Fitch Rates Frederick County, MD's $85MM GOs 'AAA'; Outlook Stable

Fitch Ratings-New York-17 March 2017: Fitch Ratings has assigned an 'AAA' rating to the following Frederick County, Maryland (the county) general obligation (G0) bonds:

--$85 million GO public facilities refunding bonds, series 2017A (2020 Crossover).

The bonds are expected to sell competitively the week of March 27th. Proceeds will be used to refund the series 2010B bonds.

In addition, Fitch affirms the following ratings:

--Issuer Default Rating (IDR) at 'AAA';
--$544.12 million GO bonds at 'AAA'.

The Rating Outlook is Stable.

SECURITY
The bonds are general obligations of the county, payable by its full faith and credit and unlimited taxing power.

KEY RATING DRIVERS

The county's 'AAA' rating reflects strong operating performance, enabled by strong revenue flexibility, expenditure control, conservative budgeting, and affordable long-term liabilities.

Economic Resource Base
Frederick County remains among the fastest growing counties in Maryland, supported by the availability of developable land and proximity to employment opportunities in the Baltimore and Washington, D.C. metro areas.

Revenue Framework: 'aaa' factor assessment
The county has strong revenue flexibility given the independent legal ability to increase property taxes without limitation. The county gains additional flexibility from remaining margin below the maximum income tax rate, which is the county's second largest revenue source.

Expenditure Framework: 'aa' factor assessment
The county has a proven history of controlling spending growth, as evidenced by positive operating results during and after the last recession. This flexibility is somewhat offset by collective bargaining requirements and the limited flexibility to reduce education spending without state approval. Carrying costs are moderately low.

Long-Term Liability Burden: 'aaa' factor assessment
The county's combined debt and unfunded pension liability burden is low. Although the current capital improvement plan includes annual debt issuance that exceeds the pace of amortization in some years, the county's long-term liability burden is expected to remain modest.

Operating Performance: 'aaa' factor assessment
Fitch expects that the county would demonstrate strong financial resilience in a typical economic downturn based on its solid reserves, revenue-raising capacity, expenditure flexibility and budgetary discipline.

RATING SENSITIVITIES
Strong Financial Position: The 'AAA' rating is sensitive to the county's sound financial performance, the maintenance of a healthy reserve cushion and solid financial management practices. The Stable Outlook reflects Fitch's expectation that such shifts are unlikely.

CREDIT PROFILE

Frederick County's sound economic base, focused in the bioscience and military sectors, shows solid prospects for continued development and expansion. The economy performed relatively well during the most recent economic downturn.

Fort Detrick, which is located in Frederick County, is the home of the National Cancer Institute, the U.S. Army Medical Research Institute of Infectious Diseases and the leading medical research laboratory for the nation's biological defense program. The Fort Detrick campus, which hosts five cabinet-level agencies, is the county's largest employer (9,100 civilian and military employees). The county has experienced significant growth in the bioscience and advanced technology industries over the past few years. The growth is due in part to the county's access to the Federal labs and other public and private high-tech facilities in the region.

With a well-educated workforce and close proximity to vibrant labor markets, the county has maintained low unemployment rates and high wealth indicators.

Revenue Framework

The revenue base is dominated by property and income taxes at 53% and 38% of total general fund revenues, respectively. Revenues showed little volatility during the last recession, declining modestly as economic conditions weakened. Subsequent revenue trends have been positive but reflect a property tax rate increase to offset declines in assessed value (AV).

General fund revenue growth over the last 10 years exceeds CPI and is on par with national GDP, factoring in both property tax rate reductions and increases and a stable income tax rate. Fitch believes revenue growth prospects are solid, based on recent AV trends, new economic development within the county and steady income tax revenue growth.

The county last increased the income tax rate to 2.96% in 2001, still below the 3.2% maximum rate allowed by state law. An increase to the maximum rate would generate $16.6 million (3% of the fiscal 2017 budget) in additional revenue annually. The county is not subject to any limitation on its property tax rate or levy; the county last increased its tax rate in 2014, followed by a smaller reduction in 2015.

Expenditure Framework

The county maintains adequate expenditure flexibility, with moderately low spending associated with fixed carrying costs.

Given the county's modest population growth (1% CAGR since 2010), the pace of growth in main expenditures is expected to increase but remain manageable based on expected revenue trends.

The county's largest expenditure category is education at roughly 52% of general fund outlays, followed by public safety at 20%. According to the state's maintenance of effort mandate, education spending cannot decline year-over-year without state approval. Given student enrollment has remained flat over the past 10 years, costs are expected to remain level. The county collectively bargains with three labor units - the fraternal order of police, the division of fire and rescue and sheriffs and corrections officers -which represent approximately one-third of the county's employees. Although the county has negotiated labor agreements with the three bargaining units, the county executive is not required to bargain. The labor agreements extend for 2 to 3 years and do not include salary increases beyond the first year (2016). Strikes are not permitted.

Carrying costs associated with debt service, actuarially determined pension payments (including the normal cost for teachers' pension) and other post-employment benefits (OPEB) actual contributions totaled about 15% of fiscal 2016 governmental spending; debt service accounted for 9% of the total.

Long-Term Liability Burden

Debt levels are low at approximately 6% of total personal income and are expected to remain low given the county's affordable debt issuance plans. The adopted fiscal 2017-2022 six-year capital improvement plan (CIP) totals approximately $663 million. School projects account for the largest spending (33% of the total) to address capacity at a number of school facilities. The plan is slightly more than 50% debt-funded.

The county provides pension benefits to its employees through a single-employer defined benefit plan and annually contributes 100% of the annual defined contribution (ADC). As of July 1, 2016, the unfunded liability was $37 million or 0.3% of personal income and the plan was 93% funded.

For a number of years the county has over-funded its OPEB ADC. As a result, the July 2016 actuarial valuation report lists the plan at 65% funded. The unfunded liability is $65.9 million or less than a half of 1% of personal income.

Operating Performance
The county historically has maintained healthy reserve levels, and continued to do so during the last recession. Fitch expects the county to manage through cyclical downturns while preserving a superior level of financial resilience. General fund reserves (17.5% of spending at fiscal 2016 year-end) are well above the county's 5% reserve policy and comfortably above the minimum reserve safety margin that corresponds to a 'aaa' financial resilience assessment, given the county's revenue and expenditure flexibility and expected revenue volatility according to the Fitch Analytical Sensitivity Tool (FAST).

During the recession the county reduced and delayed capital spending, reorganized and eliminated positions, placed a hiring freeze on vacant positions, and modified certain pension plan provisions. Fitch expects county management would respond in a similar manner during another economic downturn.

The adopted fiscal 2017 general fund budget of $560 billion is a 4.5% increase over the fiscal 2016 adopted budget. The budget includes a $25 million fund balance appropriation and no adjustment to tax rates. The budget increase mostly funds an increase in maintenance of effort for county public schools, and also includes funding of a new firefighter/EMT recruit class and a new pay scale for deputies and correctional officers. Multiyear projections show use of fund balance due to the s county requirement to appropriate reserves above the 5% reserve for operations; however, actual results historically have outperformed budget. Year-to-date operations show positive trends relative to budget. Management anticipates a reduced $8 million use of fund balance at year-end.

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Applicable Criteria

U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016)
(https://www.fitchratings.com/site/re/879478)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
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