FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Howard County, MD's $87 Million GO Bonds 'AAA'; Outlook Stable

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Fitch Ratings - New York - 22 Feb 2023: Fitch Ratings has assigned 'AAA' ratings to the following Howard County, MD general obligation (GO) bonds:

--$71.3 million consolidated public improvement project bonds, 2023 series A;

--$15.8 million metropolitan district project bonds, 2023 series B.

The bonds are scheduled to sell on a competitive basis on March 7, 2023. Proceeds of the bonds are being used to reimburse the county for the cost of certain public improvements and to repay all of the county's outstanding line of credit (approximately $76.2 million).

In addition, Fitch has affirmed the following ratings:

--Issuer Default Rating (IDR) at 'AAA';

--Outstanding GO bonds at 'AAA';

--$14.64 million 2021A equipment program certificates of participation at 'AA+'.

The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Howard County (MD) [General Government]	LT IDR	AAA Rating Outlook Stable	Affirmed	AAA Rating Outlook Stable

Howard County (MD) /General Obligation - Unlimited Tax/1 LT	LT	AAA Rating Outlook Stable	Affirmed	AAA Rating Outlook Stable
Howard County (MD) /Lease Obligations - Standard/1 LT	LT	AA+ Rating Outlook Stable	Affirmed	AA+ Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

SECURITY

The GO bonds are backed by the county's full faith and credit pledge and its unlimited taxing power.

The outstanding 2021A COPs are payable from installment payments subject to annual appropriation by the county council under the purchase agreement. If a default occurs the trustee can direct the sale of the equipment and apply the proceeds to the payment of amounts due to COPs holders. The equipment consists of electrical, cooling heating and HVAC systems upgrades, transit buses, radio equipment and water meters.

ANALYTICAL CONCLUSION

Fitch expects Howard County to maintain a high level of financial flexibility throughout economic cycles, consistent with a long history of sound operating performance and healthy reserves. The county maintains superior inherent budget flexibility in the form of an unlimited legal ability to raise revenues and solid expenditure flexibility. The county's financial profile also reflects strong revenue growth prospects from a growing property tax base. Fitch expects the county's long-term liability burden to remain low.

The 'AA+' rating on the outstanding COPs is one notch below the 'AAA' IDR, reflecting the slightly higher degree of optionality associated with debt backed by payments subject to annual appropriation.

Economic Resource Base

Howard County is a robust Baltimore-Washington, D.C. suburban enclave with a diverse local economy. The county's estimated census population was 334,529 as of 2021, a notable 16.5% increase since 2010.

KEY RATING DRIVERS

Revenue Framework: 'aaa'

Fitch expects the natural pace of general fund revenue growth to perform in line with GDP over the long term based on strong economic activity and continued investment in the county. The county has the independent legal ability to raise property tax revenues without limit, contributing to superior inherent budget flexibility.

Expenditure Framework: 'aa'

Fitch expects natural growth in spending to generally track slightly above revenue growth. Education drives the county's spending needs and is somewhat inflexible, in that any reduction in funding would require approval from the state. Nevertheless, the county's ability to make other spending cuts when needed is solid given its strong legal control over employee-related costs and staffing levels. Carrying costs related to debt, pensions and other post-employment benefits (OPEB) are moderate.

Long-Term Liability Burden: 'aaa'

The county's liability burden is largely debt driven and low relative to its resource base. Projected debt needs are manageable, and future issuances will be managed in accordance with county policies based on changes in the economy, expectations for population growth and service demands.

Operating Performance: 'aaa'

Fitch expects the county to maintain high fundamental financial flexibility throughout economic cycles based on its expenditure and revenue flexibility and expectation for compliance with its fund balance policy. Liquidity levels from all funds are very strong and budgeted pay-as-you-go capital spending, which could be curtailed if necessary, supports overall flexibility.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Not applicable given that the IDR is currently at the highest possible rating.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--An increase in the long-term liability burden maintained at 10% or more of residents' personal income;

--A pattern of increased fixed-cost spending associated with debt service and employee retirement benefits to greater than 20% of total governmental expenditures, contributing to a reduction in overall expenditure flexibility;

--A sustained decline in unrestricted general fund balance to notably lower levels, leading to lower financial flexibility.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CURRENT DEVELOPMENTS

The county ended the fiscal year June 30, 2022 with a substantial net operating surplus of approximately $75 million (5% of spending), increasing its unrestricted general fund balance to $374 million or approximately 29% of spending. With the inclusion of other available reserve balances, mainly from other governmental funds, the available reserve balance increases to a sizable $533 million or around 37% of general fund spending.

Results reflect continued robust income tax revenue growth primarily due to significant federal fiscal stimulus, including pandemic unemployment insurance, stimulus checks and paycheck protection program as well as tax base appreciation. Income tax performance also benefited from capital gains due to a strong stock market. The county experienced positive variances in spending as county departments leveraged federal funding and maintained open vacancies.

The county has received $63.3 million under the American Rescue Plan Act of 2021 (ARPA). Nearly $29 million has been allocated through December 2022; the deadline for spending is 2026.

The fiscal 2023 approved general fund budget of $1.38 billion was a $119.5 million (9.5%) increase over the fiscal 2022 approved budget. The budget includes $89 million of prior years' fund balance. The increase funds educational initiatives such as special education staffing needs and requested support for educational and behavioral health needs as well as the opening of several new schools. The budget also provides record funding support for public safety with the addition of 24 new patrol officers and the expansion of the body camera program. According to county management, general fund operating results are trending positively relative to budget -- mostly due to increases in assessed property values, strong income tax revenues and vacancy savings.

CREDIT PROFILE

The county is among the most robust in the nation, featuring a highly educated workforce employed throughout a deep and diverse economy, led by the federal government. Fort Meade, located in nearby Anne Arundel County (AA+/Stable), is a major driver of long-term regional growth, and is Maryland's largest employer. The fort -- already a home base to all six military services and several federal agencies, including the National Security Agency (NSA) -- has been named the headquarters for the U.S. cybersecurity center. The county estimates federal agencies located at Fort Meade employ approximately 15,000 county residents. A series of transportation improvements have been funded to support an additional 3,500 military positions that will be added over the next six years (which does not include any expansion of NSA personnel).

The education and healthcare sectors, led by John Hopkins University Applied Physics Laboratory (APL; 7,200 jobs), play a pivotal role in the economy and lend diversity to the notable concentration in government and government contracting, although APL works closely with the federal government. Employment growth remains steady, as the county continues to generate and retain jobs through its economic development efforts. The unemployment rate is below the state and national averages.

The county continues to focus its economic development efforts in downtown Columbia, and commercial and residential development there has contributed to the tax base and job growth. Management reports additional development areas are underway and expected to support additional growth in the tax base.

Revenue Framework

Property and income tax revenues combined made up 94% of fiscal 2022 county general fund revenues, each accounting for 47%. Assessed values (AV), which lag the actual housing and commercial market due to the statutory rolling three-year reassessment cycle in Maryland, have increased annually since 2013. The AV at $58.9 billion in 2022 was a 3.3% increase over 2021. According to data from Maryland Department of Assessments and Taxation, assessments are expected to grow 4.8% in 2024 largely due to a strong housing market.

Income tax revenue trends have similarly been consistently positive, increasing annually between 2012 and 2022. As noted above, income tax revenue stability was supported by federal funding via unemployment insurance and stimulus funds in 2020 and 2021. Income tax revenues are distributed to the county on a monthly basis, but revenue receipts often reflect prior years' economic conditions. The fiscal 2023 budget incorporates a 10% increase in income tax revenues relative to the fiscal 2022 budgeted amount which is in line with current double-digit growth trends. Multi-year projections show more conservative 4% average growth projections for revenues.

The county's natural pace of general fund revenue growth trended above inflation over the decade ending 2022. Given ongoing economic development, growth in tax base values, as well as positive housing and employment trends, revenue growth prospects are considered strong.

The county is not subject to any limitation on its property tax rate or levy, and has not increased the property tax rate in nearly two decades. The income tax rate was increased in 2004 to the maximum rate of 3.2%.

Expenditure Framework

The county's largest expenditure category is education, at roughly 50% of fiscal 2022 general fund expenditures and transfers out, followed by public safety at 10%.

Based on the county's history of structural budgetary balance and manageable but growing spending needs, Fitch expects spending growth will slightly exceed revenue growth absent policy action.

Education spending per pupil, according to the state Maintenance of Effort (MOE) mandate, cannot decline from year to year without approval from the state, which happened in some counties when income and property tax revenues weakened following the Great Recession. Changes to the MOE funding formula are still being reevaluated by the state and the monetary impact to the county is unknown.

Approximately 50% of the county's workforce is unionized with one- or two-year contracts. Strikes are not permitted, and only police & fire union arbitration results are binding on the county executive's proposed budget request. All other unions have mediation, which is not binding.

Carrying costs associated with debt service, actuarially determined pension contributions and OPEB actual contributions totaled about 12% of fiscal 2022 governmental spending; debt service accounted for nearly two-thirds of that amount. Fitch expects these costs to increase moderately due to growing debt service and changes in retiree benefit costs over time, but to remain manageable. Management typically includes pay-go capital in its budget, affording an additional source of expenditure flexibility.

Long-Term Liability Burden

Overall net debt plus the county's Fitch-adjusted net pension liabilities (NPLs) approximate a low 5% of personal income. The metric excludes self-supporting county Metropolitan District utility debt. Debt ratios increase slightly including Metropolitan District debt, which is paid from special assessments and charges levied against all property in the district for utility purposes. The general fund does not provide support to utility operations and the Metropolitan District maintains good legal rate-setting flexibility and liquidity. Utility rates are subject to county council adoption and have not been increased since 2014. There is currently no plan to increase rates.

The county will repay approximately 71% of outstanding principal within 10 years following this issuance, leaving adequate capacity to fund future borrowing needs. The county's fiscal 2023-2027 capital plan totals about $1.28 billion, including water and sewer projects. The plan is approximately 50% debt funded.

The county provides pension benefits to its employees through two single-employer defined benefit plans -- a general employee plan and a fire and police plan -- and annually makes the actuarially determined contribution to each. The county did reduce the discount rate to 7.35% in fiscal 2022 and is considering continued reductions. As of July 1, 2021, the two plans and the county's proportionate share of the Maryland Teachers' Retirement and Pension Plan had an estimated aggregate NPL of close to $535 million, or only about 2% of personal income, adjusted to reflect Fitch's standard 6% investment rate of return. The county also provides a length-of-service plan for volunteer public safety employees, which has a minimal net pension liability of $36 million.

The county administers an OPEB trust fund that provides benefits for its retirees. As of the June 30, 2021 measurement date, the net OPEB liability was $1 billion or approximately 4% of personal income. While Fitch views the liability as more flexible than the county's pension and debt obligations, increases in the OPEB liability could negatively affect Fitch's 'aaa' liability assessment. However, the county has gradually increased annual OPEB funding above the pay-go amount to reduce the liability over time.

Operating Performance

Given the moderate economic sensitivity of revenues to economic cycles and the county's superior inherent budget flexibility in the form of control over revenues and spending, Fitch expects the county to maintain a high level of financial flexibility through future downturns. In 2017, the county enhanced its 7% fund balance reserve policy to include an additional 3% policy reserve. At fiscal year-end 2022 the policy reserve, which is held in the assigned portion of the fund balance, totaled $37.1 million while the budget stabilization reserve, which is held in the committed portion of the fund balance, totaled $80.1 million or a combined total of $117 million or 8% of general fund spending, which is in-line with the revised policy. The total unrestricted general fund balance at fiscal 2022 year-end totaled $374 million or 26% of spending.

The county has shown strong budget management during periods of economic shock by implementing a hiring freeze, leaving funding of multiple vacancies unfunded as well as cutting back non-personnel costs in both fiscal 2021 & 2022. The county continues to slow hiring and hold the line on non-critical contracts and training/travel costs in an attempt to generate savings and provide flexibility given uncertainties regarding the pandemic and economic recovery.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 04 May 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

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