On August 11, 2021, the State sold $852 million in general obligation (GO) bonds for capital projects. This included $540 million in new tax-exempt bonds, $75 million in new taxable bonds, and $237 million in tax-exempt forward refunding bonds. Maryland typically issues GO bonds twice a year to support the State’s nontransportation capital program.

The true interest cost (TIC) for the sale is 1.31%. The TIC for the most recent bond sale on February 23, 2021, was 1.59%. Interest rates for municipal bonds have declined since the last bond sale. For example, The Bond Buyer’s weekly 20-bond GO Index declined from 2.44% on February 25, 2021, to 2.04% on August 5, 2021.

As with other recent issuances of new debt, the tax-exempt bonds sold generated a substantial premium, which totaled $169.3 million, after deducting the underwriter’s discount and cost of issuance. Recent guidelines from bond counsel limit the amount of premiums that can be used for GO bond debt service to capitalized interest, which is interpreted as interest payments made prior to any principal payments. Maryland GO bonds do not make any principal payments until the third year, so the first six debt service payments are capitalized interest. This limits the amount of premiums supporting debt service to $77.4 million, leaving $91.9 million to support capital projects.

New Bonds for Capital Projects

The State issued $615 million in new GO bonds. The bonds were grouped into the following three issuances:

- Series A Group 1, which sold tax-exempt bonds maturing in 5 to 10 years. Six underwriters bid for the bonds sold in Group 1, and J. P. Morgan Securities LLC (JPMC LLC) submitted the winning bid.

- Series A Group 2, which sold tax-exempt bonds maturing in 11 to 15 years. Six underwriters bid for the bonds sold in Group 2, and JPMC LLC submitted the winning bid.

- Series B, which sold taxable bonds. Eleven underwriters bid for the taxable bonds sold, and Wells Fargo, National Association submitted the winning bid. Although taxable bonds tend to sell at a higher interest rate than tax-exempt bonds, these rates are low because the State Treasurer’s Office (STO) structures the bonds with shorter maturities to minimize costs.

Exhibit 1 summarizes the key data from each Series.
Exhibit 1
New Taxable and Tax-exempt Bonds
August 11, 2021
($ in Thousands)

<table>
<thead>
<tr>
<th>Description</th>
<th>Tax Status</th>
<th>Bidders</th>
<th>True Interest Cost</th>
<th>Average Maturity (In Years)</th>
<th>Amount Sold</th>
<th>Net Premium¹ (Discount)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Series A Group 1</td>
<td>Tax-exempt</td>
<td>6</td>
<td>0.76%</td>
<td>7.58</td>
<td>$258,950</td>
<td>$80,225</td>
</tr>
<tr>
<td>Series A Group 2</td>
<td>Tax-exempt</td>
<td>6</td>
<td>1.78%</td>
<td>13.02</td>
<td>$281,050</td>
<td>89,110</td>
</tr>
<tr>
<td>Series B</td>
<td>Taxable</td>
<td>11</td>
<td>0.60%</td>
<td>3.44</td>
<td>$75,000</td>
<td>-74</td>
</tr>
</tbody>
</table>

¹ Net premium (Discount) deducts underwriters’ discount and cost of issuance.

Source: Public Resources Advisory Group; Preliminary Official Statement

Forward Refunding Bonds to Retire Callable Bonds

STO projects that this is the appropriate time to issue these forward refunding bonds. Interest rates are currently low, and STO is concerned about the potential for economic data or inflation scares that could increase interest rates. In this sale, the State issued $237 million in forward refunding bonds, of which $114 million will be settled on or near March 1, 2022, and $123 million will be settled on or near May 3, 2022. Exhibit 2 provides key summary data from the sales.

Exhibit 2
Tax-exempt Forward Refunding Bonds
August 11, 2021
($ in Thousands)

<table>
<thead>
<tr>
<th>Description</th>
<th>Settlement Date</th>
<th>True Interest Cost</th>
<th>Average Maturity (In Years)</th>
<th>Amount Sold</th>
<th>Amount Called</th>
<th>Debt Service Savings</th>
<th>NPV of Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Series C</td>
<td>March 1, 2022</td>
<td>0.87%</td>
<td>5.73</td>
<td>$113,840</td>
<td>$134,655</td>
<td>$22,387</td>
<td>$21,274</td>
</tr>
<tr>
<td>Series D</td>
<td>May 3, 2022</td>
<td>1.04%</td>
<td>6.28</td>
<td>123,285</td>
<td>141,075</td>
<td>19,010</td>
<td>17,833</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td>$237,125</td>
<td>$275,730</td>
<td>$41,397</td>
<td>$39,107</td>
</tr>
</tbody>
</table>

NPV: net present value

Source: Public Resources Advisory Group
This bond sale is more complicated and unique than previous sales have been, so this sale is a negotiated sale instead of a competitive bid. STO advises that Bank of America Securities, Inc. (B of A Securities) was chosen to be the underwriter because its affiliated underwriter, Bank of America Merrill Lynch (BAML), has been offering competitive bids recently. For example, BAML offered the lowest bid for both tax-exempt issuances during the February 2021 sale. STO believes that selecting a competitive bidder for this negotiated sale could also encourage other underwriters to offer more competitive bids for traditional tax-exempt and taxable issuances.

**Call Options and Forward Refunding Bonds’ Structure**

Maryland GO bonds are callable after 10 years. Consequently, bonds with maturities exceeding 10 years can be retired early. If market interest rates for these bonds are below the bonds’ coupon rate, the State can call the bonds and issue refunding bonds at a lower rate. The proceeds from the refunding bonds are used to retire the previously issued callable bonds.

In prior years, federal tax law allowed issuers one advanced refunding for each issuance. An advanced refunding allows the issuers to close the refunding sale before the call date so that the issuer can realize savings from lower interest rates before the call date. The federal Tax Cuts and Jobs Act (TCJA) of 2017 changed federal tax law so that advanced refunding bonds can no longer be tax deductible. This eliminated a key advantage since taxable bonds are more expensive than tax-exempt bonds. Since issuing tax-exempt advanced refunding bonds is no longer allowed, the State’s refunding options are (1) to refund tax-exempt issuances with tax-exempt refunding bonds when the bonds are callable; (2) to issue more expensive taxable advanced refunding bonds; or (3) to issue forward refunding bonds to lock into anticipated refunding savings prior to the time that the bonds can be called.

After the TCJA was enacted, there was a sharp decline in refunding issuances. From calendar 2009 to 2017, Maryland issued advanced refunding bonds at 11 bond sales, which saved the State $316 million in debt service costs. No advanced refunding bonds were issued in calendar 2018 and 2019. The State issued tax-exempt refunding bonds in February 2020. At the July 2020 bond sale, the State sold tax-exempt and taxable refunding bonds.

**August 2021 Forward Delivery Bond Sale**

With this sale, the State issues forward delivery bonds to retire GO bonds that are callable in calendar 2022. The sale has an initial closing date on August 25, 2021, with settlement dates in March and May 2022, depending on the call date of the refunded bonds. The State enters into a Forward Delivery Bonds Purchase Agreement with the underwriter, B of A Securities. The forward delivery bonds are sold to third-party purchasers. B of A Securities enters into Delayed Delivery Contracts with the purchasers of the forward delivery bonds. The State is not party to the Delayed Delivery Contracts. Except as specified, a purchaser of forward delivery bonds will not be able to withdraw their orders on the 2022 settlement dates because of market or credit changes, including changes in the financial condition, operations, performance, or prospects of the State occurring between the closing date in August 2021 and the settlement dates in 2022. As such, the purchasers of the forward delivery bonds assume the market risk.
In addition, the Forward Delivery Bonds Purchase Agreement requires that certain conditions be met by the State prior to the March and May 2022 settlement dates. Included in these conditions are that the bonds maintain an investment grade rating (ratings of BBB- by Standard and Poor’s (S&P) and Fitch and Baa3 by Moody’s), that representations made by the State are accurate, and that the State performs all required obligations. One such obligation is that the State prepare an Updated Official Statement between three weeks and five days before the respective settlement dates.

In this bond sale, each party has obligations. Although it is unlikely, it is possible that all conditions for settlement are not met. STO and its financial advisor advise that they are not aware of any Forward Delivery Bonds Purchase Agreements that failed to settle in the recent past. Additionally, the State has $4.8 million received from a good faith deposit from B of A Securities that the State could retain if the deal does not settle. However, if all conditions are not met for settlement, the State may be required to issue additional refunding bonds to call the bonds or the State may not have the proceeds to call the bonds and therefore would not realize any refunding savings.

**Effect on the State Operating Budget**

The fiscal 2022 GO bond debt service appropriation provides $1,394 million of which STO estimates $13.6 million is budgeted for the August 2021 bond sale. Actual fiscal 2022 debt service costs from this sale total $11.4 million, which is $2.2 million less than budgeted. Savings from the forward refunding bonds are realized between fiscal 2023 and 2030.

**Maryland Bonds Rated AAA-stable**

With respect to Maryland, the rating agencies identified the following strengths:

- **Wealth and Income Levels:** All rating agencies comment that Maryland’s per capita personal income is among the highest in the nation. S&P notes that per capita personal income in Maryland is 114% of the U.S. average.

- **Broad and Diverse Economy:** Strengths include abundant higher education and research institutions; proximity to the nation’s capital; transportation facilities such as the Port of Baltimore; and a concentration of employment in higher paying sectors such as business services, education and health services, and government. Moody’s notes that Maryland has a highly educated workforce whereby 40% of the population over 25 has at least a bachelor’s degree, compared to about 32% nationwide.

- **Strong and Well-embedded Financial Practices:** Fitch notes that the State has “consensus-oriented decision making with a willingness to trim spending and increase revenues, and disciplined multiyear forecasting and planning.” Moody’s considers Maryland’s “proactive financial management” to be a credit strength and that the Board of
Public Works “is empowered to make mid-year budget adjustments.” S&P notes that Maryland has a “long history of proactive financial and budget management.” The agencies also noted that the State has made numerous attempts to address the unfunded pension liability, such as increasing State and employee retirement contributions, moving to an actuarially approved approach, reducing benefits, and increasing the length of time that it takes new employees to vest. Strengths of the capital budget process include the Capital Debt Affordability Committee process and the State constitution limiting GO bond maturities to 15 years.

• **Adequate Reserves and Liquidity:** Moody’s considers the State’s adequate budgetary reserves and strong liquidity to be a credit strength. Moody’s also notes Maryland has a “very strong cash liquidity.”

However, the rating agencies did identify challenges. The most significant and consistently noted challenges relate to the State’s long-term liabilities, which primarily are State debt, and pension and other retiree benefit liabilities. Moody’s considers Maryland’s fixed costs as a share of State revenues to be in line with A-rated states, not AAA-rated states. Fitch rates Maryland’s long-term debt burden as “aa.” S&P notes that “Management of [Maryland’s] long-term liabilities are key to future credit stability” and that if “debt issuance or further obligations outpace economic growth, it could pressure our view of the State’s debt profile.” This suggests that the State should limit growth in debt to economic or fiscal indicators. The rating agencies appreciate that the State’s debt practices are strong and adhered to, which helps explain why Maryland continues to maintain a AAA rating.

Rating agencies have identified factors that could lead to Maryland being placed on credit watch or downgraded, which include:

• economic and financial deterioration that results in deficits, fund transfers, and reserve draws without a plan for near-term replenishment and structural balance;

• failure to keep a commitment to fully fund pensions; and

• increased long-term liabilities, such as debt increasing more than economic indicators or retiree benefits not mitigated by policy or budget actions.