

MOODY'S

INVESTORS SERVICE

New Issue: Moody's assigns Aaa to Howard County, MD's \$273.8M GO Bonds, 2015 Series A; outlook stable

Global Credit Research - 20 Mar 2015

Affirms Aaa on \$1.2B of outstanding parity debt

HOWARD (COUNTY OF) MD
Counties
MD

Moody's Rating

| ISSUE | | RATING |
|--|--------------------|--------|
| Consolidated Public Improvement Project and Refunding Bonds, 2015 Series A | | Aaa |
| Sale Amount | \$232,360,000 | |
| Expected Sale Date | 04/08/15 | |
| Rating Description | General Obligation | |
| Metropolitan District Project and Refunding Bonds, 2015 Series A | | Aaa |
| Sale Amount | \$41,455,000 | |
| Expected Sale Date | 04/08/15 | |
| Rating Description | General Obligation | |

Moody's Outlook STA

NEW YORK, March 20, 2015 --Moody's Investors Service has assigned a Aaa rating to Howard County's (MD) \$232.4 million Consolidated Public Improvement Project and Refunding Bonds, 2015 Series A and \$41.5 million Metropolitan District Project and Refunding Bonds, 2015 Series A. Concurrently, Moody's has affirmed the Aaa rating on \$1.2 billion of outstanding General Obligation debt. The outlook is stable.

SUMMARY RATING RATIONALE

The Aaa rating reflects the county's sizeable tax base and wealth demographic profile, satisfactory financial position supported by proactive management and comprehensive fiscal policies, as well as a manageable debt burden.

OUTLOOK

The stable outlook reflects the county's sizeable tax base that will continue to benefit from its proximity to Fort Meade, which supports approximately 40,000 county residents. The outlook also incorporates our belief that the county will continue to maintain a satisfactory reserve position despite a projected decline in fiscal 2015. Any deviation from these projections or any additional declines in reserve going forward could result in negative credit pressure.

WHAT COULD MAKE THE RATING GO DOWN

- Any additional declines in reserves beyond fiscal 2015 projections
- Significant deterioration in taxable values or demographic profile
- Downgrade of U.S. Government's Aaa bond rating

STRENGTHS

- Sizeable and economically diverse tax base
- Strong socio-economic profile with above-average wealth and income levels
- Management team that practices conservative budget and maintains comprehensive fiscal policies

CHALLENGES

- Below average reserves compared to similarly-rated entities
- Reliance on economically sensitive income tax revenues
- Employment closely linked to U.S. Government

RECENT DEVELOPMENTS

Recent developments are included in the Detailed Rating Rationale.

DETAILED RATING RATIONALE

ECONOMY AND TAX BASE: COUNTY BENEFITS FROM STRATEGIC GEOGRAPHIC POSITION; TAX BASE GROWTH RETURNS IN FISCAL 2014

The county's sizeable tax base is expected to experience moderate growth going forward due to ongoing development projects partially driven by its proximity to Fort Meade. Located along Interstate 95, Howard County benefits from its established role as a suburban center to nearby Washington, D.C. (Aa1 stable) and the City of Baltimore (Aa2 stable). The county's population has the highest wealth levels in the state and the local employment base is anchored by the technology, engineering, and research and development sectors.

The assessed valuation of the county's tax base has more than doubled since 2000 - spurred largely by new residential construction and home value appreciation through 2009 - and the full market value of the tax base reached a substantial \$44.6 billion as of fiscal 2014. Despite experiencing three years of modest declines (averaging 4.2% between fiscal 2011 and 2013), growth in the county's tax base resumed in fiscal 2014 with a 0.8% increase. Another 10.5% increase in the tax base is expected in fiscal 2015, driven by ongoing development projects and an improving housing market within the county. Conservatively, the county is projecting 3% annual growth going forward.

Overall, the statewide requirement to phase-in reassessment-related tax base growth over a three-year period helped to smooth the most recent impact of property devaluation within the county during the last few years. Further, the homestead tax credit, which limits the county's ability to capture homestead appreciation for annual tax levy purposes to 5%, helped to limit the declines in the tax levy during recent years as previous pent-up annual growth was added to the tax rolls.

Fort Meade, the state's largest employer and third largest army installation within the United States, is located less than two miles from the county line in adjacent Anne Arundel County (Aa1 stable). Due to this proximity, the county has experienced capital investment and economic growth due to the expansion of the NSA (located on the Fort Meade campus), and the establishment of the U.S. Cyber Command (Department of Defense's (DOD) centralized cyber security effort also located on the Fort Meade campus) that resulted from the DOD's most recent Base Realignment and Closure (BRAC) review. Fort Meade saw the addition of approximately 5,700 new employees under BRAC and is expected to add another 3,000 employees through 2020. The fort's expansion has served as an anchor for the relocation of defense contractors and related businesses to the area, many adding to the county's taxable base. The fort currently employs approximately 12,600 county residents, with a total of 40,000 county residents working at jobs attributed to its mission. Current ongoing construction at Fort Meade includes a \$792 million high performance computing center and a \$358 million joint operations center. The county is also expected to provide five million gallons per day of reclaimed water to cool the supercomputers on Fort Meade's campus beginning this year.

Additional growth through the recently approved plan for the redevelopment of downtown Columbia (Columbia Association senior secured bonds rated Aa1). This project is expected to include 13 million square feet of residential, commercial and retail space to be built over the next 30 years. Little Patuxent Square is the first commercial building being constructed under this plan, while various retail upgrades are either underway or have been completed. Other recent developments include a \$100 million investment into the headquarters of W.R. Grace (international chemical technology) and a \$10 million investment from NAFCO (seafood distributor) to

construct a new processing facility.

Wealth indices demonstrate the county's strong demographics. The county's median family income of \$126,530 (143.6% of US and 195.9% of MD) is the highest in the state and third highest nationally. The county's full value per capita at \$147,468 is also above average when compared to the state (131.3%) and nation (194.6%). The unemployment rate at 3.9% as of December 2014 continued to remain well below the state (5.3%) and national (5.4%) rates.

FINANCIAL OPERATIONS AND RESERVES: SATISFACTORY FINANCIAL POSITION; ADDITIONAL DRAW ON RESERVES EXPECTED IN FISCAL 2015

Despite projected draws on reserves, the county is expected to maintain a satisfactory financial position due to prudent management practices. Overall, the county has seen an increase in General Fund reserves to \$126.3 million (13.3% of General Fund revenues) in fiscal 2014 from a low of \$71.8 million (9% of General Fund revenues) in fiscal 2009. This improvement in reserve levels is attributable to conservative budgeting both on the revenue (primarily related to positive income tax performance) and expenditure side.

Most recently, the county ended fiscal 2014 with a \$7.4 million decline in General Fund balance. Net of a \$28.1 million transfer for one-time capital, the county ended the fiscal year with a \$20.7 million operating surplus. Income taxes ended the year over-budget, while expenditures ended under driven by conservative estimates and unexpected debt service savings. As of fiscal 2014, the county maintained a stabilization fund in the General Fund equal to \$59.3 million, or 6.3% of General Fund revenues. The county's largest revenue source is property taxes (48.4% of fiscal 2014 revenues), followed by income taxes (41.4%).

The adopted fiscal 2015 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 budget represented a 6% increase relative to the prior year and appropriates \$43.6 million from General Fund balance partially for non-recurring expenditures (\$13.8 million). Based on year-to-date estimates, the county expects to utilize the full fund balance appropriation, resulting in a decline in General Fund balance to \$82.7 million or an adequate 8.5% of General Fund revenues. The county proactively implemented \$15.8 million in mid-year expenditure cuts to help offset underperforming income tax revenues of the same amount. These expenditure cuts included implementing a hiring freeze for non-critical positions, identifying various departmental savings, and removing unspent pay-go funding for certain one-time initiatives. The county also expects to end with \$3 million in their Internal Service Fund at year-end, resulting in total available reserves of \$85.7 million or 8.9% of General Fund revenues.

The county's projections for fiscal 2016 through 2019 include structurally balanced budgets averaging 3.5% annual growth. Holding tax rates level, these projections include 3.2% average annual increases in property tax (averaged 2.8% increases over last five years) and 4.5% average annual increases in income tax (averaged 4.6% over last five years) revenues. While the property tax growth may seem more aggressive than historical figures, we believe the rebound in development will help to support this estimate. The county has also conservatively projected for education expenditures, averaging a 3.1% annual increase compared to a 1.8% average over the last five years. Going forward, we will monitor the county's ability to meet fiscal 2015 projection and build reserves to levels more in line with the current rating category (Median for Aaa Maryland counties: 18.5% of General Fund revenues; Median for Aaa National counties: 35.4% of General Fund revenues). Any deviation from fiscal 2015 projections or additional declines in reserves will most likely result in negative credit pressure.

Liquidity

The county's overall net cash position has increased to \$116.7 million (12.3% of General Fund revenues) in fiscal 2014 from \$73.2 million (9.0% of General Fund revenues) in fiscal 2009, due to positive budget-to-actual results. During fiscal 2014, the county realized a \$6.6 million decrease in cash primarily due to funding for one-time capital expenditures. Overall, the county has maintained a satisfactory cash position, averaging 10.9% of General Fund revenues over the last five years.

DEBT AND PENSIONS: ABOVE-AVERAGE DEBT POSITION EXPECTED TO REMAIN MANAGEABLE

The county's debt position is expected to remain affordable given additional anticipated tax base growth and the self-supporting of the county's enterprise systems. The county's direct debt is equal to an above-average, but manageable 2.4% of full valuation, net of \$258.9 million of self-supported enterprise debt. Debt service is paid through a combination of ad valorem taxes, user and connection fees, and special assessments. Amortization of debt is average, with 59.7% of principal retired within 10 years, and debt service costs were 10.5% of total fiscal 2014 operating expenditures.

Debt Structure

The county maintains a \$150 million (10.3% of total debt) line of credit with Wells Fargo Bank NA (Aa3 RUR) to provide interim capital financing for both general government and metropolitan district projects. All of the county's debt is fixed rate.

Debt-Related Derivatives

Favorably, the county is not party to any derivative agreements.

Pensions and OPEB

The county maintains two single-employer defined benefit plans, for general government employees and for police and fire officers. The county contributed \$12.8 million (1.4% of operating expenditures) to the general employee plan and \$20.8 million (2.2% of operating expenditures) to the police and fire officers' plan in fiscal 2014. Both contributions represented 100% of the actual required contributions (ARC). In addition, the county's school board participates in the State of Maryland Employees' Retirement and Pension System and the Teachers' Retirement and Pension System. Contributions to the Employees' System totaled \$13.1 million (1.4% of operating expenditures) in fiscal 2014 and were made by the county school board, while contributions to the Teachers System totaled \$59.9 million and were made directly by the State of Maryland (Aaa stable).

The county's combined adjusted net pension liability, under Moody's methodology for adjusting reported pension data, is \$840.8 million, or a below-average 0.94 times operating revenues. Moody's uses the adjusted net pension liability to improve comparability of reported pension liabilities. The adjustments are not intended to replace the county's reported liability information, but to improve comparability with other rated entities. We determined the county's share of liability for the state-run plan in proportion to its contributions to the plans.

The county also provides other post-employment benefits (OPEB) to employees. The pay-go portion of these benefits in fiscal 2014 amounted to \$15.7 million. The county is increasing its annual contribution towards the OPEB ARC (\$72.2 million), to which it contributed an additional \$12 million in fiscal 2014 from the previous year. Fixed costs of annual pension, OPEB and debt service expenditures summed to a manageable 18.5% of fiscal 2014 expenditures.

MANAGEMENT AND GOVERNANCE

Maryland counties have an institutional framework score of "Aa," or strong. Counties primarily rely on property taxes, followed closely by more economically sensitive income taxes, to support operations. Expenditures, which are primarily for education and based on a state-mandated maintenance of effort (MOE) requirement, are moderately predictable despite recent state decisions to significantly reduce highway user revenues and transfer normal teacher pension costs to counties. In addition, aside from meeting the required MOE for education, counties have the ability to reduce expenditures if necessary.

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 subsequent year's contribution to the budget stabilization reserve. The county is expected to meet its budget stabilization reserve policy in fiscal 2015 and going forward.

KEY STATISTICS

- 2014 Tax Base Size - Full Value (in 000s): \$44,552,141
- 2014 Full Value Per Capita: \$147,468
- 2012 Median Family Income as % of US median: 195.9%
- 2014 Operating Fund Balance as % of Revenues: 13.62%
- Five-Year Dollar Change in Fund Balance as % of Revenues: 11.05%
- 2014 Operating Cash Balance as % of Revenues: 12.59%
- Five-Year Dollar Change in Cash Balance as % of Revenues: 4.69%

- Institutional Framework: Aa
- Operating History - Five-Year Average of Operating Revenues/ Operating Expenditures: 1.01x
- Net Direct Debt/Full Value: 2.36%
- Net Direct Debt/Operating Revenues: 1.13x
- Three-Year Average of Moody's Adjusted Net Pension Liability/Full Value: 1.34%
- Three-Year Average of Moody's Adjusted Net Pension Liability/Operating Revenues: 0.66x

OBLIGOR PROFILE

Located between the City of Baltimore and the District of Columbia, the county has a population of 302,113.

LEGAL SECURITY

The bonds are secured by the unlimited ad valorem tax pledge of the entire county.

USE OF PROCEEDS

Proceeds from the Consolidated Public Improvement Project and Refunding Bonds, 2015 Series A will refinance a portion of county's outstanding Bond Anticipation Note (BAN), Series 2014 and reimburse the county for various general government capital projects. In addition, the 2015 Series A bonds will refund portions of the Series 2007A, Series 2008A, Series 2009A, Series 2009B, Series 2010A, Series 2011A, Series 2011B, and Series 2012A for an estimated net present value savings of \$11.1 million, or 8.2% of refunded principal, with no extension of maturity.

Proceeds from the Metropolitan District Project and Refunding Bonds, 2015 Series B will refinance the remaining portion of the county's Outstanding BAN, Series 2014 and fund various capital projects for the water and sewer system. In addition, the Series 2015A bonds will refund portions of the Series 2006A, Series 2007A, Series 2008A, Series 2009A, and Series 2009B bonds for an estimated net present value savings of \$825,526, or 5.2% of refunded principal, with no extension of maturity.

RATING METHODOLOGY

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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