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Howard (County of) MD

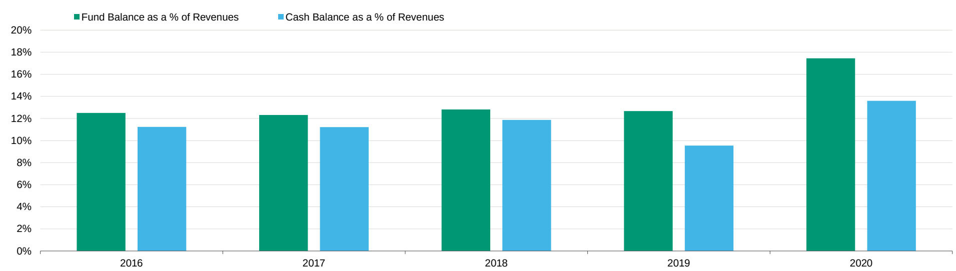
Update to credit analysis

Summary

Howard County (Aaa stable) benefits from its proximity to the Baltimore-Washington metro area and Fort Meade, and is experiencing moderate economic and employment growth. As a result of increasing development, the county's revenue base is growing, which will support its adequate financial position. The county has historically maintained reserve levels below the Aaa-median, however, due to strong budgeting practices and adherence to formal fiscal policies, its financial position is likely to remain stable.

As business activity and population increase, additional infrastructure investment, particularly for the schools, general county facilities, water, and wastewater utilities is becoming increasingly important. Consequently, because of management's plans to address capital needs with additional debt, Howard County's debt burden will increase.

Exhibit 1
Historically stable financial position
Fiscal 2016-2020



Source: Howard County, MD & Moody's Investors Service

Credit strengths

- Large tax base with strong institutional presence and proximity to the Baltimore Washington metro area
- Above average wealth and income levels
- Management team practices conservative budgeting and maintains formal fiscal policies

Credit challenges

- Reserve levels markedly below the Aaa median
- Reliance on economically sensitive revenues

» Growing debt burden

» Employment closely linked to US government

Rating outlook

The stable outlook reflects the likelihood that the county's financial position will remain sound given management's adherence to formal fiscal policies. Any deviation from current projections or any additional declines in reserves going forward could result in negative credit pressure. The outlook also reflects future growth in the county's base given ongoing commercial and residential development spurred by proximity to the District of Columbia (Aaa stable) and the institutional presence of Fort Meade, which employs approximately 15,000 Howard County residents.

Factors that could lead to an upgrade

» Not applicable

Factors that could lead to a downgrade

» Declines in general fund reserves and liquidity

» Tax base erosion

» Material increase in debt burden resulting in strained financial position

» Downgrade of the U.S government's Aaa rating

Key indicators

Exhibit 2

Howard (County of) MD	2016	2017	2018	2019	2020
Economy/Tax Base					
Total Full Value ($000)	$47,641,613	$49,626,809	$51,518,005	$53,412,616	$55,178,323
Population	308,447	312,495	315,327	318,855	321,000
Full Value Per Capita	$154,456	$158,808	$163,380	$167,514	$171,895
Median Family Income (% of US Median)	194.0%	190.9%	189.1%	187.4%	187.4%
Finances					
Operating Revenue ($000)	$1,052,250	$1,035,960	$1,070,909	$1,111,661	$1,193,842
Fund Balance ($000)	$131,497	$127,649	$137,266	$140,876	$208,343
Cash Balance ($000)	$118,281	$116,288	$127,055	$106,141	$162,237
Fund Balance as a % of Revenues	12.5%	12.3%	12.8%	12.7%	17.5%
Cash Balance as a % of Revenues	11.2%	11.2%	11.9%	9.5%	13.6%
Debt/Pensions					
Net Direct Debt ($000)	$1,142,887	$1,192,690	$1,294,175	$1,329,546	$1,341,472
3-Year Average of Moody's ANPL ($000)	$680,139	$687,858	$763,382	$820,928	$861,725
Net Direct Debt / Full Value (%)	2.4%	2.4%	2.5%	2.5%	2.4%
Net Direct Debt / Operating Revenues (x)	1.1x	1.2x	1.2x	1.2x	1.1x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	1.4%	1.4%	1.5%	1.5%	1.6%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	0.6x	0.7x	0.7x	0.7x	0.7x

Source: Howard County, MD & Moody's Investors Service

Profile

Howard County is located between the City of Baltimore (Aa2 stable) and the District of Columbia and has a population of approximately 321,000

Detailed credit considerations

Economy and tax base: strategically located tax base with moderate growth; stability from significant institutional and military presence

Howard County's tax base will experience moderate growth because of economic expansion and diversification related to the presence of Fort Meade, as well as its favorable proximity to the Baltimore-Washington metropolitan area. The county's full value increased 3.3% in fiscal 2020 to reach $55.2 billion, and the five year compound annual growth rate was 3.8%. The statewide requirement to phase in reassessment related tax base growth over a three-year period helps to balance growth in the county. Additionally, the homestead tax credit, which limits the county's ability to capture homestead appreciation for annual tax levy purposes to 5%, allows pent up growth to smooth tax base levels during periods of declines or stagnation. The county's full value is comparable to the national Aaa-median of $51.3 billion. Future growth will be driven by continued residential, commercial, and industrial developments throughout the county.

Fort Meade, the state's largest employer and second largest army installation within the US, is located less than two miles from the county line in adjacent Anne Arundel County (Aa1 stable). The fort currently employs approximately 55,000 employees (15,000 within the county), and tenant organizations include U.S. Cyber Command and the National Security Agency (NSA). Due to this proximity, Howard County benefits from capital investment and economic growth. Current expansion activity at the Fort, primarily roadway and barracks projects, total $344 million (about 42% funded) and will likely add 3,500 jobs between fiscal 2019 and 2024. The East (Cyber) Campus at Fort Meade is also planning a $1.8 billion expansion, and funding sources are currently being determined. The county also provides up to five million gallons per day of reclaimed water to cool the supercomputers on Fort Meade's campus, which began in fiscal 2016.

The county's low unemployment rate of 4.9% in November 2020 is still below both the state (6.6%) and national (6.4%) levels, reflecting a strong and underlying local economy in spite of the ongoing coronavirus pandemic. Resident wealth levels are strong, with 2019 median family income of $144,807 (187.4% of US and 140.4% of MD) representing the highest in the state. Full value per capita at $173,051 is also above average and surpasses the national Aaa-median of $122,849.

Financial operations and reserves: sound albeit below average reserve levels to remain stable given sound management practices and policies

The county's financial position will remain sound, but narrow relative to other similarly-rated counties because of adherence to fiscal policies, active management practices, and long-term financial forecasting. Overall, the county experienced an increase in total general fund reserves to $208.6 million (17.4% of general fund revenues) in fiscal 2020 from $126.3 million (13% of general fund revenues) in fiscal 2014. This improvement is attributable to conservative budgeting both on the revenue (primarily related to positive income and property tax performance) and expenditure side, with a notable increase in fiscal 2020 largely from savings and funding received because of the coronavirus pandemic.

The county finished fiscal 2020 with a $68 million general fund operating surplus because of an increase in income taxes stemming from the delayed impact of the federal tax law change, as well as CARES Act funding ($37.4 million) and Coronavirus Relief Fund (CRF) receipts ($28.4 million) from the State of Maryland. The county's largest revenue source is property taxes (47.3% of fiscal 2020 revenues), followed by income taxes (43.4%). The county maintains a stabilization “rainy day fund” in the general fund equal to $75.8 million, or 6.3% of general fund revenues in fiscal 2020. The county has never utilized funds from this reserve, which would require County Council approval.

The fiscal 2021 budget maintains the property tax rate at 1.014 cents per $100 of assessed valuation and the local income tax rate of 3.2%, the maximum level permitted under state law. The estimated budget reflects a 1.8% decrease relative to fiscal 2020. Year-end results anticipate a solid surplus after income tax revenue from the first quarter exceeded budgetary expectations. The county also implemented the following revenue enhancements: increased the fire and rescue tax by 6 cents, increased the refuse curbside collection fee to $310 per year from $210, and will phase in a school facilities surcharge that will increase annually through 2022.

Going forward, we will monitor the county's ability to meet projections and build reserves to levels more in line with the current rating category (median for Aaa Maryland counties: 24% of general fund revenues; median for Aaa national counties: 34.7% of General Fund revenues). Declines in reserves will likely result in negative credit pressure.

Liquidity

The county's general fund cash position increased in fiscal 2020 to $150.8 million (12.6% of revenues) from $93 million (8.4% of revenues) in fiscal 2019. The county's cash position falls below similarly rated credits nationally.

Debt and pensions: above-average debt burden, supported by independent utility funds, expected to increase given substantial capital improvement plans; low pension liability

While the county's debt burden is moderate, it will increase given additional plans for bond issues totaling nearly $930 million between fiscal 2021 and 2025 to support capital projects. The county monitors bond authorizations with a Spending Affordability Advisory Committee, and while the current capital budget anticipates between $70 to $90 million annually for general capital projects and $40 to $65 million annually for utility projects, the committee recommends limiting annual issues to $100 million, and internal county projections reflect additional bond issues closer to $750 million over the next five years. The planned level of issuance will coincide with amortization of outstanding debt, affording the county some operating flexibility.

Additionally, further growth in the tax base will mitigate the effects of additional debt, as will moderate capital spending from pay-go funding totaling approximately $70 million between fiscal 2019 and 2024, and the independence of the utility funds to support their portion of debt service.

Post-issuance, the direct debt burden will be $1.6 billion, or 2.6% of 2020 full value, net of $437 million of self-supported enterprise debt. Because the county also issues debt for its schools, its direct debt burden is elevated compared to peers. The median debt burden for similarly rated counties is approximately 0.6% of full value nationally, and 2.1% of full value in MD.

Debt service is paid through a combination of ad valorem taxes, user and connection fees, and special assessments. Debt service accounted for 10.3% of operating revenues.

The county maintains a $1.98 billion five-year Capital Improvement Plan (2021-2025), with the majority of projects allocated for education, general county initiatives, and water, sewer, and storm drainage. The plan is financed through a variety of bonds, grants, state aid, and pay-go funding.

Legal security

The 2021 A&B bonds are secured by the county's absolute and unconditional ad valorem tax pledge.

Debt structure

All of the county's debt is fixed rate. Amortization is average, with 59.2% of principal retired within 10 years.

Debt-related derivatives

The county is not party to any derivative agreements.

Pensions and OPEB

Pensions are not a source of pressure for the county. The majority of the county's employees participate in the two county-administered retirement plans. As of fiscal 2020, the county's (including its component units) adjusted net pension liabilities (ANPL), based on a 3.51% discount rate, totaled $997 million. Comparatively, the GASB reported net pension liabilities, based on a 7.36% discount rate, totaled $180.3 million. The ANPL represents a manageable 0.72 times operating revenue and 1.56% of full value.

Exhibit 3
Fixed Costs Dashboard
Fiscal 2020

2020	(000)	% of Operating Revenues	Discount Rate
Operating Revenue	1,193,842	n/a	n/a
Reported Unfunded Pension Liability	180,312	15%	7.36%
Moody's Adjusted Net Pension Liability	996,887	84%	3.51%
Reported Net OPEB Liability	430,355	36%	3.56%
Moody's Adjusted Net OPEB Liability	434,904	36%	3.51%
Net Direct Debt	1,341,472	112%	n/a
Debt & unfunded retirement benefits (Moody's adjusted)	2,773,263	232.30%	
Pension Contribution	45,127	3.78%	n/a
OPEB Contribution	11,779	0.99%	n/a
Debt Service	123,253	10.32%	n/a
Total Fixed Costs	180,159	15.09%	n/a
Tread Water Gap	(5,026)	-0.42%	n/a
Moody's Adjusted Fixed Costs	175,133	14.67%	n/a

Source: Howard County, MD & Moody's Investors Service

In fiscal 2020, the county contributed $45.1 million to the plans, which surpassed its "tread water indicator"[1], a credit positive.

The county also provides other post-employment benefits (OPEB) to employees (and the school system employees).

ESG considerations

Environmental

The county's exposure to long-term environmental trends is consistent with that of the US local government sector, which as a whole, is low. However, environmental considerations are material to the county's credit profile given its history of severe flooding particularly in its downtown area. According to data from Moody's affiliate Four Twenty Seven, the county has elevated exposure to rainfall and extreme weather events, which is notable given that the county is a large residential hub within a strong economic region. Still, the county's operations and economy will likely be able to withstand weather-related events given management's proactive long-range capital planning and the state and federal governments' history of providing disaster relief to local governments following a major weather event. Further, the county secured state grant funding at a minimum of $8 million spread out over three years to fund the "comprehensive flood mitigation fund," which prioritizes capital projects and resiliency efforts for the county's historic districts affected by flooding.

Social

Social issues, which include demographics, labor force, and income metrics, are material to the city's credit quality and are incorporated by way of full value per capita and median family income. While social issues do not currently pose a credit risk, we will continue to monitor a variety of factors such as demographics, income levels, population trends and employment levels, as these remain important key credit metrics.

Governance

Like issuers across every sector, governance considerations are material to the county's credit quality. Howard County will continue to benefit from strong management, conservative budgeting practices, and adherence to multiple formal fiscal policies. By county charter, the general fund is required to maintain a budget stabilization reserve (committed fund balance) equal to a minimum 7% of audited prior year general fund expenditures, a threshold the county has met in each of the last five fiscal years.

Management also designates additional funds within the general fund balance for the two subsequent year's contribution to the budget stabilization reserve. The county is expected to meet its budget stabilization reserve policy going forward.

Maryland Counties have an Institutional Framework score of Aa, which is high compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. While the sector's largest revenue source, property taxes, is not subject to any statewide caps, income taxes account for approximately a third of revenues and are capped at 3.2%. Unpredictable revenue fluctuations tend to be minor, or under 5% annually.

Across the sector, fixed and mandated costs are generally greater than 25% of expenditures. Maryland has public sector unions, which can limit the ability to cut expenditures. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

Rating methodology and scorecard factors

The US Local Government General Obligation Debt Rating Methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 4

Howard (County of) MD

Scorecard Factors and Subfactors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$55,178,323	Aaa
Full Value Per Capita	$173,051	Aaa
Median Family Income (% of US Median)	187.4%	Aaa
Notching Factors:[2]		
Institutional Presence		Up
Finances (30%)		
Fund Balance as a % of Revenues	17.5%	Aa
5-Year Dollar Change in Fund Balance as % of Revenues	9.1%	A
Cash Balance as a % of Revenues	13.6%	Aa
5-Year Dollar Change in Cash Balance as % of Revenues	7.4%	A
Management (20%)		
Institutional Framework	Aa	Aa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	1.0x	A
Notching Factors:[2]		
Unusually Strong or Weak Budgetary Management and Planning		Up
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	2.6%	A
Net Direct Debt / Operating Revenues (x)	1.2x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	1.6%	Aa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	0.7x	Aa
	Scorecard-Indicated Outcome	Aaa
	Assigned Rating	Aaa

[1]] Economy measures are based on data from the most recent year available.
[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology.
Source: Howard County, MD & Moody's Investors Service

Endnotes

1 Our "tread water" indicator measures annual government contribution required to prevent reported net pension liabilities from growing, given the entity's actuarial assumptions. An annual government contribution that treads water equals the sum of employer service cost and interest on the reported net pension liability at the start of the fiscal year. A pension plan that receives an employer contribution equal to the tread water indicator will end the year with an unchanged net pension liability relative to the beginning of the year if all plan assumptions hold. Net liabilities may decrease or increase in a given year due to factors other than the contribution amount, such as investment performance that exceeds or falls short of a plan's assumed rate of return. Still, higher contributions will always reduce unfunded liabilities faster, or will allow unfunded liabilities to grow more slowly than lower contributions.

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