Maryland GFOA 2017 Summer Conference

Credit Rating Panel

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FitchRatings

Topics of Interest

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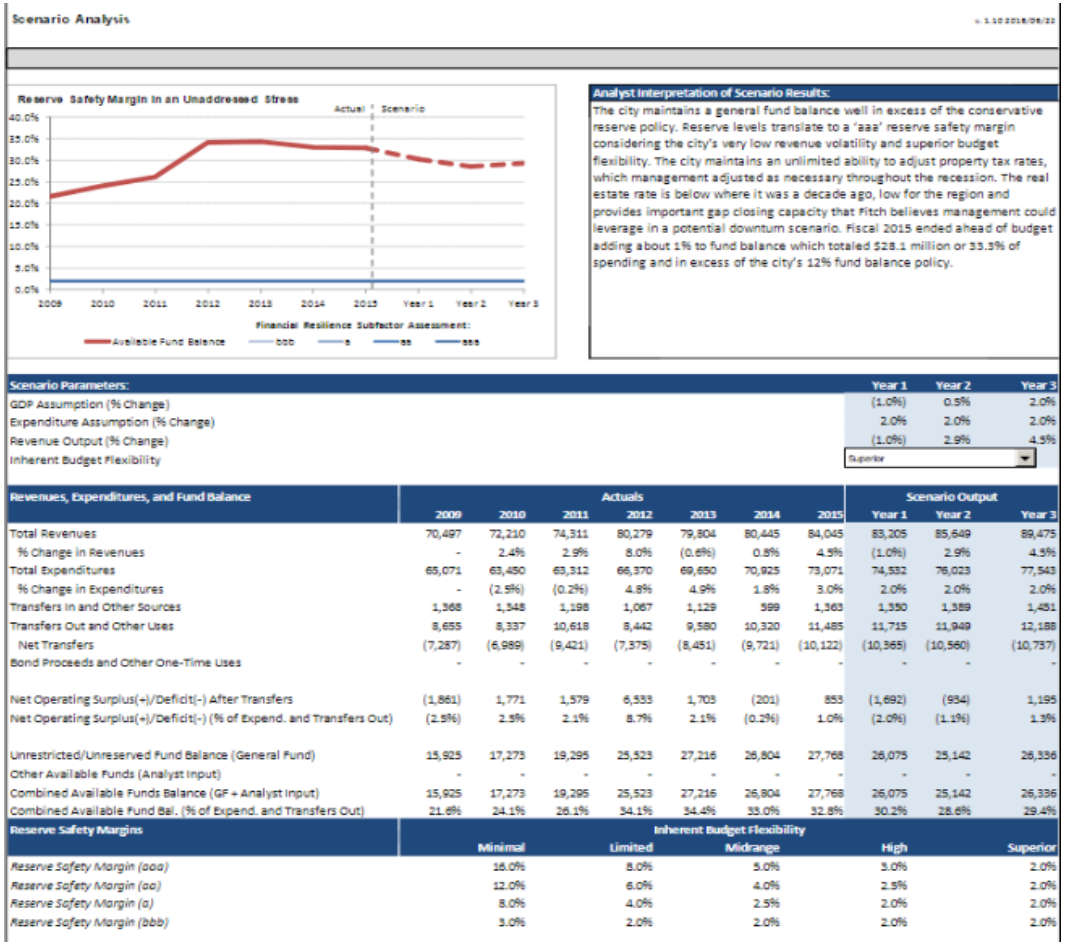
New Criteria Brings Changes

- Fitch released its new U.S. Tax-Supported Rating Criteria in April 2016
- Introduction of the Issuer Default Rating (IDR)
- Key Rating Factors (KRFs)
  - Cover both the institutional framework in which an issuer operates and performance within that framework
  - Fitch will publish key rating factor assessments ('aaa' through 'bb')
- Rating outcome does not reflect standard weighting of KRFs
  - Consideration of issuer-specific qualitative and quantitative factors

Rating Through-the-Cycle

- Scenarios address rating tolerance



Scenario Analysis

Analyst Interpretation of Scenario Results:

The city maintains a general fund balance well in excess of the conservative reserve policy. Reserve levels translate to a 'aaa' reserve safety margin considering the city's very low revenue volatility and superior budget flexibility. The city maintains an unlimited ability to adjust property tax rates, which management adjusted as necessary throughout the recession. The real estate rate is below where it was a decade ago, low for the region and provides important gap closing capacity that Fitch believes management could leverage in a potential downturn scenario. Fiscal 2015 ended ahead of budget adding about 1% to fund balance which totaled $28.1 million or 33.3% of spending and in excess of the city's 12% fund balance policy.

Scenario Parameters:	Year 1	Year 2	Year 3
GDP Assumption (% Change)	(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)	2.0%	2.0%	2.0%
Revenue Output (% Change)	(1.0%)	2.9%	4.5%
Inherent Budget Flexibility	Superior		

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2009	2010	2011	2012	2013	2014	2015	Year 1	Year 2	Year 3
Total Revenues	70,497	72,210	74,311	80,279	79,804	80,445	84,045	83,205	85,649	89,475
% Change in Revenues	-	2.4%	2.9%	8.0%	(0.6%)	0.8%	4.5%	(1.0%)	2.9%	4.5%
Total Expenditures	65,071	63,450	63,312	66,370	69,650	70,925	73,071	74,532	76,023	77,543
% Change in Expenditures	-	(2.5%)	(0.2%)	4.8%	4.9%	1.8%	3.0%	2.0%	2.0%	2.0%
Transfers In and Other Sources	1,368	1,348	1,198	1,067	1,129	599	1,363	1,350	1,389	1,451
Transfers Out and Other Uses	8,655	8,337	10,618	8,442	9,580	10,320	11,485	11,715	11,949	12,188
Net Transfers	(7,287)	(6,989)	(9,421)	(7,375)	(8,451)	(9,721)	(10,122)	(10,365)	(10,560)	(10,737)
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	(1,861)	1,771	1,579	6,533	1,703	(201)	853	(1,692)	(934)	1,195
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	(2.5%)	2.5%	2.1%	8.7%	2.1%	(0.2%)	1.0%	(2.0%)	(1.1%)	1.3%
Unrestricted/Unreserved Fund Balance (General Fund)	15,925	17,273	19,295	25,523	27,216	26,804	27,768	26,075	25,142	26,336
Other Available Funds (Analyst Input)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Analyst Input)	15,925	17,273	19,295	25,523	27,216	26,804	27,768	26,075	25,142	26,336
Combined Available Fund Bal. (% of Expend. and Transfers Out)	21.8%	24.1%	26.1%	34.1%	34.4%	33.0%	32.8%	30.2%	28.6%	29.4%

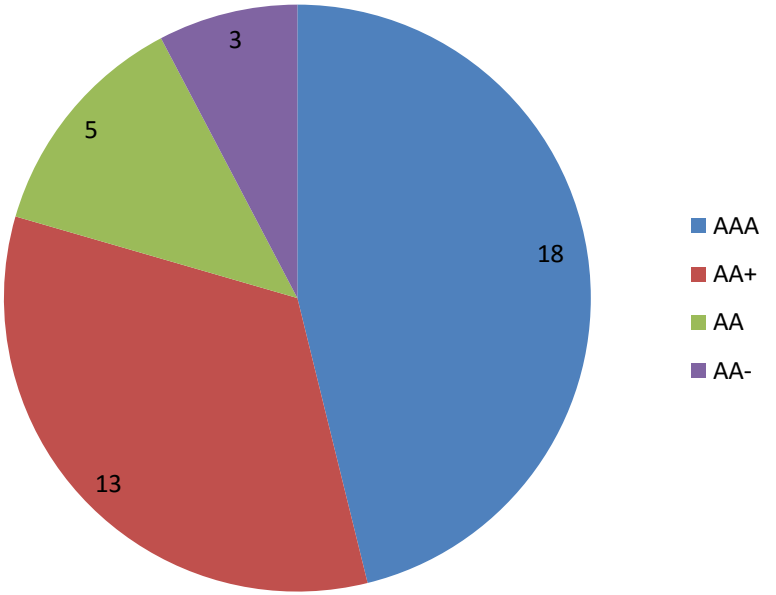
Reserve Safety Margins	Inherent Budget Flexibility				
	Minimal	Limited	Midrange	High	Superior
Reserve Safety Margin (aaa)	16.0%	8.0%	5.0%	3.0%	2.0%
Reserve Safety Margin (aa)	12.0%	6.0%	4.0%	2.5%	2.0%
Reserve Safety Margin (a)	8.0%	4.0%	2.5%	2.0%	2.0%
Reserve Safety Margin (bbb)	3.0%	2.0%	2.0%	2.0%	2.0%

- Considers how a government's revenues may be affected in a cyclical downturn and the options available to address the resulting budget gap
- Conveys the range of performance where a rating would be expected to remain stable
- Recognizes that an issuer's financial position will fluctuate through an economic cycle

Criteria Implementation: MD Local Government Ratings

- 39 city and county issuers reviewed (GO and IDRs)
  - 30 rating affirmations and 9 upgrades
- Rating upgrades largely reflect criteria change
  - More focused consideration of economic factors
  - Sufficiency of economic resources relative to the issuer's risk profile

Fitch MD Local Government IDR Distribution



Maryland Local Governments – Revenue Framework

- KRF assessments – mostly 'aaa'
- Generally strong growth prospects in-line with Fitch's view of the State.
  - Risk factors present, including slowed personal income growth
  - Maryland revenues could be affected by federal spending decisions more than other states. In addition to Medicaid and other national policy questions, Maryland benefits more from direct federal employment, military activity, and federal contracting than other states.
- Economic profile remains strong
  - Industry diversity – service dominated
  - High wealth and skilled labor
- Unlimited ad valorem taxing power – focus on legal authority a key criteria change
- Stable tax base - Zillow Home Prices (May 2017) are up 4.6% y-o-y across the State; 1.9% 1-year forecast

Maryland Local Governments – Expenditure Framework

- KRF assessment of 'aa' for most MD local governments
- Solid flexibility, manageable spending pressures
  - Sound legal control over personnel costs – bargained labor terms but ability to impose cuts
  - Most entities have regained capacity to reduce spending in a downturn without threatening basic service levels
- Debt and retiree benefits consume a reasonable portion of governmental spending
- Education funding
  - MOE provides some constraints
  - Lack of independent ability to reduce spending below MOE

Maryland Local Governments – Long-term Liabilities

- KRF assessment of 'aaa' for the strong majority of MD local governments
- Many comfortably within 'aaa' metric guidance (10% of personal income)
- Key criteria changes
  - Focus on combined debt and pension metric
  - Liabilities expressed as a percentage of personal income not market value
- Conservative debt management practices
- Infrastructure funding concerns
  - For the third year in a row, the National League of Cities' 2016 survey of fiscal conditions cited a lack of infrastructure funding as the leading budgetary concern, above employee salary, pension and healthcare benefits as a source of pressure

Pensions Growing, Few Reporting Surprises

- Pension liabilities rising with lower discount rates, weak investment performance
- Reporting under new GASB standards implemented
  - Increased comparability and information on cost-sharing plans support analysis
  - Reported liability burdens now more volatile given elimination of "asset smoothing"
- Fitch liability adjustment now assumes 6% fixed discount rate (May 2017 criteria update)
  - Low likelihood that pension assets will grow as fast as in past
  - More precise estimate of magnitude of liability

Maryland Local Governments – Operating Framework

- KRF assessment of 'aaa' for 24 of 25 MD local governments rated by Fitch
- The adequacy of an issuer's financial flexibility and reserves is considered in the context of its inherent budget flexibility and the decline in revenue an issuer might experience in an economic downturn
- Superior inherent budget flexibility reflects broad legal control over leading sources of revenue and personnel-related costs, and low fixed-cost burden
- Revenue sensitivity analysis produced via Fitch Analytical Sensitivity Tool (FAST)
- Analytical interpretation – expectations of what an issuer would do in response to a cyclical revenue decline is key to the analysis
- Budget management practices examined for deferral of required spending, risk to outside parties, and timeliness and quality of financial information, among other factors

U.S. Local Government Outlook Stable for 2017

- Core fundamentals remain strong
- The average IDR across U.S. local government portfolio lies between 'AA' and 'AA+' and reflects the following strengths shared by most municipalities
  - The authority to levy property taxes, nonpayment of which can result in property foreclosures
  - Additional taxing power that can include various sales and income taxes
  - The ability to control spending to at least a moderate degree
  - The essentiality of and lack of competition for services provided by local governments
  - Moderate carrying costs relative to spending and long-term liabilities relative to income
- Ratings account for normal cyclical variations
- No expectation for economic cycle of unusual depth or duration or fundamental change in intergovernmental relationships

Related Research

- U.S. Public Finance Tax-Supported Rating Criteria (May 2017)
- Revised Pension Risk Measurements (Enhancing Pension Analysis in U.S. Public Finance Tax-Supported Rating Criteria)
- U.S. Tax-Supported Criteria Implementation Update: More Focused Analysis and More Robust Communication (January 2017)
- Tax-Supported Criteria Revision (April 2016)
- 2017 Outlook: US Local Governments (December 2016)
- Work Force Evaluation Key to Local Government Analysis (October 2015)
- Pension Obligation Bonds – Weighing Benefits and Costs (March 2015)
- New Pension Perspectives – Long-Awaited GASB Pension Changes Begin (February 2015)

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