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Before the

Senate Budget & Taxation Committee
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Good afternoon, Chairman Kasemeyer, and members of the committee. I am pleased to have the opportunity to appear before you to discuss the public debt budget. As usual, Mr. Frank and the Department of Legislative Services staff have done an excellent job in the analysis of the budget and with the issues surrounding it.

Before turning to a discussion of the matters raised by Mr. Frank, I would like to update you on the following:

- Maryland's AAA ratings and comments from the rating agencies on the State's credit;
- Recap of calendar year 2017 bond sales;
- Municipal bond market update; and
- Upcoming 2018 First Series General Obligation bond sale.

Rating Agency Update

On August 3, 2017, in conjunction with the sale of Maryland's General Obligation Bonds State and Local Facilities Loan of 2017, Second Series, Moody's Investors Service, S&P Global (S&P) and Fitch Ratings all reaffirmed their AAA ratings for Maryland's General Obligation debt. The rating reports from this sale are available on the Treasurer's website at www.treasurer.state.md.us.

Maryland is one of only 11 states to hold the coveted AAA rating, the highest possible rating, from all three major rating agencies. S&P has rated the bonds AAA since 1961. Moody's Investors Service has assigned the bonds a rating of Aaa since 1973, and Fitch Ratings has rated the bonds AAA since 1993. The other ten states that hold AAA ratings from all three rating agencies are Delaware, Georgia, Iowa, Missouri, North Carolina, South Dakota, Tennessee, Texas, Utah and Virginia.

The State of Maryland is scheduled to have a call with all three major rating agencies tomorrow, February 14, to discuss the State's rating in advance of the March 7 bond sale. As always, the Treasurer's Office will provide updates on the rating agency reports once we receive the State's ratings on February 22.

Calendar Year 2017 Bond Sales

We continue to plan and conduct our bond sales effectively, while striving to maintain Maryland's coveted AAA bond rating. The calendar year 2017 bond sales outlined below reflect a continuation of these efforts.

The **2017 General Obligation Bonds, First Series A** were sold on March 8, 2017 and consisted of $575,000,000 in tax-exempt new money bonds. The proceeds were used to finance capital projects. The sale had a True Interest Cost (TIC) of 2.84% and included a premium of $91,186,871 million to offset debt service costs.

The **2017 General Obligation Bonds, First Series B** were sold on March 8, 2017, and consisted of $100,000,000 in taxable bonds. The proceeds were used to finance capital projects deemed to have private activity that made them ineligible for tax-exempt financing. Series B received a TIC of 2.04%.

The **2017 General Obligation Bonds, First Series C** were sold on March 8, 2017, and consisted of $465,685,000 in tax-exempt refunding bonds. The proceeds were used to refinance previously issued bonds at a lower rate, which saved the State $24,251,272 in debt service costs on a net present value basis. Series C received a TIC of 1.72%.

The **2017 General Obligation Bonds, Second Series A** were sold on August 16, 2017 and consisted of $550,000,000 in tax-exempt new money bonds. The proceeds were used to finance new projects. Series A received a True Interest Cost (TIC) of 2.29% and included a premium of $93,874,850 to offset debt service costs.

The **2017 General Obligation Bonds, Second Series B** were sold on August 16, 2017 and consisted of $785,340,000 in tax-exempt refunding bonds. The proceeds were used to refinance previously issued bonds at a lower rate, which saved the State $75,832,051 in debt service costs on a net present value basis. Series B received a TIC of 1.66%.

The **Qualified Zone Academy Bonds (QZAB) of 2017** were sold on December 6, 2017 and totaled $4,832,000. These were tax credit bonds bearing no interest. QZAB proceeds are used to fund capital improvements and repairs at existing schools in which at least 35% of the students are eligible for free or reduced-price lunch.

Municipal Bond Market Update

Municipal bond yields have steadily increased since the beginning of the calendar year. As of February 8, 2018, the 10-Year MMD was 2.42%, 44 basis points higher than it was on January 2, 2018. The Board of Governors of the Federal Reserve System ("the Fed") is expected to continue to gradually raise interest rates in 2018. Even with additional increases by the Fed, however, yields on municipal bonds remain extremely low by historical standards and the State should continue to receive excellent rates on its general obligation bonds.

2018 First Series General Obligation Bonds

The next general obligation financing is scheduled for March 7, 2018 and is expected to total $525 million ($475 million in tax-exempt bonds and $50 million in taxable bonds).

Requested Responses to the Analyst's Issues

The State Treasurer should be prepared to brief the committees on the effect of federal tax law changes on capital costs.

Mr. Frank has done an excellent job laying out the impact of federal tax law changes on Maryland's cost of capital. As he notes, there are three primary changes – the possibility of decreased demand due to lower corporate and individual tax rates; the elimination of the tax exemption on advance refunding bonds; and the elimination of tax-credit bonds.

The analysis correctly points out that demand for tax-exempt bonds may decrease due to the new lower corporate and individual tax rates. With lower tax rates, the demand for securities that function as methods of tax avoidance for corporations and high net worth individuals may be decreased. Lower demand could lead investors to ask for higher yields on municipal bonds, which would increase the State's borrowing cost (this may have already occurred, based on the increase in yields since the beginning of the year).

This is not certain, however, since some appetite for tax avoidance will continue. It is also possible that a demand-based increase in yields may be offset somewhat by decreased supply, since the repeal of the tax exemption on advance refunding bonds (discussed in further detail in the following paragraph), which made up nearly a third of the municipal issues in calendar year 2017, will significantly decrease the amount of new tax-exempt bonds available for purchase. The bond market may be somewhat volatile over the next few months as it finds a new equilibrium.

Tax-exempt advance refunding bonds led the State to realize over $100 million in debt service savings in 2017 alone, and the repeal of these instruments will increase the State's debt service costs over what they would have been had they remained. However, as noted in the analysis, tax-exempt current refundings, in which a bond is refunded no sooner than 90 days before the call date, remain an option. These refundings will likely be smaller than recent advance refunding issues sold by the State, but will still decrease the State's debt service costs. New methods of legally refunding bonds before their call date on a tax-exempt basis may also be developed. None of these methods will be as efficient as advance refundings, but the Treasurer's Office will still be able to find debt service savings moving forward.

Finally, tax credit bonds – the most relevant example being Qualified Zone Academy Bonds (QZABs) – were repealed entirely. QZABs funded certain types of school construction projects at no cost of capital to the State. The projects may be funded instead with general funds or general obligation bonds if State policymakers decide to do so.

I would be happy to address any questions you have.