FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Howard County, MD's $364 Million GOs 'AAA'; Outlook Stable

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Fitch Ratings - New York - 02 Apr 2020: Fitch Ratings has assigned a 'AAA' rating to the following Howard County, MD general obligation (GO) bonds:

--$118,765,000 Consolidated Public Improvement Project Bonds, 2020 Series A;

--$49,515,000 Metropolitan District Project Bonds, 2020 Series B;

--$145,445,000 Taxable Consolidated Public Improvement Project Refunding Bonds, 2020 Series C;

--$50,475,000 Taxable Metropolitan District Refunding Bonds, 2020 Series D.

The bonds are scheduled to sell on a negotiated basis during April. Bonds proceeds of the Series A and B bonds will be used to repay all or a portion of the county's outstanding Series 2017 bond anticipation notes. The taxable Series C and D bonds are being issued to reimburse the county for the cost of certain public improvements and to refund certain outstanding county and Metropolitan District bonds.

The Rating Outlook is Stable.

In addition, Fitch has affirmed the following ratings:

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

--Outstanding GO bonds at 'AAA'.

SECURITY

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

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 strong financial profile also reflects strong revenue growth prospects from a growing property tax base, manageable expenditure growth and a demonstrated ability to reduce expenditures during economic downturns. Fitch expects the county's long-term liability burden to remain low.

ECONOMIC RESOURCE BASE

Howard County is a wealthy Baltimore-Washington, D.C. suburban enclave with a diverse local economy. The county's estimated census population was 323,196 as of 2018 a 12.6% increase since 2010.

KEY RATING DRIVERS

Revenue Framework: 'aaa'

Fitch expects the natural pace of general fund revenues 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, and high level of services provided to residents. 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 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 a conservative 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

Developments that May, Collectively or Individually, Lead to Positive Rating Action:

--Not applicable.

Developments that May, Collectively or Individually, Lead to Negative Rating Action:

--An increase in the long-term liability burden to 10% or greater, compared with residents' personal income, due to a combination of additional debt issuance or changes in net pension liabilities without corresponding growth in the resource base.

-- 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

Best/Worst Case Rating Scenarios - Public Finance:

Ratings of Public Finance 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 https://www.fitchratings.com/site/re/10111579.

CURRENT DEVELOPMENTS

Sectorwide Coronavirus Implications

The recent outbreak of coronavirus and related government containment measures worldwide creates an uncertain global environment for U.S. state and local governments and related entities in the near term. While Howard County's most recently available fiscal and economic data may not fully reflect impairment, material changes in revenues and expenditures are occurring across the country and are likely to worsen in the coming weeks and months as economic activity suffers and public health spending increases. Fitch's ratings are forward looking, and Fitch will monitor developments in state and local governments as a result of the severity and duration of the virus outbreak, and incorporate revised expectations for future performance and assessment of key risks.

CREDIT PROFILE

The county is among the wealthiest 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 both Maryland's and the county's largest employer. The fort -- already a home base to all five military services and several federal agencies, including the National Security Agency -- 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.

The education and healthcare sectors, led by John Hopkins University Applied Physics Laboratory, play a pivotal role in the economy and lend diversity to the notable concentration in government. Employment growth remains steady, as the county continues to generate and retain jobs through its economic-development efforts. The unemployment rate is historically well below the state and national averages.

The county continues to focus its economic development efforts in downtown Columbia, MD, and new commercial and residential development contributed to tax base and job growth over the past several years. Management reports a number of new developments planned or underway that are expected to support additional growth in the tax base. However, the effect of recent coronavirus-related declines in economic activity is uncertain.

REVENUE FRAMEWORK

Property taxes are the largest revenue source for the county at 51% of fiscal 2019 general fund revenues, followed by income taxes at 42%. Assessed values (AV), which lag the actual housing and commercial market due to the statutory rolling three-year reassessment cycle in Maryland, have increased consecutively over the past seven years at growth rates mostly in line with or close to GDP. The state reported AV at $54.8 billion in 2020, which is a 3% increase over 2019.

According to fiscal 2019 general fund results, income tax revenues increased 4% yoy following gains of 2% in fiscal 2018. Projections for income tax revenues for fiscal 2020 remain positive due to strong economic growth that occurred in the county, and the lag in collections and timing of revenue distribution to the county. Income tax revenues reported in April by residents and businesses are primarily reflected as a distribution in November of the following calendar year, with periodic distributions throughout the fiscal year from additional income tax payments. Based on this distribution, income tax revenues are projected to be strong for the beginning of fiscal 2021, but would likely see a decline in fiscal 2022 based on the current coronavirus situation and income tax filings for calendar 2020 being made in April 2021.

The county's natural pace of general fund revenue growth trended in line with inflation when revenues are adjusted for tax policy changes over the past decade. However, given ongoing economic development, growth in tax base values above pre-recession levels, as well as positive housing and employment trends over the past six years, 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 59% of fiscal 2019 general fund expenditures, followed by public safety at 12%.

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

According to the state's maintenance-of-effort mandate, education spending cannot decline yoy without state approval. Approximately 50% of the county's workforce is unionized with one- or two-year contracts. Strikes are not permitted, but arbitration results are binding on the county executive's proposed budget request. However, the county council is not obligated to agree.

Carrying costs associated with debt service, actuarially determined pension contributions and OPEB actual contributions totaled about 14% of fiscal 2019 governmental spending; debt service accounted for roughly 60%. Fitch expects these costs to increase moderately due to growing debt service costs and changes in retiree benefit costs over time, but to remain manageable. Management typically includes capital pay-go 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 approximate a low 7% of personal income. The metric excludes self-supporting county Metropolitan District utility debt. Debt ratios increase slightly to 8% 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 no plan to increase rates.

The county is under contract with a private consortium (Edgemoor-Star America Judicial Partners) for the construction of a new circuit courthouse via a Public Private Partnership (P3) Agreement. The cost of the project is approximately $167 million. The county plans to issue approximately $75 million of GO bonds in 2021. The county will make ongoing annual availability payments for the 30-year term of the project agreement. The availability payment will include a $6.6 million capital charge component and a $3.3 million facility-management charge contributing to growth in annual general fund operating costs. The project company will use the availability payment to cover loan repayments/debt service on the outstanding debt associated with the P3.

The county will repay approximately 65% of outstanding principal within 10 years following this issuance, leaving adequate capacity to fund future borrowing needs. The fiscal 2020 capital budget totals $206 million, with $90 million coming from GO bonds. The county's fiscal 2021-2025 capital plan totals just over $1.8 billion, excluding water and sewer projects. The county expects to authorize $70 million-$90 million per year in bonds to support future capital projects. The county council approved an increase in the school surcharge fee applied to any new building permits, effective January 2020, and such fees will be used to support school building projects providing additional support for these developments. An increase in governmental debt, along with an increase in Fitch-adjusted net pension liabilities (NPLs) without a corresponding increase in the resource base resulting in the liability burden exceeding 10% of personal income would likely result in a downward change in the long-term liability assessment.

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. As of July 1, 2019, the plans (including the county's proportionate share of the Maryland Teachers' Retirement and Pension Plan) had an estimated aggregate NPL of close to $509 million, or only about 2% of personal income, adjusted to reflect Fitch's standard 6% investment rate of return. The Fitch-adjusted ratio of combined assets to liabilities equates to 67%. The county also provides a length-of-service plan for volunteer public safety employees, which has a minimal net pension liability of $22 million.

The county administers an OPEB trust fund that provides benefits for its retirees, and the trust had a balance of about $154 million as of fiscal YE 2019. The reported fiscal 2019 net OPEB liability was $1.3 billion, based on a 3.56% discount rate, or a slightly high 5% of personal income.

OPERATING PERFORMANCE

The county's 'aaa' operating performance assessment is based on Fitch's view of the county's significant gap-closing capacity and superior inherent budget flexibility in the form of unlimited revenue raising ability and solid expenditure flexibility. Fitch believes the county has high fundamental financial flexibility to withstand an economic downturn and will make efforts to restore reserves during periods of economic growth.

In response to a weak revenue growth environment during the last recession, the county used reserves to balance operations, in addition to controls on spending. During the subsequent recovery, the county rebuilt reserves to currently healthy levels. The unrestricted general fund balance of $128 million at fiscal YE 2019 was equal to almost 12% of spending. The unrestricted fund balance includes the county's budget-stabilization reserve, which is held within the committed fund balance and is to be maintained at 7% of spending according to the county charter. During fiscal 2017, the county established an additional reserve of $5 million in the assigned portion of the general fund balance. This balance was increased to $7.5 million in fiscal 2019. The county plans to increase this reserve to 3% of general fund spending over the next 10 years.

The adopted fiscal 2019 general fund budget kept the tax rate stable but included a $23.2 million fund balance appropriation. The majority of the appropriation was a one-time $11 million payment to address a deficit in the school board's health and dental fund. The budget also funded $7 million in road resurfacing. Operating results reflect conservative revenue and spending assumptions, and a minor change in the yoy unrestricted fund balancer.

The original 2020 general fund budget of $1.16 billion is a 2% increase over the fiscal 2019 budget. The budget keeps the real property tax rate stable but includes a $0.06 increase to the fire and rescue tax rate. The fund balance appropriation is reduced to $9.3 million. The budget increase funds a new class of fire and emergency services workers, and an $18 million increase to the school system. The budget also includes $15 million for flood mitigation to address flooding in Ellicott City following two major incidents in 2016 and 2018. The state, in conjunction with the Maryland Department of Housing and Community Development, will be granting over $11 million in funding to support the county's flood-mitigation efforts.

Management reports revenues to date exceeded budgetary estimates due to stronger than anticipated income taxes (up 7.8% yoy) and conservative expenditure assumptions. Other nonproperty tax revenues performed well through March, but are projected to decline during the remainder of the year due to the coronavirus situation. Even with these estimated declines, management is projecting a moderate general fund net operating surplus for fiscal YE 2020.

The fiscal 2021 budget is in preliminary stages. Due in part to property tax base growth, the March 1 estimate for general fund growth was 3.3%, or $38 million yoy. However, due to the coronavirus situation, general fund revenue estimates were adjusted down by $17 million with a revised overall growth rate of 1.8%. Fiscal 2021 income tax revenue distributions will reflect 2019 filings and are therefore estimated to increase 2.5% yoy. The impact from a decline in income taxes due to the coronavirus is likely to be greater in fiscal 2022 due to the lag time in distributions. Management forecasts show a slowdown in revenues for the next few years, with expenses outpacing revenue growth. Fitch expects management to manage and control spending as it has historically done, draw on reserves as needed, and use its legal unlimited ability to raise revenues if necessary to mitigate the budget impact from an expected decline in revenues during this upcoming downturn.

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.

ESG CONSIDERATIONS

ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
Howard County (MD) [General Government]	LT IDR	AAA	Affirmed
• Howard County (MD) /General Obligation - Unlimited Tax/1 LT	LT	AAA	Affirmed

VIEW ADDITIONAL RATING DETAILS

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

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

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Howard County (MD)	EU Endorsed

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