MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aaa to $1.268B of Maryland GO bonds; outlook stable

State has $8.97 billion GO debt outstanding with this sale

MARYLAND (STATE OF)
State Governments (including Puerto Rico and US Territories)
MD

Moody's Rating

ISSUE		RATING
General Obligation State and Facilities Loan of 2015, First Series B Tax-Exempt Refunding Bonds		Aaa
Sale Amount	$750,000,000	
Expected Sale Date	03/04/15	
Rating Description	General Obligation	
General Obligation State and Local Facilities Loan of 2015, First Series A Tax-Exempt Bonds		Aaa
Sale Amount	$518,000,000	
Expected Sale Date	03/04/15	
Rating Description	General Obligation	

Moody's Outlook STA

NEW YORK, February 19, 2015 --Moody's Investors Service has assigned a Aaa rating to the State of Maryland's General Obligation State and Local Facilities Loan of 2015, First Series. The borrowing consists of $518 million in tax-exempt bonds (First Series A) and $750 million in tax-exempt refunding bonds (First Series B), both to be sold competitively. The bonds are expected to sell March 4.

SUMMARY RATING RATIONALE

The highest quality rating reflects Maryland's strong financial management policies and stable economy with high personal income levels. The rating also acknowledges the state's economic exposure to constrained federal spending, its above average debt burden and large unfunded pension liabilities relative to the size of its economy.

OUTLOOK

The outlook for Maryland's general obligation debt is stable. Consistent with its history of strong financial management, the state has been appropriately addressing its structural budget gap and pension funding concerns even under pressure from federal budget reductions.

WHAT COULD MAKE THE RATING GO UP

- Maryland's Aaa rating is at the highest level.

WHAT COULD MAKE THE RATING GO 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, including failure to take actions to reverse its negative fund balance

-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

-Downgrade of the US government

STRENGTHS

-History of strong financial management

-Strong economy with high personal income levels

-Adequate reserve levels despite recent draws

CHALLENGES

-Continuing budget pressure

-Low retirement system funded levels

-Above average debt burden

-Reliance on federal jobs in era of retrenchment

RECENT DEVELOPMENTS

Recent developments are incorporated in the detailed rating rationale.

DETAILED RATING RATIONALE

ECONOMY: FEDERAL CUTBACKS A DRAG ON MARYLAND ECONOMY

MARYLAND JOB GROWTH LAGS NATION

While not suffering as deep a recession, Maryland's economy lags the nation in response to federal spending cutbacks. Federal jobs account for more than 5% of Maryland employment, compared to about 2% nationally. The state's job growth has diminished, from 1.3% in 2012 to 0.6% in 2014. On the plus side, the state's unemployment rate averaged 5.8% in 2014 compared to 6.2% nationally. The impact of federal sequestration may be tapering off, reducing this source of drag on state economic and revenue growth.

The December Bureau of Revenue Estimates (BRE) meeting resulted in less optimistic economic forecasts than those developed earlier in 2014. Employment growth forecasts dropped to 1.1% in 2015 and 1.3% in 2016 compared to the previous 1.8% for both years. Personal income growth is projected to gain slow momentum, growing to 3.8% in 2015 from 1.1% in 2013. The forecasts are somewhat conservative compared to those of major forecasting firms. BRE's forecasts are the outcome of the state's binding consensus revenue forecasting process.

With a population of just 5.9 million, Maryland's 2014 per capita personal income of $53,826 is 120% greater than the national average of $44,765. In addition to a large percentage of well-paid residents employed by the federal government, Maryland has an economic concentration in industries such as information and business and professional services, where college and advanced degrees are more frequently required than in some other sectors.

FINANCES AND LIQUIDITY

Audited Financial Position Negative in 2014

On an audited GAAP basis, the state's available balances dipped into negative territory in 2014. The state's unassigned fund balance - those funds that are not otherwise restricted or committed - has been negative since the state applied revised accounting standards in fiscal 2011. Unassigned balances deteriorated from -$292 million at the end of fiscal 2011 to -$916 million at the end of fiscal 2014. This amount is less than offset by the amount in the revenue stabilization account (RSA), leaving the state's GAAP-basis net available funds at negative $152 mllion at the close of fiscal 2014, or less than -1% of revenues. By contrast, during the previous decade the state built its GAAP-basis available balances to nearly $2.3 billion in 2007, a cushion of more than 15% of revenues.

The negative unassigned balance stems largely from a transfer of local income tax reserves to the state general fund for budget balancing purposes. While the state often employs this mechanism to manage its budget, it typically repays the transferred amounts in subsequent years. However the state legislature opted to forgo repayment of certain transfers resulting in the negative fund balance. Negative balances for uncommitted funds are atypical of Aaa-rated states except during recession.

On a cash basis, the state's position is more favorable. The Revenue Stabilization Account (RSA) account was $764 million as of the close of fiscal 2014, 5% of general fund revenues. The state has maintained the RSA at the 5% target since 2012. On a budgetary basis, the state expects to end fiscal 2015 with cash balances of $823 million, which includes a $37 million general fund ending balance.

State Making Adjustments to Fiscal 2015 Budget; Proposal for Fiscal 2016 Presented By Governor

Revenue collections have fallen short of expectations for several BRE projection cycles, prompting the BRE in December to cut its 2015 and 2016 revenue estimates by a total of roughly $270 million. Taking into account a previous downward revision of $177 million along with other adjustments, the state's mid-year 2015 shortfall is $423 million, growing to a gap of $802 million in 2016.

Through a mix of actions including those by the Board of Public Works (BPW), consisting of the governor, the comptroller, and the treasurer, Governor Hogan proposes to close the current year gap with roughly $300 million in spending reductions and about $160 million in revenues and transfers. Transfers include another loan from the local income tax reserve that would be repaid in 2016. The BPW is granted significant authority to make spending adjustments when the legislature is not in session, which we view as an important credit strength.

Contributing to the budget gaps are unexpectedly large increases in Medicaid enrollment stemming from the implementation of the Affordable Care Act, a shortfall in video lottery terminal revenues and other miscellaneous items.

Spending growth overall is driven by several factors, including growing Medicaid enrollment, the education funding formula and debt service. Because of the sluggish housing market, growing debt service costs cannot be paid entirely from the statewide property tax, requiring growing supplemental resources from the general fund.

The governor's executive budget proposal for fiscal 2016 seeks to reduce spending growth across the board. The proposed $766 million in spending actions comprise the bulk of the executive's program to balance the budget and eliminate a structural gap that the state has struggled to eliminate for a decade. The proposals include medical provider rate reductions, agency cuts and cuts to employee compensation and would result in spending growth 2.4%, less than projected revenue growth of 3.5%.

The proposals are expected to be extensively debated by the General Assembly.

Liquidity

Although the state's general fund budgetary cash position has deteriorated, its liquidity is bolstered by unfettered access to the state's short-term investment pool. The average end-of-month balance in the pool in fiscal 2014 was nearly $6 billion, or about 40% of revenues.

DEBT AND PENSIONS

Maryland's debt levels relative to 50-state medians are high. Moody's 2014 State Debt Medians ranks Maryland eighteenth for debt as a percent of personal income and fourteenth 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.

Debt Structure

The state's tax-supported debt will total $11.8 billion with this sale. The state's debt consists primarily of general obligations bonds (75%) and consolidated transportation revenue bonds (15%). The remaining debt consists of GARVEEs, lease commitments and bay restoration bonds. Maryland has about $54.7 million of outstanding variable rate debt that was issued by the Maryland Stadium Authority for baseball stadium improvements.

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. Even so, despite its high debt burden the state ranked 22nd in debt service as a percent of pledged revenue in our 2014 State Debt Medians report.

Debt-Related Derivatives

Maryland has no derivatives in relation to tax-supported debt.

Pensions and OPEB: State Gradually Reduced Pension Burden and Controls OPEB

The financial condition of Maryland's retirement system represents a credit challenge for the state. The state's reported funded ratio is 68.7% for fiscal 2014, representing a reported unfunded liability of $19.6 billion. The state's three-year average Moody's adjusted net pension liability (ANPL) through fiscal 2012 is $38 billion, or 132% of governmental revenues. The state's pension burden as measured by this metric is 7th highest of the 50 states and significantly more than twice the median of 52%. Our adjustments to reported state pension data include a common 20-year amortization period, as well as an assumed 13-year duration of plan liabilities and a market-based discount rate to value the liabilities, rather than the long-term investment return used in reported figures. Our adjusted liability amounts currently exclude the state's two smaller plans, for legislators and judges.

Contributing to the state's large net pension liability are asset losses associated with the financial crisis and the enactment in 2002 of a corridor funding method that resulted in contributions less than actuarially required when the pension system has a funded ratio of less than 90%.

The state has taken a number of measures to reduce its pension burden. Reforms in 2011 to both pension and retiree health (OPEB) plans reduced the pension liability by more than $400 million and halved the OPEB liability.

The pension reform was coupled with statutory requirements to allocate a portion of the resulting annual savings to make additional payments to the plan. In 2012, the state enacted legislation to shift over four years the responsibility for paying the normal cost of teacher pension to local governments, saving roughly $100 million in the first year of implementation.

In 2013 legislative session, the General Assembly enacted a bill to phase out the corridor funding method over a 10-year period by increasing the rate at which contributions increase while continuing to make supplemental contributions. The 2014 enacted budget reduced the amount of additional contributions to the plan for gap-closing purposes, delaying the target date at which the system would reach full funding. Investment returns in recent years have been greater than actuarially assumed, accelerating the amortization schedule for the pension's unfunded liabilities but potentially providing an additional opening for the legislature to again reduce the supplemental contributions to the system.

In contrast to growing pension contributions, OPEB annual required contribution (ARC) declined to $580 million in 2014 from $634 million as the state realizes the benefits of its reforms to retiree health benefits enacted in 2012. While the state established a trust fund to accumulate assets to offset accrued OPEB liabilities, it does not regularly contribute to it and instead pays for current benefits on an annual basis. As of June 30 2014, the fund held $250 million in assets to offset $8.9 billion in liabilities.

GOVERNANCE

Maryland's financial practices and flexibility are very strong. For example, the state has a binding consensus revenue forecast, multi-year financial planning, and the Board of Public works is able to respond swiftly to mid-year budget challenges. The state also has no tax and spending limitations or supermajority requirements limiting its flexibility.

KEY SCORECARD STATISTICS

Per capita income relative to U.S. average: (121.8%)

Industrial diversity (1=most diverse): (0.83)

Employment volatility (U.S.=100): (72)

Available balances as % of operating revenue (5-yr. avg.): (1.7%)

NTSD/total governmental revenue: (35.6%)

3-year avg. adjusted net pension liability/total governmental revenue: (137.1%)

OBLIGOR PROFILE

Maryland is the 19th largest state by population, at 5.98 million. Its state gross domestic product is 15th largest. The state has above-average wealth, with per capita personal income equal to 122% of the US level. The state has the 5th lowest poverty rate among states.

LEGAL SECURITY

The bonds are a general obligation of the state, secured by its full faith and credit.

USE OF PROCEEDS

The proceeds of the First Series A bonds will be used for various public purposes of the state. The proceeds of the First Series B bonds will be used to advance refund certain outstanding general obligation bonds for debt service savings.

RATING METHODOLOGY

The principal methodology used in this rating was US States Rating Methodology published in April 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

Analysts

Marcia Van Wagner
Lead Analyst
Public Finance Group
Moody's Investors Service

Nicholas Samuels
Additional Contact
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653

Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
USA

MOODY'S
INVESTORS SERVICE