

CREDIT OPINION

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New Issue

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St. Mary's County, MD

New Issue - Moody's Assigns Aa2 to St. Mary's County, MD's 2016 GO Bonds; Revises Outlook to Positive

Summary Rating Rationale

Moody's Investors Service has assigned a Aa2 rating to St. Mary's County, MD's \$25 million Consolidated Public Improvement Bonds, Series 2016. Concurrently, Moody's has affirmed the Aa2 rating on the county's \$32.6 million of general obligation (GO) debt outstanding. The outlook is positive.

The Aa2 rating incorporates the county's sizeable and stable tax base that is anchored by the Naval Air Station Patuxent River (NAS Pax River), above-average resident wealth levels, healthy reserves and liquidity supported by formal fiscal policies, and low debt and pension burdens.

Credit Strengths

- » Sizeable and stable tax base anchored by NAS Pax River
- » Above-average socioeconomic profile
- » Formal fiscal policies
- » Low debt and pension burdens

Credit Challenges

- » Local economy and employment vulnerable to federal military cuts
- » Reliance on economically sensitive revenues

Rating Outlook

The positive outlook reflects the county's stable technology-based local economy that will likely continue to experience growth, given further development within the technology sector as well as other industries. The positive outlook additionally incorporates the county's plan to rebuild reserves given a change from cash-funding pay-go capital projects to issuing debt. Despite future additional debt plans, debt levels are expected to remain low.

Factors that Could Lead to an Upgrade

- » Increase in reserves resulting from reduction of pay-go capital projects
- » Continued tax base growth

Factors that Could Lead to a Downgrade

- » Trend of operating deficits and declining reserve levels
- » Deterioration of tax base and socioeconomic profile

Key Indicators

Exhibit 1

St. Mary's (County of) MD	2011	2012	2013	2014	2015
Economy/Tax Base					
Total Full Value (\$000)	\$ 11,279,785	\$ 11,400,733	\$ 11,460,098	\$ 11,675,990	\$ 11,882,198
Full Value Per Capita	\$ 104,944	\$ 104,606	\$ 107,025	\$ 107,641	\$ 107,646
Median Family Income (% of US Median)	143.5%	142.7%	147.1%	151.9%	151.9%
Finances					
Operating Revenue (\$000)	\$ 196,046	\$ 202,802	\$ 200,982	\$ 204,231	\$ 209,431
Fund Balance as a % of Revenues	23.2%	29.2%	25.9%	21.6%	21.3%
Cash Balance as a % of Revenues	41.2%	46.2%	47.1%	46.3%	35.0%
Debt/Pensions					
Net Direct Debt (\$000)	\$ 103,877	\$ 97,665	\$ 100,961	\$ 92,172	\$ 82,605
Net Direct Debt / Operating Revenues (x)	0.5x	0.5x	0.5x	0.5x	0.4x
Net Direct Debt / Full Value (%)	0.9%	0.9%	0.9%	0.8%	0.7%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	N/A	0.9x	1.0x	0.9x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	N/A	1.5%	1.8%	1.7%

Source: Moody's Investors Service

Detailed Rating Considerations

Economy and Tax Base: Technology-Based Local Economy Dominated by Major Navy Base

The local economy will likely continue to grow given the county's strong technology sector anchored by NAS Pax River. NAS Pax River is the navy's center for avionics research and development, testing, evaluation, and acquisition. The base hosts the Naval Air Systems Command and Naval Air Warfare Center Aircraft Division and had a total economic output of \$7.5 billion in 2012. The presence of NAS Pax River attracts high technology industries to the county.

The county also focuses economic development efforts in other sectors, including tourism and recreation, healthcare, higher education, and advanced manufacturing. Continued economic development resulted in tax base growth averaging 2.4% annually for the five years ending in 2015. The full value is estimated to grow another 1.3% in 2016 to \$12.0 billion, which is above the US median.

Given the number of high-paying technology-based jobs in the county, resident wealth levels continue to increase with the median family income at 151.9% of the US median in 2014. The March 2016 unemployment rate of 4.5% is lower than the state (4.8%) and national (5.1%) rates for the same time period. The county's largest employer is NAS Pax River, with approximately 25,000 employees. Other large employers include defense contractors. Although the large amount of defense-related employers leaves the county vulnerable to federal military cuts, NAS Pax River has not experienced major cuts given its role as a strategic research base and is expected to continue strong operations.

Financial Operations and Reserves: Healthy Reserves Despite Use of Fund Balance for Pay-Go Capital Projects

The financial position will remain healthy given county management's commitment to conservative budgeting and adherence to formal fiscal policies. Despite the use of fund balance in fiscal 2013 and 2014 to fund the county's other post-employment benefit (OPEB) trust and pay-go capital projects, reserves have remained above the county's policy level, but below the US median. Fiscal 2015

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ended with an operating surplus of \$533,000, increasing the available fund balance to \$44.6 million, or a healthy 21.3% of General Fund revenues.

Property taxes are the main source of operating revenues at 49.9%, and have been growing as a result of the county's increasing assessed value. Economically sensitive income taxes are the second largest source of operating revenues at 38.7%.

County management estimates the available fund balance to decline to \$38.0 million, or a still solid 18.0% of estimated fiscal 2016 revenues, due to the use of \$11.8 million of fund balance for pay-go capital projects. The fiscal 2017 budget represents a 3.1% increase from the previous year's budget and does not include the use of fund balance. The county plans to reduce the amount of capital projects funded by pay-go going forward, which will allow the county to rebuild General Fund reserves.

LIQUIDITY

General Fund net cash at the end of fiscal 2015 is strong at \$73.2 million, or 35.0% of General Fund revenues, which is in line with similarly-rated entities.

Debt and Pensions: Low Debt and Pension Burdens

The county's debt burden will increase in the next five years given additional debt plans, but will remain low due to the currently modest level of debt outstanding and rapid principal amortization. Including the new issuance, the direct debt burden will be below-average at 0.8% of full value.

The county's 2017-2022 Capital Improvement Plan totals \$278 million, and largely supports public schools (33.9%), public facilities (26.5%), and highways (22.1%). The plan will be mostly bond-funded (52.8%), with a portion funded by state and federal grants (32.2%).

DEBT STRUCTURE

All of the county's debt is fixed rate, and amortization of debt is rapid with 75.2% of principal retired in 10 years. Fiscal 2015 debt service accounts for a low 4.7% of General Fund revenues.

DEBT-RELATED DERIVATIVES

St. Mary's County is not a party to any derivative agreements.

PENSIONS AND OPEB

The county participates in multi-employer, defined benefit retirement plans administered under the State Retirement and Pension System of Maryland for county and school employees. The county also administers a Sheriff's Office Retirement Plan, a single-employer defined benefit pension plan, as well as a length of service program for the Volunteer Fire Departments, Rescue Squads and Advanced Life Support Unit. The county's combined contributions to the plans was \$13.5 million in fiscal 2015, or an affordable 6.5% of operating revenues.

The county's adjusted net pension liability (ANPL) in fiscal 2015, under Moody's methodology for adjusting reported pension data, was \$157 million, or a below-average 0.8 times operating revenues. Moody's uses the ANPL 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.

The county funds its OPEB liability through a trust. Fiscal 2015 OPEB contributions totaled \$7.1 million, or a minimal 3.4% of operating revenues. The county contributed 117% of its annual OPEB cost in fiscal 2015, and the reported liability was 56.9% funded at the end of fiscal 2015. County management plans to contribute only the pay-go amount of the OPEB cost in fiscal 2016 and 2017. Total fixed costs, including debt service, pension, and OPEB, accounts for an affordable 14.6% of fiscal 2015 operating revenues.

Management and Governance: Formal Fiscal and Debt Policies; Strong Institutional Framework

Formal fiscal and debt policies will continue to support healthy financial operations of the county. The county maintains a fund balance policy to maintain its reserves at 15% of General Fund revenues, including a Bond Rating Reserve at 6% of revenues, a Rainy Day Fund at \$1.6 million, and the unassigned fund balance. Debt policies include limits on total debt at 2% of assessed value, and annual debt service at 10% of the General Fund budget. Despite future debt plans, the county will maintain debt levels well within its policies.

County management also maintains financial flexibility through conservative budgeting, and has the ability to increase the income tax rate to augment revenues, if needed, given that the current income tax rate of 3.0% is below the statutory limit.

Maryland counties have an institutional framework score of "Aa," or strong. Revenues are moderately predictable, since counties rely on both property and income taxes. Revenue-raising ability is high as there is no statewide cap on property taxes. However, several counties have locally imposed property tax caps and the income tax rate is capped at 3.2%. Expenditures, which are primarily for education and based on a state-mandated maintenance of effort (MOE) requirement, are moderately predictable. Aside from meeting the required MOE for education, counties have a moderate ability to reduce expenditures given a limited union presence and moderate fixed costs.

Legal Security

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

Use of Proceeds

Proceeds from the 2016 GO bonds will primarily finance road, public safety, and public school improvements, as well as other various capital projects.

Obligor Profile

St. Mary's County covers an area of 764 square miles and is located on a peninsula in southern Maryland with over 500 miles of shoreline. The county has a population of approximately 111,000.

Methodology

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

Ratings

Exhibit 2

St. Mary's (County of) MD

Issue	Rating
Consolidated Public Improvement Bonds, Series 2016	Aa2
Rating Type	Underlying LT
Sale Amount	\$25,000,000
Expected Sale Date	07/26/2016
Rating Description	General Obligation

Source: Moody's Investors Service

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