



RATING ACTION COMMENTARY

Fitch Rates Howard County, MD's \$82 Million GO Bonds 'AAA'; Outlook Stable

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Fitch Ratings - New York - 09 Feb 2022: Fitch Ratings has assigned 'AAA' ratings to the following Howard County, MD general obligation (GO) bonds:

--\$49.52 million consolidated public improvement project bonds, 2022 series A;

--\$18.17 million metropolitan district project bonds, 2022 series B.

The bonds are scheduled to sell on a competitive basis on March 1, 2022. Proceeds of the bonds are being used to reimburse the county for the cost of certain public improvements and to repay all or a portion of the county's outstanding GO bond anticipation notes.

In addition, Fitch has affirmed the following ratings:

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

--Outstanding GO bonds at 'AAA';

--\$17.4 million 2021A equipment program certificates of participation at 'AA+'.

The Rating Outlook is Stable.

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 wealthy Baltimore-Washington, D.C. suburban enclave with a diverse local economy. The county's estimated census population was 332,317 as of 2020, a 16% 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 a positive rating action/upgrade:

--Not applicable.

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

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

--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

Howard's financial performance remains solid despite experiencing minor pandemic-related non-ad valorem revenue pressures. The county ended the fiscal year ended June 30, 2021 with a substantial net operating surplus of \$127.5 million (11% of spending), increasing its unrestricted general fund balance to \$325 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 \$624 million or around 55% of general fund spending.

Results reflect robust income tax revenue growth primarily due to significant federal fiscal stimulus, including pandemic unemployment insurance, stimulus checks and paycheck protection program. The stimulus helped the county avoid a potential income tax loss that was originally anticipated at the onset of the pandemic. Income tax performance also benefited from capital gains due to a strong stock market. Additionally, real property tax revenue continued to grow due to rising property valuation. The county experienced positive variances in spending as county departments leveraged federal funding.

In fiscal 2021, the county received approximately \$48 million in coronavirus pandemic relief funding from federal, state and other sources, including \$43 million under the Coronavirus Aid, Relief, and Economic Security Act (CARES), and received \$32 million under the American Rescue Plan Act of 2021 (ARPA). The county anticipates receiving an additional \$32 million under ARPA during fiscal year 2022.

The county's fiscal 2022 general fund budget of \$1.2 billion is up 7% over the prior year's original budget. The largest increase is associated with education, an increase of \$20 million, of which \$12.5 million will go toward the \$39.2 million deficit in the Howard County Public School System health fund. Other expense drivers are associated with enhancing public safety initiatives. Based on current estimates, property taxes are tracking to budget, while income taxes are expected to exceed budgeted figures. Due to positive revenue performance to date, the County anticipates it will end fiscal year 2022 with another operating surplus.

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 Maryland'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 and government contracting. 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 tax base and job growth. Management reports a number of new developments planned or underway that are expected to support additional growth in the tax base.

Revenue Framework

Property taxes are the largest revenue source for the county at 48% of fiscal 2021 general fund revenues and transfers in, followed by income taxes at 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 \$56.9 billion in 2021 is a 3.3% increase over 2020. The fiscal 2022 budget uses an AV of \$58.7 billion for revenue estimates.

Income tax revenue trends have similarly been consistently positive, increasing annually between 2012 and 2021. 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. As such, the county has budgeted fiscal 2022 income tax revenue growth at a conservative 6% despite recent more robust double-digit growth trends.

The county's natural pace of general fund revenue growth trended above inflation, but below national GDP growth when revenues are adjusted for tax policy changes over the decade ending 2021. However, 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 60% of fiscal 2021 general fund expenditures and transfers out, followed by public safety at 11%.

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.

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. The MOE funding formula for education spending was reevaluated by the Kirwan Commission. However, recommendations made by the commission were significant and are currently being reassessed. It is unclear how changes may impact the county's spending flexibility.

Approximately 50% of the county's workforce is unionized with one- or two-year contracts. Strikes are not permitted, only police & fire union arbitration results are binding on the county executive's proposed budget request. The other unions have mediation, which is not binding. 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 15% of fiscal

2021 governmental spending; debt service accounted for roughly 64% 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 7% 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 no plan to increase rates.

The county is under contract with a private consortium (Edgemoor-Star America Judicial Partners) for the operation of the new circuit courthouse via a public private partnership (P3) agreement. The \$75 million milestone payment was funded with the series 2021A bonds. 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 67% 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 billion, including water and sewer projects. The county expects to

authorize \$70 million-\$90 million per year in bonds to support future capital projects.

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, 2020, measurement date the net OPEB liability was \$1.8 billion or approximately 7% of personal income. While Fitch views the liability as more flexibility than the county's pension and debt obligations, increases in the OPEB liability could negatively affect Fitch's 'aaa' liability assessment.

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 2021 the budget stabilization reserve, which is held in the assigned portion of the fund balance, totaled \$77.6 million while the policy reserve, which is held in the unassigned portion of

the fund balance, totaled \$33.3 million or a combined total of \$114 million or 10% of general fund spending, which is in-line with the revised policy.

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.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT ◆

RATING ◆

PRIOR ◆

Howard County (MD) [General Government]	LT IDR	AAA Rating Outlook Stable
	AAA Rating Outlook Stable	
	Affirmed	

Howard County (MD) /General Obligation - Unlimited Tax/1 LT	LT	AAA Rating Outlook Stable	AAA Rating Outlook Stable
	Affirmed		

Howard County (MD) /Lease Obligations - Standard/1 LT	LT	AA+ Rating Outlook Stable	AA+ Rating Outlook Stable
	Affirmed		

[VIEW ADDITIONAL RATING DETAILS](#)

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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)

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Howard County (MD)

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US Public Finance Infrastructure and Project Finance North America

United States
