FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Maryland DOT's $628 Million Consolidated Transportation Bonds 'AA+'; Outlook Stable

Fri 10 Sep, 2021 - 5:18 PM ET

Fitch Ratings - San Francisco - 10 Sep 2021: Fitch Ratings has assigned a 'AA+' rating to the following Maryland Department of Transportation (MDOT) consolidated transportation bonds:

--$295 million series 2021A;

--$138 million refunding series 2021B;

--$52 million refunding series 2022A (forward delivery);

--$143 million refunding series 2022B (forward delivery).

Additionally, Fitch has affirmed the following ratings:

--Outstanding MDOT consolidated transportation bonds at 'AA+';

--Outstanding MDOT county transportation bonds issued on behalf of Baltimore city at 'AA+'.

The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING	PRIOR
Maryland, State of (MD) [General Government]		

Maryland, State of (MD) /Transportation Revenues - County/1 LT	LT	AA+ Rating Outlook Stable	Affirmed	AA+ Rating Outlook Stable
Maryland, State of (MD) /Transportation Revenues/1 LT	LT	AA+ Rating Outlook Stable	Affirmed	AA+ Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

The series 2021A and refunding series 2021B bonds are expected to be offered by competitive sale on Sept. 29 2021.

The refunding series 2022A bonds are expected to be offered by negotiated sale on Sept. 30, 2021, with anticipated closing date of March 3, 2022.

The refunding series 2022B bonds are expected to be offered by negotiated sale on Sept. 30, 2021, with anticipated closing date of Nov. 3, 2022.

SECURITY

Consolidated transportation bonds are payable from a portion of taxes collected in the state's transportation tr fund (TTF), following certain statutory allocations (collectively, pledged tax revenues), and prior to being availab for other uses by MDOT. The pledged tax revenues are defined in section 3-215 of the Transportation Article of Annotated Code of Maryland (the act). If the pledged tax revenues become insufficient to meet debt service requirements, net operating revenues of the department are available for that purpose under section 3-215 of t act.

County transportation bonds are paid from an allocation of highway user revenues (HUR), which are capital gra paid to Baltimore City, counties and municipalities from all revenues of the TTF, but subordinate to the pledge fo the consolidated transportation bonds and certain other MDOT expenses. The amount of the capital grants is statutorily linked to deposits to the gasoline and motor vehicle account (GMVRA), which is a broad subset of tax deposited to the TTF.

ANALYTICAL CONCLUSION

The 'AA+' ratings on MDOT's consolidated transportation and county transportation bonds reflect limited grow prospects for the various dedicated taxes and robust resilience of the structure to economic declines. Fitch's analysis is based on MDOT policy guidelines for maximum anticipated leverage for all bonds that could draw on dedicated taxes including the consolidated and county transportation bonds, and federal grant anticipation revenue bonds (GARVEEs) issued by the Maryland Transportation Authority. Notably, Maryland's final outstand GARVEEs matured in fiscal 2020, and the state has no legal authorization for further issuance.

KEY RATING DRIVERS

MODEST GROWTH PROSPECTS: Long-term growth prospects for revenues pledged to MDOT's consolidated transportation and county transportation bonds are modest. They include a mix of transportation-specific and other receipts. Motor fuels taxes are indexed to inflation, improving their growth prospects, which remain ultimately linked to consumption. Dedicated taxes and other available revenues have been affected by statutor changes to rates and distribution.

AMPLE CUSHION FOR DEBT SERVICE: Pledged revenues provide ample coverage of debt service on consolida and county transportation bonds, and the structure offers robust resilience through cyclical declines. A two-pronged ABT for the consolidated transportation bonds that requires 2x coverage by both pledged tax revenue and net department revenues, and a more stringent 2.5x management practices on both measures limit leverag A separate ABT tied to HUR distributions to local governments limits leverage on the county transportation bo

CAPPED BY STATE CREDIT QUALITY: Fitch caps the ratings on MDOT's consolidated and county transportatio bonds at the state of Maryland's IDR (AAA/Stable) given the legislature's regular statutory changes to dedicate taxes, including providing operating support for general state operations.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to a positive rating action/upgrade:

--Sustained and material improvement in long-term growth prospects for pledged revenues to be at or near the pace of long-term national economic growth, which Fitch considers unlikely.

Factors that could, individually or collectively, lead to a negative rating action/downgrade:

--Sustained material weakening of pledged revenue coverage and structural resilience. Fitch considers this unlil given the limitations on additional debt issuance and diversity of pledged revenue sources;

--Negative rating action on the state's IDR, given that ratings are capped by the state's IDR.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case ratin upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The comple span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

DEDICATED TAX CREDIT PROFILE

The ratings on the consolidated and county transportation bonds are capped by Maryland's 'AAA' IDR, due to th legislature's track record of changes to pledged revenues. While section 3-215 of the act includes non-impairm provisions, the statute allows the legislature to modify the structure of taxes before they are subject to the plec The legislature has periodically made rate and distribution changes to pledged taxes, other departmental reven and distributions. For example, the state made statutory changes for the corporate income tax distribution to th TTF in fiscal years 2013, 2014 and 2017.

The legislature also may divert transportation fund resources for general fund purposes, subject to an emergen declaration by the governor and a three-fifths vote of both legislative houses; any diversions require repayment five years. For additional information on Maryland's 'AAA' IDR, please see 'Fitch Rates Maryland's $858MM GC 'AAA'; Outlook Stable,' at www.fitchratings.com.

CAREFUL MANAGEMENT OF DEBT AND CAPITAL NEEDS

Consolidated transportation bonds are integrated into the state's strong debt management framework. The statutory ceiling on total consolidated transportation bonds that may be outstanding is $4.5 billion. A separate annual statutory cap on outstanding bonds is approximately $3.7 billion for fiscal 2022. New issuance requires Board of Public Works approval (made up of the governor, treasurer and comptroller), and the state constitutio mandates that consolidated transportation bonds mature within 15 years.

MDOT has the discretion to reduce outlays in its Consolidated Transportation Program (CTP) if revenues underperform. These actions also reduce the need for additional debt issuance. Following a prudent decrease ir CTP spending to $2.9 billion during an uncertain fiscal 2021, MDOT recently released a draft fiscal 2022-2027 which increases fiscal 2022 spending to $3.5 billion (a 25% increase). The six-year $16.4 billion CTP budget is $ billion higher than previous budget. $900 million of this increase comes from federal relief funds, with the additional $300 million representing improved revenue forecasts.

Including projected future issuances to support capital plan targets, MADS on the consolidated transportation bonds is forecast to reach $498 million in fiscal 2027. At this level, MDOT estimates coverage by forecast pledg tax revenues would be a very strong 5.2x, while coverage by forecast net department revenues would be 2.6x.

The pledged tax revenues for the consolidated transportation bonds have consistently provided ample coverag despite their economic sensitivity and the effects of statutory changes. They include portions of the motor fuel vehicle titling tax, corporate income tax, and sales and use tax on short-term vehicle rentals. Fiscal 2020 pledge taxes were flat at $2.1 billion as maximum annual debt service (MADS) increased 10% to $457 million, leading t decreased MADS coverage of 4.6x, compared with 5.1x times coverage the prior year.

A volatile fiscal 2021 produced no change to MADS coverage at 4.6x as limited overall growth in pledged reven was offset by increased pro-forma MADS (based on the department's draft 2022-2027 capital plan). The broad of pledged revenues exceeded budgeted declines, instead increasing by a modest 2.6%. Motor fuel tax revenue declined sharply by 7.1% yoy, while pledged corporate taxes increased 16% yoy and titling taxes grew 12.1%.

The new draft CTP budget assumes robust yoy pledged tax revenue growth of 5.4% and 6.8% in fiscal 2022 and 2023, respectively, with annual growth of just under 2% thereafter. Fitch considers these projections somewha optimistic, but more achievable than projections produced at the outset of the pandemic. Fitch notes that MDC has proactively adjusted bond issuance plans to maintain pledged tax coverage at sound levels. The draft 2022-2027 CTP plan's pro-forma indicates MADS and pledged tax coverage should remain above 4x, providing ample cushion in the event of slower revenue growth.

MDOT's net revenues, primarily transportation-related fees and operating receipts (totaling $1.4 billion in fisca 2021), provide an additional backstop beyond the pledged tax revenues. These revenues are legally required to used for consolidated transportation debt service if pledged taxes are insufficient. The department projects net operating revenues will peak in fiscal 2022, but decrease gradually thereafter. MDOT projects coverage from ne revenues alone will exceed the department's policy of 2.5x coverage throughout the capital plan, an improveme from the last published budget's projection that net revenues would fall below the 2.5x times threshold in two years of the six-year capital plan. Fitch anticipates pledged tax revenue coverage will remain strong, mitigating risk from lower net revenues coverage.

County Transportation Bonds Details

Revenues pledged for county transportation bonds are a statutorily defined share of HUR and overlap consider with revenues pledged for consolidated transportation bonds. Fiscal 2020 pledged revenues for outstanding county transportation bonds (all issued on behalf of the City of Baltimore) of $146 million covered 7.3x MADS. MDOT projects fiscal 2021 coverage of 8.4x MADS.

Through fiscal 2019, revenues available for HUR distributions were essentially a subset of the taxes pledged fo consolidated transportation bonds. Beginning fiscal 2020 (following a 2018 statutory change), pledged revenue for county transportation bonds are subordinate to debt service on the consolidated transportation bonds and other MDOT operating expenses, but are now drawn from the entirety of the TTF. From fiscal 2020 through 20 the total HUR distribution will be equivalent to 13.5% of the deposits to the gasoline and motor vehicle revenue account (GMVRA), stepping down to 9.6% beginning fiscal 2025. Baltimore City's respective shares during thes periods are 8.3% and 7.7%.

GMVRA deposits include some or all of the taxes pledged to consolidated transportation bonds including the m
fuel and vehicle titling tax, corporate income tax, and sales and use tax on short-term vehicle rentals. The GMVI
also receives vehicle registration fees, which are part of the revenues available for consolidated transportation
bonds debt service in the event pledged taxes are insufficient.

MODEST GROWTH PROSPECTS

Fitch views the drivers and growth prospects for pledged tax revenues for the consolidated transportation bon
to be modest, consistent with a 'a' assessment. Historical growth has been relatively robust, approximately 5% o
an average annual basis over the past decade, but Fitch attributes much of that to various tax and fee policy changes that do not materially affect underlying growth prospects.

Pledged tax revenues are primarily, although not exclusively, linked to transportation activity, with motor fuels
taxes comprising approximately 50% of pledged tax revenues, and titling taxes another roughly 40%. The motor
fuels tax includes an inflation adjustment that supports growth going forward, but trends remain limited by Fitc
overall expectations for modest growth in most motor vehicle transportation-linked tax revenues. A share of statewide corporate income tax comprises approximately 7% of pledged tax receipts and modestly exposes the
pledged tax revenues to economic trends beyond transportation activity.

Revenues pledged for the county transportation bonds exhibit similar growth prospects given the significant overlap with revenues pledged for consolidated transportation bonds.

ROBUST RESILIENCE OF FINANCING STRUCTURE

Fitch assesses the resilience of the financing structure to be robust for both consolidated transportation and county transportation bonds, despite vulnerability of pledged tax revenues to economic cyclicality.

For the long-term assessment of structural resilience, Fitch applies both the FAST to assess the impact of a pre-pandemic moderate economic downturn expectation (using a 1% decline in national GDP scenario) and the larg
decline in revenues over the period covered by the revenue sensitivity analysis. Based on a 15-year pledged revenue history, the FAST model generates a 3% moderate recession scenario decline in pledged revenues. The largest consecutive historical decline was 6.7%, from fiscal 2006 to 2008.

For county transportation bonds, pledged revenues are also sensitive to economic cyclicality. Given the overlap
revenues with the consolidated transportation bonds discussed above, Fitch evaluates the resiliency of the structure using the same pledged revenues as for consolidated transportation bonds.

At maximum anticipated leverage, pledged tax revenues could withstand a 60% decline while maintaining sum
sufficient debt service coverage. This decline is equivalent to approximately 37x the FAST scenario decline, and
the largest consecutive historical decline, a robust level of resilience warranting a 'aaa' assessment.

Fitch's analysis incorporates full leveraging to the 2.5x pledged revenues management practice for the consolid transportation bonds; to the 2x HUR allocation ABT for local governments for county transportation bonds; an maximum issuance to the ABT for federal grant anticipation revenue bonds (GARVEEs) issued by the Maryland Transportation Authority for which a portion of TTF receipts serves as a backstop to federal aid. The ABT for th GARVEEs (of which none are currently outstanding) allows for pro-forma maximum annual debt service up to tl times the level of federal aid obligation authority in the most recently completed fiscal year.

Fitch considers the maximum anticipated leverage used in its analysis to be fairly conservative. The consolidate transportation bonds also have a more stringent ABT of 2x net department revenues ($1.4 billion in fiscal 2020 versus $2.1 billion in pledged tax revenues), and the management practice of 2.5x net department revenues as v For the county transportation bonds, Baltimore city remains the only local government that has participated in program. Finally, the last series of GARVEE bonds matured in fiscal 2020 and the state has no current statutory authorization or plans to seek any for GARVEE bonds.

Pledged revenues are diversified, but susceptible to economic cyclicality. For example, during the Great Recessi sharp losses in the titling tax were softened by smaller declines in the other pledged revenues. Conversely, the pandemic saw titling and corporate revenues offset a large decrease in motor fuel taxes.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means E issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

FITCH RATINGS ANALYSTS

Bryan Quevedo
Director
Primary Rating Analyst
+1 415 732 7576
bryan.quevedo@fitchratings.com

Fitch Ratings, Inc.
One Post Street, Suite 900 San Francisco, CA 94104

Eric Kim
Senior Director
Secondary Rating Analyst
+1 212 908 0241
eric.kim@fitchratings.com

Douglas Offerman
Senior Director
Committee Chairperson
+1 212 908 0889
douglas.offerman@fitchratings.com

MEDIA CONTACTS

Sandro Scenga
New York
+1 212 908 0278
sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 04 May 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Maryland Department of Transportation (MD)	EU Endorsed, UK Endorsed

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