MARYLAND STATE TREASURER

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X00A00 Public Debt
Fiscal 2026 Operating Budget
Response to Department of Legislative Services

Senate Budget and Taxation Committee
Chair Guy Guzzone
February 4, 2025

House Appropriations Committee
Chair Ben Barnes
February 7, 2025

The State Treasurer's Office (STO) continues to prioritize Maryland's credit quality in spite of difficult economic circumstances, which the rating agencies have been closely monitoring. In May 2024, shortly after the collapse of the Francis Scott Key Bridge, STO convened a meeting for the State's fiscal leaders and representatives from the rating agencies to discuss coordinated recovery efforts and fiscal planning. As the budget for fiscal year 2026 is finalized, STO will continue corresponding with the rating agencies and the State's financial advisors about the solutions that will address the structural deficit. For the reasons stated below, with a few exceptions, the State Treasurer's Office (STO) respectfully requests that the committees concur with the Department of Legislative Services' (DLS) recommendation for the proposed Public Debt budget for fiscal year 2026.

Fiscal 2026 Operating Budget

As noted in the DLS analysis, the fiscal 2026 Public Debt budget makes assumptions for the amount of premium and refunding savings generated from the planned June 2025 sale and also assumes a specific structure for applying the refunding savings. The DLS analysis proposes alternative assumptions and structures. STO cautions that, with current market conditions, there is considerable volatility surrounding all of these estimates. The tables below illustrate the variance that can occur with varying structures and within a two-week window. This highlights the difficulty in accurately projecting the outcome for a transaction not scheduled to occur for several months.

Estimated Premium Generated from June 2025 Sale
($ in Millions)

	5% Coupons Current Conditions	5% Coupons + 50bps	4% Coupons for Longer Maturities
12/9/24	$134.1	$99.6	$106.3
12/23/24	108.5	75.1	84.6
1/17/25	103.3	73.5	79.7
1/29/25	111.5	77.7	84.1

Estimated Refunding Savings

($ in Millions)

	Upfront Savings	Level Savings
12/23/24	$30.0	$5.4
1/17/25	29.7	$6.2
1/29/25	32.6	5.7

With every transaction STO considers, there are several factors when determining what is in the best interest of the State regarding the timing and structure of a deal. What allows STO to be successful is the autonomy to evaluate and make decisions as we move through the sale process.

I can assure the Committees that we evaluate all options and decision points in constructing the transaction that will uphold the quality of the State's credit and be the most advantageous for the State's finances. STO regularly seeks the advice of the State's financial advisors and monitors capital spending needs to help ensure that we achieve the most favorable financing each time the State goes to market. As an example of the State's success, despite the assigned negative outlook from Moody's last May, the State issued $1.2 billion in general obligation bonds at its June 2024 sale, with a combined eight different banks submitting bids. The sale had an all-in TIC of 3.37% and generated nearly $154 million in premium.

Coupon Rates for Callable Bonds

Regarding coupon rates, STO consults with the State's financial advisors before each bond sale to ensure appropriate couponing parameters are included in the Notice of Sale. For callable bonds, generally the 5% coupon, which is standard for tax-exempt municipal bonds, will incur a lower yield to the call ("YTC") date of the bonds, which is typically ten years after the issuance date. On this call date, the bonds can be refinanced at the then current market rate. Lower coupon bonds, for example 3% or 4% coupons, generally have a higher yield to the call date, but a lower yield to the final maturity ("YTM"), resulting in lower true interest cost ("TIC"). Given these tradeoffs, in order to minimize the State's borrowing costs, STO must consider refunding the bonds.

For a fifteen-year maturity, the current reported borrowing yield for a AAA rated entity is 3.32%, assuming a 5% coupon and the standard ten-year par call, according to The Municipal Market Monitor (TM3) municipal index, a primary source for fixed income client data. A 4% coupon's yield is estimated to be 3.58%. Assuming that both bonds are refinanced at the ten-year call date, the State will have paid an additional 26 basis points in yield to borrow using a 4% coupon. The reported yield for a 3% coupon is 3.90%, an even greater borrowing cost.

Couponing Analytics
Delivery Date: 6/25/2025

Tenor	Type	Maturity	Call Date	Coupon	Stated Yield	Bond Price	Bond YTC	Bond YTM	Yield Kick
15	5% Coupon	6/1/2040	6/1/2035	5.000%	3.32%	114.114%	3.320%	3.756%	0.436%
15	4% Coupon	6/1/2040	6/1/2035	4.000%	3.58%	103.482%	3.580%	3.694%	0.114%
15	3% Coupon	6/1/2040	6/1/2035	3.000%	3.90%	89.883%	4.260%	3.900%	0.000%

If the bonds are not refinanced, then the lower coupon bond will have a lower yield for the fifteen-year maturity. For example, the 5% coupon has a yield to maturity of 3.76%, while the 4% coupon has a yield to maturity of 3.69%. If the bonds are not refunded, the 4% coupon would save approximately 6.2 basis points in borrowing cost. The State's financial advisor maintains option models to weigh the relative probabilities of future refundings and further quantify the tradeoffs between minimizing borrowing yield to call date or maturity.

While STO will continue to monitor the coupon parameters as part of each sale, the historical and quantitative analysis has often suggested that the 5% coupon minimizes the State's realized borrowing cost.

Recommended Actions

1. *Reduce general obligation bond debt service to be consistent with a $900 million June 2025 bond sale. The fiscal 2026 allowance assumes that $1,390 million in new par value bonds will be issued in June 2025. The State Treasurer's Office advises that the current estimate is that $900 million will be issued, so the allowance overbudgets debt service costs. Savings from the smaller bond sale are partially offset by the assumption that the State will maximize the present value of savings from a refunding issuance by spreading the savings out over multiple years rather than front loading the savings.*

STO Response: Concur under the assumptions offered in the analysis. However, STO cautions that there is considerable volatility in the markets that may impact the State's ability to achieve the assumed amount of refunding savings and premium generated from the sale. STO requests the legislature's continued support of the Treasurer's Office to make any necessary adjustments to the structure of the planned sale to ensure the most advantageous transaction for the State. We will provide additional updates and revised estimates throughout the budget process.

Fulfilling the State's debt service obligations is of the utmost importance to this Office in order to maintain the high quality of the State's credit, uphold the State's commitments to its investor community, and meet STO's constitutional obligations. Should the legislature adopt this recommendation to align with the DLS estimate, STO requests that safety net parameters be put in place to access necessary funding to ensure the appropriation is kept whole for the amount of debt service required after the conclusion of the June 2025 sale.

2. ***Adopt State Policy of Having Multiple General Obligation (GO) Bond Sales:*** *State procurement policy goals include providing a framework whereby procurements allow the State to get maximum benefits from its purchasing power. Consistent with this policy, GO bonds are sold by competitive sealed bids. Generally, at least three bidders are required for each sale. To further increase purchasing power, the State Treasurer's Office (STO) has divided tax-exempt GO bonds into multiple bidding groups in each sale. These policies strengthen the State's purchasing power. To keep costs low, Maryland has historically divided issuances into multiple sales in each fiscal year. Since fiscal 2022, the State has combined issuances into one large bond sale. Advantages to having multiple sales each year include (1) smaller and more competitive sales; (2) diversification of risks associated with the timing of bond sales; and (3) reduced budgetary uncertainty when approving annual operating budgets. STO should return to the policy of having multiple annual bond sales if total issuances exceed $700 million. If there are two sales, the second sale's competitive bids should be opened before the second week of March so that debt service costs are known before the operating budget is enacted.*

STO Response: Concur in part. Consistent with current STO practice to evaluate all decision points relating to the timing and structure of a sale when making issuance plans, STO agrees that there may be opportunities where conducting two bond sales per year are advantageous. However, with the multitude of factors that go into the appropriate timing and structing of a successful sale, STO requests the budget committees consider modifying the narrative to continue to afford the Treasurer's Office the flexibility to make those decisions in the best interest of the State.

3. ***Study Group to Reevaluate General Obligation (GO) Bond Issuance Assumptions:*** *The budget bill authorizes GO bonds. There are no costs to these authorizations until bonds are sold. Capital projects often take years to complete, so there has been a consistent level of authorized but unissued debt. To estimate GO bond issuances, the State relies on a formula developed over 30 years ago. In recent years, the pace of capital spending has slowed. Historically, the amount of authorized but unissued debt has been about 20% of all authorized debt. This increased to 24% at the end of fiscal 2023 and 27% at the end of fiscal 2024. In recognition of recent trends, the State Treasurer's Office (STO) should convene an interim study group to evaluate GO bond issuances and determine if revised policies are appropriate. The study group should report its findings to the Capital Debt Affordability Committee at its calendar 2025 briefings. The study group should include the Department of Budget and Management and the Department of Legislative Services.*

STO Response: Concur.