Fitch Ratings

FITCH AFFIRMS ST. MARY'S COUNTY, MD $84 MILLION ULTGO'S AT AA+; OUTLOOK STABLE

Fitch Ratings-New York-22 October 2013: Fitch Ratings has affirmed the following rating for St. Mary's County, MD (the county):

--Approximately $83.9 million outstanding unlimited tax general obligation bonds at 'AA+'.

The Rating Outlook is Stable.

SECURITY

The bonds are general obligations of the county, and its full faith and credit and unlimited taxing power are irrevocably pledged to repayment of the bonds.

KEY RATING DRIVERS

ECONOMIC BASE CONCENTRATED IN MILITARY: Local employment is centered on the Naval Air Station Patuxent River (NAS). The high concentration in the government and military sector exposes the county to risks arising from potential defense and other federal spending reductions. These risks are mitigated in part by the recognized essentiality of these facilities.

LOW DEBT WITH RAPID AMORTIZATION: Continued strong control of capital expenditure growth is expected to result in continued moderate overall debt levels. Debt amortization is above average.

HEALTHY RESERVES AND BUDGETARY FLEXIBILITY: Reserve levels and financial flexibility remain sound, supported by prudent fiscal policies and planning. Reserve levels somewhat compensate for the limited economic base.

RATING SENSITIVITIES

MILITARY AND FEDERAL GOVERNMENT REDUCTIONS: The rating is sensitive to shifts at the NAS that would diminish its centrality as the economic engine for the county. Also, notable federal budget reductions could result in the softening of the regional economy given the preponderance of direct and indirect federally funded employment. Fitch would not expect changes in federal and military funding to be sufficiently severe as to alter the credit fundamentals.

CREDIT PROFILE

St. Mary's County is located in the southern part of Maryland bordering the Patuxent and Potomac Rivers as well as Chesapeake Bay. The county's 2012 population of 108,987 is among the fastest growing in the state, at 21% over the past decade. The county's population levels reflect in part the expansions at the NAS.

EMPLOYMENT BASE CONCENTRATED IN MILITARY SECTOR

The NAS is a significant factor in the local economy with over 22,000 workers, nearly one-half of whom are civilian personnel. The overall strategic importance of the NAS is expected to remain high, somewhat tempering potential program cancellations and cuts at the federal level. During the recent federal shutdown 2,000 NAS employees were furloughed, although most returned the following week.

Other major county employers include St. Mary's Hospital, a 96-bed full service facility with over 1,200 employees. An emphasis on tourism and outdoor activity over the past few years is evidenced by steady average annual growth of 6.6% in the county's accommodations tax between fiscals 2009 and 2013. The county intends to open a new Navy Museum within the next year.

County average annual employment growth over the past ten years has been a steady 1.6%, helping to maintain unemployment rates, 6.6% in July 2013, below state and national averages; for July 2013, the county unemployment rate was 6.6% compared to the state (7.0%) and nation (7.7%). Per capita income levels are 20% higher than the U.S. in part due to a cluster of higher wage technology jobs in the area.

Like all Maryland municipalities, the county benefits from a triennial assessment practice which smoothes annual volatility in tax base performance. The county adopted a homestead percentage of 105%, which means that assessments on certain owner occupied residential property may not increase by more than 5% in any given year. Growth in excess of 5% is credited, or 'banked', and can be used to offset future tax base declines. Significant banked tax base growth coupled with relatively mild tax base declines has permitted the county to maintain consistent property tax collections.

HIGH FINANCIAL FLEXIBILITY AND RESERVES A CREDIT STRENGTH

Additions to sound reserves and sustained financial flexibility reflect the county's strong financial management. The county has consistently preserved a separate bond rating reserve of around 6% of general fund expenditures ($12.2 million in 2013) and a rainy day fund of $1.625 million. The bond rating fund is set by formal debt policy but can be utilized subsequent to a simple majority vote of the County Commissioners.

The county concluded fiscal 2012 with a $13.5 million general fund surplus, equal to 7.1% of spending. With the surplus, the unrestricted fund balance for fiscal 2012 equaled a healthy 31% of general fund spending, including the rainy day fund. Estimated year-end 2013 results indicate that the county will realize another operating surplus due in part to better than budgeted tax revenues and continued expenditure control.

The fiscal 2014 budget includes revenue increases of 5.2%, compared with the fiscal 2013 approved budget. The 2014 budget focuses on expenditure efficiency, includes a small $523,000 fund balance appropriation for one-time expenses related to operations, and $12.9 million of fund balance appropriation for non-recurring costs. Expenditures are budgeted to increase commensurate with revenues.

Property tax collections, which comprise about one-half of the revenue stream, have increased an average of 6.5% annually since fiscal 2008. The county's property tax rate is not subject to a cap or limitation on annual growth. The current rate of $0.857 per $100 assessed value (AV) is among the lowest in the state and has not been raised over the past eight years.

The county's income tax collections, which constitute 37.6% of revenues, have experienced an average annual growth rate of 5% between fiscal 2008 and fiscal 2012. The income tax rate is subject to a statutory cap of 3.2%. The county currently falls below this with a rate of 3.0%, providing revenue flexibility.

LOW DEBT LEVELS

The county has carefully managed its capital program spending and issuance of debt, leading to low overall debt levels at $989 per capita and 0.8% of market value. Also, amortization is rapid at 80.2% within ten years and debt service represents a low 6% of governmental spending.

The county has adopted a fiscal 2015-2019 capital improvement plan totaling $195 million, led by $73 million for public school projects and $44 million for public facilities projects. Funding sources include approximately $77 million from federal sources and $90 million in tax-supported bonds, with the county projected to issue approximately $30 million in fiscal 2015 and $20 million issued annually for fiscal 2016 -2018. The borrowings will result in only a modest up-tick in debt servicing costs.

Long-term liabilities related to employment benefits are not expected to pressure future operations. The county provides pension benefits to its employees through participation in the state plan. The county has consistently contributed 100% of the annual required contribution. The funding of the state pension has deteriorated in recent years, with a June 30, 2012 adjusted funded ratio of 57.7%. Although local contributions have not increased, the state has instituted cost shifts to address underfunding in its teacher's pension system, which the county funded and has built into its recurring costs. Should the county be required to increase its contribution in the future, Fitch is confident that the county will be able to respond easily due to its prudent financial practices, with minimal impact to the county's debt profile.

The county also provides other post-employment benefits (OPEB) to its retirees. As of 2012, the unfunded actuarial accrued liability associated with the county's OPEB obligation totaled 0.4% of market value. The county established an OPEB trust in fiscal 2009 and has almost achieved full funding of the annual required contribution (ARC). Total carrying costs consisting of debt service, total pension ARC, and the county's actual OPEB contribution, are a low 12.3% of spending.

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In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial Associates, S&P/Case-Shiller Home Price Index, IHS Global Insight, National Association of Realtors.

Applicable Criteria and Related Research:
--'Tax-Supported Rating Criteria' (Aug. 14, 2012);
--'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

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http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314
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