June 2024 General Obligation Bond Sale

On June 5, 2024, the State sold $1.2 billion in general obligation (GO) bonds for capital projects. This was $1 billion in new tax-exempt bonds and $200 million in new taxable bonds. The true interest cost (TIC) for the sale's tax-exempt bonds is 3.28%, and the TIC for the taxable bonds is 4.52%. The TIC for the most recent tax-exempt bond sale in March 2023 was 2.91%, and the TIC for the taxable bonds was 4.07%. The higher TIC is consistent with recent increases in interest rates. The taxable bonds TIC was higher than tax-exempt bonds with longer maturities, which highlights the additional costs paid when taxable bonds are issued.

The bonds are grouped into the following four issuances:

- Series A Group 1, which sold tax-exempt bonds maturing in 5 to 9 years. Six underwriters bid for the Group 1 bonds, and BofA Securities submitted the winning bid.
- Series A Group 2, which sold tax-exempt bonds maturing in 10 to 12 years. Six underwriters bid for the Group 2 bonds, and Morgan Stanley & Co. LLC submitted the winning bid.
- Series A Group 3, which sold tax-exempt bonds maturing in 13 to 15 years. Six underwriters bid for the Group 3 bonds, and J.P. Morgan submitted the winning bid.
- Series B, which sold taxable bonds maturing in 3 to 5 years. To minimize additional costs resulting from higher interest rates for taxable bonds, the bonds are structured so that these bonds share the shortest maturities. Six underwriters bid for the Series B bonds, and Wells Fargo submitted the winning bid.

Exhibit 1 summarizes key data from each series.

Exhibit 1

New Taxable and Tax-exempt Bonds

June 5, 2024 Sale
($ in Thousands)

Description	Tax Status	Bidders	True Interest Cost	Average Maturity in Years	Amount Sold	Net Premium[1]
Series A Group 1	Tax-exempt	6	2.92%	7.44	$351,630	$46,438
Series A Group 2	Tax-exempt	6	3.14%	10.98	300,505	50,933
Series A Group 3	Tax-exempt	6	3.57%	13.98	347,865	53,923
Series B	Taxable	6	4.52%	3.92	200,000	0

[1] Net premium deducts $1.3 million for underwriters' discount and cost of issuance.

Source: Public Resources Advisory Group

Fiscal 2025 Capital and Operating Budget Impacts

Debt service costs are less than projected, and the bonds sold at a premium. Fiscal 2025 debt service is fully funded, so the debt service savings and premium revenues will accumulate in the Annuity Bond Fund (ABF), increasing the end of fiscal 2025 balance by $149.6 million. **Exhibit 2** shows that debt service costs are $2 million less than budgeted. Lower debt service costs are attributable to lower coupon rates for taxable bonds of between 4.44% and 4.61%, compared to estimated coupon rates of 5.00%. The State did not estimate any bond sale premiums, so $147.6 million in net premiums will go to the ABF balance. These net premiums are bond sale proceeds that will require 15 years of debt service payments to retire.

Exhibit 2
Effect of Bond Sale on Annuity Bond Fund
Fiscal 2025
($ in Thousands)

Projected Debt Service Costs	$58,250
Actual Debt Service Costs	56,243
Reduced Debt Service Costs	**$2,007**
Bond Proceeds (Net Premiums) Supporting Capitalized Interest*	**$147,639**
Increase in Fiscal 2025 End-of-year Fund Balance	**$149,646**

*The $147.6 million is the share of premiums that the State can apply to debt service under federal rules. Another $5.1 million of premiums is available to fund capital projects.

Note: These are preliminary results, final amounts will be available after closing on June 18, 2024.

Source: Public Resources Advisory Group

The sale's net premiums totaled $152.6 million. Federal regulations limit how much of the proceeds generated by bond premiums can support debt service to $147.6 million. The remaining $5.1 million in premiums is allocated for additional project funding that can support tax-exempt capital projects authorized in 2025. The large end-of-year ABF balance will reduce projected general fund debt service costs in fiscal 2026 by almost $150 million, offering some much needed budget savings.

Maryland Bonds Rated AAA but Moody's Revises Outlook to Negative

The three rating agencies rated Maryland GO bonds AAA, based on the following credit strengths:

- high wealth and income levels;
- a broad and diverse economy;
- strong and well-embedded financial practices;
- strong debt affordability management and rapid debt amortization; and
- adequate reserves and liquidity.

The data used by all three rating agencies was provided through the State's transparent forecasting and budgeting processes. While Standard and Poor's (S&P) and Fitch continue to rate Maryland's outlook as stable, Moody's revised its outlook for Maryland to negative. Moody's cited "expected structural imbalances and planned depletion of General Fund surplus through fiscal 2025, which threatens to undermine performance relative to peers."

The Department of Legislative Services (DLS) observes that this is not the first time Moody's has applied a negative outlook with its Maryland rating. In July 2011, while federal officials were struggling to increase the federal debt ceiling, Moody's applied a negative outlook to Maryland and four other states due to high reliance on federal spending. While there was evidence that interest rates were higher at the initial bond sale conducted several weeks after the negative outlook was issued, there is no statistical evidence that there were any effects beyond that initial sale. After the federal debt ceiling crisis ended, the negative outlook was withdrawn. DLS will continue to monitor any impacts of the current negative outlook from Moody's.

Moody's also applied a negative outlook to the Baltimore City Public Schools Construction and Revitalization Program, the Baltimore Board of School Commissioners, and the Maryland Infrastructure Financing Intercept Program. Other issuances, like Built to Learn and Maryland Stadium Authority revenue bonds, are unaffected.

Challenges Identified by Rating Agencies That Could Lead to Ratings Downgrade

S&P and Fitch did identify challenges and factors that could lead to a ratings downgrade or negative outlook, such as:

- Fitch notes that a "failure to adhere to policies to address large, unfunded pension liabilities" or an "economic or financial deterioration leading to continued structural operating deficits that cause reserve draws beyond fiscal 2025, without a plan for near-term replenishment" could individually or collectively lead to a downgrade.
- S&P notes that the "ability to manage these costs while keeping its liabilities within the State's affordability guidelines, particularly during downturns and periods of increased spending demands, is crucial to rating stability."

- Maryland is a high debt state, and Fitch ranks the State's long-term liabilities as AA, which implies that managing debt is key to maintaining a AAA rating.

- S&P advises that it scores Maryland at AA+ due to high liabilities like debt and unfunded pension and Other Post Employment Benefit liabilities. S&P has "notched up to AAA, as allowed per our state rating methodology, due to Maryland's strong financial management and ability and willingness to adjust spending, if revenues decline, which we believe supports credit characteristics in line with those of comparable 'AAA' rated peers."