Summary:
St. Mary's County, Maryland; General Obligation

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Credit Profile

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Rationale

S&P Global Ratings assigned its 'AA+' rating to St. Mary’s County, Md.’s, series 2018 public improvement general obligation (GO) consolidated public improvement bonds. At the same time, S&P Global Ratings affirmed its 'AA+' rating on the county's existing GO debt. The outlook is stable.

The bonds are a GO of the county, secured by its full-faith-and-credit pledge. Proceeds from this issue will fund various capital projects.

In our opinion, the rating reflects the county's:

- Strong economy, with projected per capita effective buying income at 122% of the national level and market value per capita of $112,052;
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2017;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 22% of operating expenditures;
- Very strong liquidity, with total government available cash at 35.5% of total governmental fund expenditures and 8.0x governmental debt service, and access to external liquidity we consider strong;
- Very strong debt and contingent liability profile, with debt service carrying charges at 4.5% of expenditures and net direct debt that is 44.3% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of market value and rapid amortization, with 65.3% of debt scheduled to be retired in 10 years; and
- Very strong institutional framework score.

Strong economy

We consider St Mary's County's economy strong. The county has an estimated population of 112,908. The county has a projected per capita effective buying income of 122% of the national level and per capita market value of $112,052. Overall, market value grew by 1.8% over the past year and totals $12.7 billion for fiscal 2019. The county unemployment rate was 4.0% in 2017.
St. Mary’s County is situated on a peninsula in southern Maryland and bounded by the Patuxent River, the Chesapeake Bay, and the Potomac River. Although it is not technically a part of the Washington D.C. metropolitan statistical area (MSA), the northern portion of St. Mary's County is located about 40 miles southeast of the capital and residents have direct access to employment opportunities throughout the county and the Washington MSA. The Naval Air Station Patuxent River (Pax River) is the county's largest employer and anchors the area economy. Pax River is headquarters for the Naval Air Warfare Center Aircraft Division and Naval Air Systems Command, and more than 50 other tenant commands. The military installation employs about 25,000 people and continues to foster growth, particularly in the form of additional defense, engineering, and technology jobs.

Non-defense industry-related economic development also continues at a modest pace. Projects include the expansion of the county airport, and technology-related and retail developments. The county's health care and higher education component remains stable, with St. Mary's Hospital, which recently merged with MedStar Health, and the College of Southern Maryland and St. Mary's College continuing facility expansions. St. Mary's County continues to promote its tourism sector as well. Historically, the county unemployment rate has been below state and national averages.

As a result of ongoing development and property revaluations, the county's tax base has experienced consistent growth of almost 2% annually over the past decade, increasing to an estimated $12.7 billion in fiscal 2019. There is no concentration in the tax base, with leading taxpayers accounting for just 3.6% of total assessed value (AV).

**Very strong management**

We view management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Highlights include the use of historical trend analysis for budget preparation and looking back three to four years for both revenues and expenditures. Budget-to-actuals are monitored monthly with reports provided to the board monthly from all eight departments. In our opinion, the reports are detailed in nature but are not all inclusive with finances. The county adopted a five-year formal long-term financial plan in 2017 that it updated in fiscal 2018. Management indicates it will continue to update its long-term financial projections on an annual basis. St. Mary's County maintains a six-year rolling capital improvement plan (CIP) that identifies all projects and funding sources. It also maintains its own investment policy. Investments and performance are monitored monthly, with reports provided to the board monthly. The county's formal debt management policy requires total debt not to exceed 2.15% of AV or debt service expenditures above 10% of the general fund budget. The county's formal reserve policy requires a minimum 15% of general fund revenues, consisting of the bond rating fund (6% of revenues), the rainy-day fund, and the unassigned general fund. In addition, St. Mary's has a make-up provision requiring replenishment of reserves over one to three years.

**Strong budgetary performance**

St Mary's County's budgetary performance is strong, in our opinion. The county had operating surpluses of 2.4% of expenditures in the general fund and of 2.5% across all governmental funds in fiscal 2017 after accounting for bond proceeds used to fund capital expenditures.

In fiscal years 2013-2016, the county spent some of its excess general fund reserves to address one-time pay-as-you-go capital projects in lieu of long-term financing. However, the county has increased the fund balance in fiscal years 2017
and 2018, according to audited and unaudited results, respectively.

St. Mary's County increased general fund reserves by $8.2 million because of a strong operating surplus for the year, as well as a $3.0 million transfer to the general fund from the capital projects fund for reimbursement of previously used pay-as-you-go funds from the general fund. Management attributes the surplus to conservative budgeting and continued good revenue growth.

Officials estimate fiscal 2018 will close with an approximately $6.0 million operating surplus, which management expects to add to total available reserves. The county indicates fiscal 2018 was similar to the previous year and that the surplus is mainly attributable to conservative budgeting, and increased property and income tax revenues. Total reserves (including the unassigned general fund balance, the bond reserve fund, and the rainy day fund) are projected to equal about $52 million or 23.4% of budget at fiscal 2018 yearend.

The adopted fiscal 2019 budget represents a 4% increase from the previous year and totals $230.2 million. The county budgeted for 2% increases in both property and income tax revenues due to continued growth, because the property and income tax rates remained unchanged for the year. Management also budgeted almost $2.0 million in pay-as-you-go capital expenditures for the year. Nevertheless, management indicates it expects to end the year with at least break-even operations.

Property taxes accounted for about half of total general fund revenues in fiscal 2017, followed by income taxes at 40%, with both sources showing consistent growth over the past five years. In addition, St. Mary's County maintains significant taxing flexibility, in our view, given the county's income tax rate of 3.0% is well below the 3.2% maximum and its property tax rate of 84.78 cents per $100 of AV is well below peers' in Maryland. The county has not increased its property or income tax rates in many years.

**Very strong budgetary flexibility**

St Mary's County's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 22% of operating expenditures, or $47.4 million.

The county's available reserves consist of unassigned and assigned general fund reserves as well as the committed portion of the general fund, which consists of the rainy-day reserve and bond rating reserve.

With the projection of a $6.0 million surplus for fiscal 2018 and a balanced budget for fiscal 2019, in addition to the county's fund balance policy, we expect total available reserves to remain very strong, above 20% of expenditures for the foreseeable future.

**Very strong liquidity**

In our opinion, St Mary's County's liquidity is very strong, with total government available cash at 35.5% of total governmental fund expenditures and 8.0x governmental debt service in 2017. In our view, the county has strong access to external liquidity if necessary.

In our view, the county has had strong external access to liquidity, issuing GO debt, when required, over the past 20 years. The county does not hold any investments we deem aggressive.
St. Mary's County maintains some privately placed equipment leases with TD Equipment Finance Inc. and Banc of America Public Capital Corp., currently totaling about $7.7 million in principal outstanding for both governmental and enterprise purposes. While some of the events of default associated with these leases may be viewed as permissive, given the county's very strong liquidity and available reserves, we do not believe these private placements, or any of the county's other financial instruments, pose a material contingent liquidity risk.

**Very strong debt and contingent liability profile**

In our view, St Mary's County's debt and contingent liability profile is very strong. Total governmental fund debt service is 4.5% of total governmental fund expenditures, and net direct debt is 44.3% of total governmental fund revenue. Overall net debt is low at 0.8% of market value, and approximately 65.3% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

The county's six-year CIP totals $296.3 million, about half of which management expects to fund with additional debt issuances. We understand the county could issue about $30 million of additional new money GO debt following this issuance within the next 12-18 months to finance various capital needs. Despite the possible issuance and increase in debt service costs, we do not expect this to negatively affect St. Mary's debt and liability factor score, considering its rapid amortization schedule.

St Mary's County's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 4.4% of total governmental fund expenditures in 2017. Of that amount, 3.1% represented required contributions to pension obligations, and 1.3% represented OPEB payments. The county made its full annual required pension contribution in 2017.

The county participates in the state-administered pension plan, as well as the county's Sheriff's Office Retirement Plan. The county funds the full annual required contribution for both pension plans.

The funded ratio of the state-administered pension plan was 69.4% as of June 30, 2017. The county's proportionate share of the net pension liability is $23.6 million. The Sheriff's plan net pension liability was $42.2 million as of June 30, 2016. The Sheriff's plan was 65.0% funded.

St. Mary's County provides OPEB to eligible employees. Although the county has an established OPEB trust, which it has historically contributed to, it did not contribute to it in fiscal years 2016 or 2017, but rather made the pay-as-you-go portion. This decision was made mainly to rebuild reserves and for tax relief purposes. Due primarily to the strong funding level, at 68.5% in fiscal 2017, the county only made the OPEB pay-as-you-go contribution in fiscal 2018 and budgeted for only the pay-as-you-go portion in the fiscal 2019 budget. The unfunded actuarial accrued liability totals $31.9 million.

**Very strong institutional framework**

The institutional framework score for Maryland counties is very strong.

**Outlook**

The stable outlook reflects our opinion of the county's large and diverse property tax base that will likely continue to
experience good growth due, in part, to the Pax River Naval Air Base within its borders, as well as a stable health care and education base. We believe St. Mary's County will likely maintain what we consider its very strong budgetary flexibility and liquidity, as well as strong budgetary performance, supported by well-embedded fiscal policies and practices. As a result, we do not expect to change the rating within the two-year outlook horizon.

**Upside scenario**
If St. Mary's County were to experience continued improvement in its economic metrics, as well as positive financial operations, and increased reserves to levels more commensurate with higher rated peers’, holding all other factor scores constant, we could raise the rating.

**Downside scenario**
Although unlikely in our opinion, if the county were to experience significant fiscal pressures and reserves were used to bridge any imbalances, either for capital or operations, we could lower the rating.

**Related Research**

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- 2017 Update Of Institutional Framework For U.S. Local Governments

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.