February 2021 General Obligation Bond Sale

On February 23, 2021, the State sold $475 million in general obligation (GO) bonds to fund capital projects. This included $425 million in new tax-exempt bonds and $50 million in new taxable bonds. Maryland typically issues GO bonds twice a year to support the State's nontransportation capital program. The Department of Legislative Services has prepared this document to provide an overview of the bond sale and its impact on the operating budget and capital program.

The true interest cost (TIC) for the February 2021 bond sale is 1.59%. The TIC for the most recent bond sale in July 2020 was 1.11%. The TIC is higher because interest rates have increased since the last sale, especially in recent weeks. As with other recent issuances of new debt, the new tax-exempt bonds sold generated a substantial premium totaling $134 million, after deducting the underwriter's discount and cost of issuance.

Tax-exempt Bonds

The State issued $425 million in tax-exempt bonds, which was a large bond sale. In an effort to increase competition, the State Treasurer's Office (STO) divided the sale into two bidding groups, $207 million in Group 1 and $218 million in Group 2.

Six underwriters bid for the $207 million of bonds sold in Group 1. Bank of America Merrill Lynch submitted the winning bid with a TIC of 0.93%. The bonds' maturities ranged from 4 years to 10 years with an average maturity of 7.5 years. The Group 1 sale generated a premium totaling $60.8 million, after deducting the cost of issuance and the underwriters' discount.

Four underwriters bid for the $218 million of bonds sold in Group 2. Bank of America Merrill Lynch submitted the winning bid for Group 2 with a TIC of 2.03%. The bonds' maturities range from 11 years to 15 years with an average maturity of 13.1 years. The higher TIC for Group 2 is attributable to the longer maturities. After deducting the cost of issuance and the underwriter's discount, the Group 2 sale generated a premium totaling $73.7 million.

Taxable Bonds

Eight underwriters bid for the $50 million of taxable bonds sold. Wells Fargo, National Association submitted the winning bid with a TIC of 0.49%. The bonds' maturities ranged from 3 years to 4 years with an average maturity of 3.4 years. The taxable bonds essentially sold at par, so there was no premium. Although taxable bonds tend to sell at a higher rate than tax-exempt bonds, these rates are low because STO issues taxable bonds at shorter maturities to minimize costs.

Effect on the State Operating Budget and Capital Program

The fiscal 2022 GO bond debt service allowance provides $1,394 million, of which $27 million supports the February 2021 bond sale. Actual fiscal 2022 debt service costs from this sale total $20.9 million, which is $6.1 million less than budgeted.

The fiscal 2022 budget projected $128.2 million in premiums from this sale. Actual premiums totaled $134.4 million, which is $6.2 million more than estimated. Advice from bond counsel limits premiums from this sale so that premiums can only support debt service to capitalized interest, which is defined as the first three years' interest payments. This totals $63.2 million. Since premiums exceed capitalized interest, the additional $71.2 million in premiums is available to support capital projects.

Maryland Bonds Rated AAA-stable

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

- ***Wealth and Income Levels:*** S&P notes that Maryland's per capita personal income was $64,640, which is 114% of the national average in 2019.

- ***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 "very strong fiscal management with consensus-oriented long-term planning and multiple sources of flexibility, all of which position the state to address implications of the ongoing coronavirus pandemic." 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 considers that Maryland's financial "practices are strong, well embedded, and likely sustainable." 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 that the budget increases the Rainy Day Fund balance to nearly $1 billion at the end of fiscal 2022.

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 Post Employment Benefits (OPEB) liabilities. Moody's Scorecard considers Maryland's debt and pension liabilities to be more in line with AA-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 is key to future credit stability." As previously mentioned, the State's debt practices are strong and the State adheres to them, which helps explain why Maryland has a AAA rating even though the debt profile matches a AA state.

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
- "if debt issuance outpaces economic growth, it could pressure our view of the State's debt profile" as noted by S&P.