FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Howard County, MD's $124 Million GO Bonds 'AAA'; Outlook Stable

Mon 12 Feb, 2024 - 12:52 PM ET

Fitch Ratings - New York - 12 Feb 2024: Fitch Ratings has assigned 'AAA' ratings to the following Howard County, MD general obligation (GO) bonds:

--$97,145,000 consolidated public improvement project bonds 2024 series A (tax-exempt);

--$24,285,000 metropolitan district project bonds 2024 series B (tax-exempt);

--$2,265,000 consolidated public improvement project bonds 2024 series C (taxable).

The bonds are scheduled to sell on a competitive basis on Feb. 27, 2024. Proceeds of the bonds will be used to reimburse the county for the cost of certain public improvements and to repay all or a portion of the county's outstanding bond anticipation notes. Par amounts are preliminary and subject to change.

In addition, Fitch has affirmed the following ratings:

--Howard County's Issuer Default Rating (IDR) at 'AAA';

--Outstanding GO bonds at 'AAA';

--Equipment program certificates of participation series 2021A 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 county's '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 335,411 as of 2022, a notable 17% 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, which bolsters its 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. However, 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 should not materially alter the burden metric as 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:

--A sustained increase in the long-term liability to in excess of 10% or more of residents' personal income with a commensurate rise in fixed carrying cost associated with debt service and employee retirement benefits to greater than 20% of total government expenditures;

--A continual decline in unrestricted general fund balance close to or below 10%, leading to lower financial flexibility and resilience assessment.

CURRENT DEVELOPMENTS

The county ended the fiscal year June 30, 2023 with a net operating surplus of approximately $82 million (6% of spending), increasing its unrestricted general fund balance to $485 million or approximately 36% 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 57% of general fund spending.

Fiscal year end 2023 results reflect continued robust income tax revenue growth due to a sizeable over distribution by the state attributable to a lag in reconciliation, with increased capital gains and pandemic related federal stimulus from several years prior fueling the growth. The county additionally experienced positive variances in spending as county departments held open positions and maintained its focus on improving operating efficiencies.

The county has received $63.3 million under the American Rescue Plan Act of 2021 (ARPA), with $45.5 million that has been allocated through December 2023; the deadline for spending is 2026. ARPA funds were used for one-time purposes, with a focus on health and frontline workers, child care support, workforce retention and infrastructure and technology improvements.

The fiscal 2024 general fund budget of $1.5 billion is a $119.5 million (9.5%) increase over the fiscal 2023 approved budget. The budget includes $100 million use of fund balance reserve for one-time use consisting of pay-go capital projects for education and infrastructure needs, as well as to provide grants, health and mental health initiatives, and funding for youth and education programs and other non-recurring needs.

The fiscal 2024 approved budget included no changes to the property, income, transfer and recordation tax rates and includes new positions for public safety, technology and education. According to county management, general fund operating results are positive relative to the budget 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 is a home base to all six military services and several federal agencies, including the National Security Agency (NSA), which is also a 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 five years (which does not include any expansion of NSA personnel).

Employment growth remains steady, as the county continues to generate and retain jobs through its economic development efforts. The unemployment rate remains below the state and national averages. 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.

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 97% of fiscal 2023 county general fund revenues, each accounting for 47% and 50% of total general fund revenues, respectively. 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 $60.9 billion in 2023 was a 3.5% increase over 2022. According to data from Maryland Department of Assessments and Taxation, assessments are expected to grow 4.3% in 2024 and 4.8% in 2025 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 fiscal year 2023. Fitch believes the county's revenue growth prospects are considered strong, given ongoing economic development, growth in tax base values and population, as well as positive housing and employment trends.

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 58% of fiscal 2023 general fund expenditures and transfers out, followed by public safety at 12%.

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.

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 15% of fiscal 2023 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 in the same range. 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 6% 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 68% of outstanding principal within 10 years following this issuance, leaving adequate capacity to fund future borrowing needs. The county's fiscal 2025-2029 capital plan totals about $1.5 billion, including water and sewer projects. The plan is approximately 51% 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 reduced the discount rate to 7.35% in fiscal 2022 and 7.25% in fiscal 2024.

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 $528 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 $26 million.

The county administers an OPEB trust fund that provides benefits for its retirees. As of the June 30, 2022 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 2023 the policy reserve, which is held in the assigned portion of the fund balance, totaled $43 million while the budget stabilization reserve, which is held in the committed portion of the fund balance, totaled $81 million or a combined total of $124 million or 11% of general fund spending, which is in line with the revised policy. The total unrestricted general fund balance at fiscal 2023 year-end totaled $484 million or 36% 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 recent years. The county continues budget conservatively and proactively manages cost to generate savings and provide flexibility throughout economic cycles.

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

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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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

Endorsement Policy

ENDORSEMENT STATUS

Howard County (MD)	EU Endorsed, UK Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. Sector-specific best- and worst-case scenario credit ratings are listed in more detail at https://www.fitchratings.com/site/re/10238496

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