June 8, 2022 General Obligation Bond Sale

On June 8, 2022, the State sold $1,050 million in general obligation (GO) bonds for capital projects. This was $900 million in new tax-exempt bonds and $150 million in new taxable bonds. The true interest cost (TIC) for the sale's tax-exempt bonds is 2.90%, and the TIC for all bonds is 2.92%. The TIC for the most recent tax-exempt bond sale on August 11, 2021, was 1.42%. The higher TIC is consistent with recent increases in interest rates. As with other recent issuances of new debt, the tax-exempt bonds sold at a premium, which totaled $169.3 million, after deducting the underwriter's discount and cost of issuance.

New Bonds for Capital Projects

The $1,050 million in new GO bonds were grouped into the following four issuances:

- Series A Group 1, which sold tax-exempt bonds maturing in 5 to 9 years. Nine underwriters bid for the bonds sold in Group 1, and Morgan Stanley & Co. LLC submitted the winning bid.

- Series A Group 2, which sold tax-exempt bonds maturing in 10 to 12 years. Six underwriters bid for the bonds sold in Group 2, and BofA Securities submitted the winning bid.

- Series A Group 3, which sold tax-exempt bonds maturing in 13 to 15 years. Six underwriters bid for the bonds sold in Group 2, and BofA Securities submitted the winning bid.

- Series B, which sold taxable bonds maturing in 3 to 5 years. Since taxable bonds are sold at higher interest rates, the bonds are structured so that taxable bonds share the shortest maturities. This minimizes additional costs paid for taxable bonds. Eight underwriters bid for the taxable bonds sold, and Wells Fargo, National Association submitted the winning bid.

Exhibit 1 summarizes the key data from each series.

Exhibit 1
New Taxable and Tax-exempt Bonds
June 8, 2022
($ in Thousands)

Description	Tax Status	Bidders	True Interest Cost	Average Maturity In Years	Amount Sold	Net Premium[1] (Discount)
Series A Group 1	Tax-exempt	9	2.33%	7.19	$335,180	$58,751
Series A Group 2	Tax-exempt	6	2.83%	10.97	261,780	53,202
Series A Group 3	Tax-exempt	6	3.30%	13.97	303,040	57.312
Series B	Taxable	8	3.18%	3.70	150,000	-269

[1] Net premium (Discount) deducts underwriters' discount and cost of issuance.

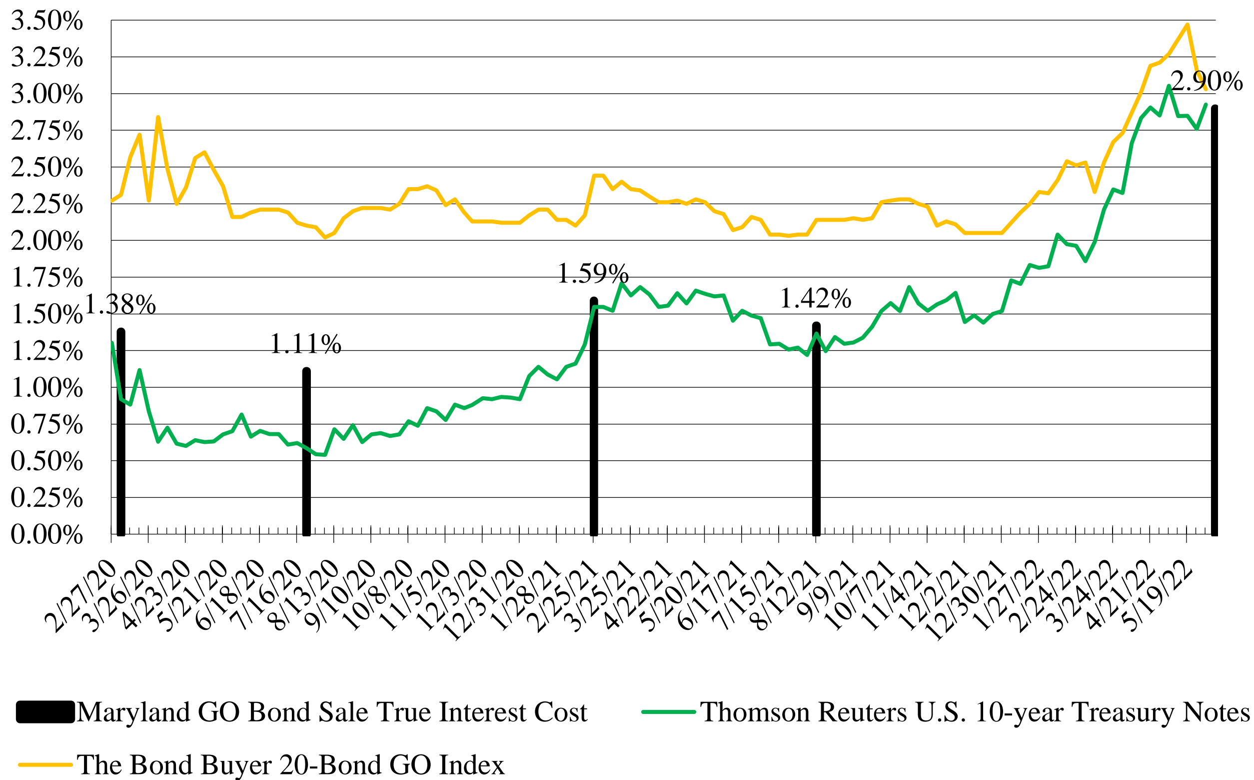
Source: Public Resources Advisory Group

The State generally issues GO bonds twice a year, the first in February or March and the second in July or August. With the retirement of Treasurer Nancy Kopp and the election of Delegate Dereck E. Davis as the new Treasurer in December 2021, the decision was made to consolidate the planned winter and summer bond sales for 2022 into one sale.

Sharp Increases in State and Municipal Bond Interest Rates

The Department of Legislative Services' (DLS) annual sum of least squares analysis of each GO bond sales' TIC suggests that the primary factor influencing the TIC is market interest rates. Interest rates have increased sharply in recent months, thus increasing this bond sale's TIC. **Exhibit 2** shows the strength of the link between interest rates and the TIC of Maryland bond sales. A common measure of state and municipal bonds' interest rates, The Bond Buyer 20-Bond Index, showed interest rates increasing 94 basis points (2.53% to 3.47%) from March 17, 2022, to May 19, 2022. Since peaking, interest rates declined by 44 basis points (3.47% to 3.03%) in the weeks before the bond sale. Even at 3.03%, interest rates are substantially higher than projected in February 2022. Forecasts of 10-year U.S. Treasury notes from Moody's Analytics and IHS Markit expected interest rates to increase but only by 20 basis points (from 1.97% to 2.17%). DLS uses these forecasts to evaluate whether bond sale premiums assumed in the budget are reasonable. There is an inverse relationship between interest rates and the amount of premiums; as interest rates increase, premiums decrease. Since interest rates are substantially higher than projected, premiums are less than previously estimated.

Exhibit 2
Effect of Bond Market Volatility on
Tax-exempt General Obligation Bond Sales
February 27, 2020, to June 8, 2022



GO: general obligation

Note: The most recent published data for The Bond Buyer 20–Bond Index is June 3, 2022, five days before the bond sale.

Source: The Bond Buyer; Public Resources Advisory Group; Department of Legislative Services

Capital and Operating Budget Impacts

This bond sale realized $169 million in premiums that can support operating or capital projects. As shown in **Exhibit 3**, DLS estimates that remaining fiscal 2022 as well as fiscal 2023 commitments supported by bond sale premiums total $415 million. Premiums from this bond sale reduce the remaining commitments to $246 million.

Exhibit 3
Summary of General Obligation Bond Sale
June 8, 2022
($ in Millions)

Bond Sale Premiums (Net of Expenses)	**$169**
Commitments	
Fiscal 2022 Debt Service	-$88
Fiscal 2022 Capital Projects	-16
Fiscal 2023 Debt Service	-51
Fiscal 2023 Capital Projects	-260
Total Commitments	**-$415**
Fiscal 2023 Shortfall after Bond Sale	**-$246**

Source: Public Research Advisory Group; Department of Budget and Management; Department of Legislative Services

Another bond sale is scheduled for winter 2023. DLS estimates that, if market conditions for the winter sale are similar to the June 2022 bond sale and $450 million in tax-exempt bonds are issued, the sale will realize $85 million in premiums. DLS cautions that market conditions could be quite different, so the premiums realized could vary substantially. But even if the State receives substantial premiums in the winter sale, they would be well short of meeting commitments. It appears likely that substantial deficiency appropriations or GO bond authorizations will be required to meet these commitments.

Maryland Bonds Rated AAA-stable

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

- ***Wealth and Income Levels:*** All rating agencies commented that Maryland's per capita personal income is among the highest in the nation. Moody's Investors Service and Standard & Poor's (S&P) Global Ratings note that Maryland's 2021 per capita personal income is 109% 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.

- ***Strong and Well-embedded Financial Practices:*** Fitch Ratings 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 "strong financial management" to be a credit strength. S&P notes that Maryland has a "long history of proactive financial and budget management" and that, if necessary, spending can be reduced with approval of the Board of Public Works. The agencies also noted that the State has made numerous attempts to address unfunded pension liabilities. 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:*** S&P considers the State's Revenue Stabilization Account balance, which is expected to be 10% of revenues, to be strong.

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. Specific factors that could lead to Maryland being placed on credit watch or downgraded include:

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

- reliance on nonrecurring funds to balance the State budget;

- 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.