for fiscal 2014, which is the same amount recommended for fiscal 2013. State-supported debt levels are projected to remain within the limitations established for debt to personal income (4%). The limit for debt service as a percent of revenue remains at 8% or less. Legislation was approved in 2013 that enhances funding for transportation purposes over a multiple year period. Sales tax rates on gas and special fuel will incrementally increase through fiscal 2018. This change, among others, initially provides $116 million of funding in fiscal 2014, increasing to $753 million through fiscal 2018. If taxation of internet sales is authorized by the federal government, the revenue is dedicated to this plan, and if not, contingent increases in sales tax have been authorized. The legislature also restricted the transfer of funds out of the transportation trust fund. The governor must declare a fiscal emergency, and the general assembly must approve the transfer by a three-fifths majority.

The Maryland State Retirement and Pension System recorded an unfunded actuarial accrued liability of $19.6 billion as of June 30, 2012. The pension funded ratio was 63.5%, which we consider to be below average. This is a decline from the funded ratio of 80.4% recorded in fiscal 2007. Like many public pension funds, the stock market decline affected investment performance. The current assumed investment return assumption is 7.75%, which has not always aligned with the actual investment returns of 4.13% (five year), 8% (10 year), and 6.84% (20 year). Returns over the past 25 years are slightly higher, at 8.05%. In 2013, the pension board authorized a phased reduction of the earnings estimate to 7.55% from 7.75%.

The decline in the funded ratio is also attributable to contributions below the ARC for the past four years based on the current statutory funding requirement. In fiscal 2012, the state funded only 67.5% of its ARC. Legislation was approved in 2013 that phases out the current corridor funding method over 10 years and replaces it with a 25 year closed-end amortization. The adopted 2012 budget plan included reforms to the Teachers' and Employees' Pension System. The approved reforms affect both current and new employees. For both current members, as of June 30, 2011, and new hires after that date, the contribution rate will increase to 7.00% from 5.00%, and the cost-of-living adjustments will be capped at 2.50% if the assumed rate of return (7.75%) for investments in the previous year is achieved and 1.00% if it is not met.

For new employees, the annual benefit multiplier will be 1.5%, and average final compensation will be calculated using the highest five consecutive years. An employee must have 10 years of service before being vested. Normal service retirement age will be raised to age 65 from 62; however, members could retire if the sum of age and eligibility service equals 90 and receive full benefits. Early retirement age will be raised to age 60 and 15 years of eligibility service from age 55 with 15 years of eligibility service.

Based on the reforms, including those enacted in 2013, the state's actuary projects that the system will be 80% funded by 2025, and it will achieve full funding by 2038.

As of June 30, 2012, the actuarial accrued OPEB unfunded liability was $9.4 billion. The ARC was $704.4 million in fiscal 2012. Maryland funded 53% of the annual pay-as-you-go costs of OPEB in fiscal 2012. This liability is lower than the $15.9 billion recorded prior to the health care benefit reforms approved by the general assembly in 2011. The reforms included increased premium payments and prescription drug copayments. We believe that the reforms should moderate future cost pressure. For fiscal 2013, the state estimates a lower ARC $634.5 and the pay-go contributions increased to 60.6% of the ARC. Chapter 355 of the Laws of 2007 created the postretirement Health Benefits Trust Fund as an irrevocable trust. The amount held in trust for OPEB as of June 30, 2012 was $207 million.

Standard & Poor's assigned a score of '2.8' out of '4.0' to Maryland's debt and liability profile, in which '1.0' is the strongest.

Related Criteria And Research

- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- USPF Criteria: Financial Management Assessment, June 27, 2006
- State And Local Government Ratings Are Not Directly Constrained By That Of The U.S. Sovereign, Aug. 8, 2011
- U.S. State And Local Government Credit Conditions Forecast, July 8, 2013

Ratings Detail (As Of July 12, 2013)		
Maryland GO bnds		
Long Term Rating	AAA/Stable	Affirmed
Maryland GO bnds		
Long Term Rating	AAA/Stable	Affirmed
Maryland GO bnds		
Long Term Rating	AAA/Stable	Affirmed
Maryland GO bnds		
Long Term Rating	AAA/Stable	Affirmed

Ratings Detail (As Of July 12, 2013) (cont.)		
Maryland GO tax-exempt rfdg bnds		
Long Term Rating	AAA/Stable	Affirmed