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Fitch Affirms Talbot County, MD's GOs at 'AAA'; Outlook Stable

Ratings Endorsement Policy

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Fitch Ratings-New York-12 September 2014: Fitch Ratings has affirmed the 'AAA' rating on the following Talbot County, Maryland (the county) bonds:

--$28.1 million general obligation (GO) bonds series 2006, 2008, and 2010.

The Rating Outlook is Stable.

SECURITY
The bonds are a full faith and credit obligation of Talbot County, payable from ad valorem taxes on all taxable property within the county. However, property tax revenue growth is capped each year by charter at the lesser of 2% or general inflation.

KEY RATING DRIVERS

STABILIZED STRONG FINANCIAL PROFILE: Conservative budgeting practices support the county's strong financial position characterized by sound revenue flexibility and ample liquidity. A structural imbalance in the general fund from fiscals 2010 to 2012 was resolved in fiscal 2013, and the county is continuing to build its sizable reserves.

RURAL, BUT STABLE ECONOMY: The county's rural economy is dominated by agriculture, tourism, and healthcare. Unemployment rates are comparable to the national average and wealth levels are above the national average.

LOW DEBT LEVELS: Debt levels are expected to remain low given the county's modest capital needs and rapid amortization.

MANAGEABLE RETIREE COSTS: Statutorily mandated increases in teacher pension contributions are not expected to pressure the county's budget, given that current costs comprise only a small portion of the county's overall budget. Recent efforts by the county to prefund its other post-employment benefit (OPEB) liability are viewed favorably by Fitch.

RATING SENSITIVITIES

SHIFT IN FUNDAMENTALS: The rating is sensitive to shifts in credit fundamentals. The Stable Outlook reflects Fitch's opinion that such shifts are unlikely.

CREDIT PROFILE
The county is located on the western shore of the DelMarVa Peninsula, about 50 miles east of Washington, DC. The county's population as of 2013 was 37,931, a .6% increase since 2010.

STABILIZED STRONG FINANCIAL POSITION
Despite a structural imbalance in the general fund from fiscal years 2010 to 2012, the county consistently exceeds its fund balance policy, which calls for unrestricted reserves in the general fund to exceed 15% of general fund spending. The county posted $19.4 million in unrestricted general fund balance at fiscal year-end 2013, a strong 28.3% of spending. Fitch believes that the county's stable economy, ample revenue flexibility, and careful expenditure management should support sound reserves over the longer term.

The county currently holds roughly $9.3 million in committed reserves in a capital projects fund comprised of prior surpluses from the general fund. In fiscal 2012, the county authorized use of the fund to support general fund operations; the county made only one $1 million transfer into the general fund. Given the improving revenue environment, Fitch believes that further transfers are unlikely.

DEMONSTRATED REVENUE FLEXIBILITY
In order to address its fiscal imbalance, the county adjusted both revenues and expenditures and has yielded surplus operations in fiscal 2013 and 2014. Layoffs, pay freezes, and furloughs helped control expense growth. The county utilized some of its ample revenue flexibility in fiscal 2013 by raising the local income tax rate from 2.25% to 2.4%. The county has been able to raise the tax levy a cumulative 16% from fiscal 2010 to 2013, largely driven by an opportunity provided to the county by the state to break the tax cap in fiscal 2013 and add an additional $1.9 million in education-dedicated revenue to levy. The county's property tax rate remains the lowest for any county in the state of Maryland and the income tax rate is still well below its cap of 3.2%; Fitch believes this provides the county with further revenue flexibility if necessary.

The county projects a $1.4 million surplus for a fiscal 2014, which Fitch believes is reasonable given the budgeted $570,000 surplus and its history of conservative revenue/expenditure assumptions. The county's fiscal 2015 general fund budget is balanced with no transfers in and no appropriation of general fund balance. While a formal plan has not been implemented, management plans to continue to rebuild fund balances drawn down during the recession.

LIMITED ECONOMY FOCUSED ON TOURISM, AGRICULTURE AND HEALTHCARE
The county is predominantly rural, with farmland comprising nearly 60% of its land area. While agriculture is economically important, the county's main attraction is its 600 miles of shoreline, with the leisure and hospitality industries representing an important share of the employment base.

In addition to hospitality and tourism, healthcare is another important sector to the county as evidenced by Shore Health Systems accounting for the 12% of county employment. Fitch believes that the long-term prospects for the regional health center are positive, as Shore Health Systems serves an important regional need and continues to expand its operations.

The county's unemployment rate decreased to 6.1% as of June 2014 from 7.1% a year prior and remains comparable to the state average. The decline in the unemployment rate was driven by a notable decrease in the county's labor force over the same period. Fitch believes this trend is attributable to the county's sizable and growing retiree population and high median age. The county's population, which has grown at a rate comparable to the rest of Maryland, is one of the smallest amongst Maryland counties.

FAVORABLE DEBT PROFILE
Overall debt levels are low at roughly $1,794 per capita and 0.8% of market value. Amortization is rapid, with 76% of principal retired in 10 years. The county's capital improvement needs are manageable, with larger school and library renovation projects expected to be funded with grants and debt. Fitch does not expect the county's preliminary plans for debt issuance related to these projects to have a material impact on the overall debt profile.

MODEST PENSION AND OPEB COSTS
Long-term liabilities related to employment benefits are not expected to pressure future operations. The county provides pension benefits to its employees through the State of Maryland Employees Retirement and Pension System (SMERPS) and to board of education employees through the State of Maryland Teachers Retirement and Pension System (SMTRSP). The county consistently pays 100% of its combined required contributions, which accounts for a low 3.2% of total governmental spending. Pension costs for county employees are anticipated to remain stable, although contribution levels for board of education employees are expected to increase at a manageable rate over the next several years as the state addresses the underfunded SMTRSP.

The county also provides OPEB to its retirees, and the county's unfunded OPEB liability is low at .4% of market value. The county has contributed a cumulative $9 million in earmarked general fund reserves to an OPEB trust over the past four fiscal years in an effort to prefund the OPEB liability, which Fitch views favorably. Total carrying costs, including debt service and costs related to post-retirement benefits, are very low at only 5.8% of total governmental spending in fiscal 2013.

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In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial Associates, S&P/Case-Shiller Home Price Index, IHS Global Insight, National Association of Realtors, and Zillow.

Applicable Criteria and Related Research:
--'Tax-Supported Rating Criteria' (Aug. 14, 2012);
--'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

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Tax-Supported Rating Criteria
U.S. Local Government Tax-Supported Rating Criteria

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