Summary:
Maryland Department of Transportation; Gas Tax

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Rationale

Standard & Poor's Ratings Services assigned its 'AAA' long-term rating, and stable outlook, to Maryland Department of Transportation's (MDOT) $150 million consolidated transportation bonds, series 2015 (second issue) and $349 million consolidated transportation refunding bonds, series 2015. At the same time, Standard & Poor's affirmed its 'AAA' rating, with a stable outlook, on MDOT's parity debt outstanding.

The rating reflects what we view as:

- Maryland's diverse, broad-based economy, which contributes to growth in overall pledged revenues;
- A diverse transportation trust fund (TTF) revenue stream that is levied statewide (5.98 million residents);
- Steady growth in pledged revenues over time, despite some volatility during recessionary periods;
- Strong coverage from fiscal 2014 pledged taxes and net revenues of pro forma maximum annual debt service (MADS) at 5.4x and 3.0x, respectively. This is also well above the respective additional bonds test requirements of 2.0x;
- Prudent management practices; and
- A rapid maturity schedule, with a statutory maximum maturity of 15 years for transportation bonds.

The series 2015 bonds and refunding bonds are being issued to provide funding for the MDOT consolidated transportation program (CTP) and advance refund a portion of outstanding debt.

The bonds are secured primarily by a gross pledge of a portion of MDOT’s motor vehicle fuel tax (45% of fiscal 2014 pledged taxes), excise taxes on motor vehicle sales -- titling tax (44%), a portion of the corporate income tax (9%), and sales and use tax applied to short-term vehicle rentals (1.8%). The motor vehicle fuel tax includes revenue from a base tax rate imposed per gallon and adjusted for CPI as well as a sales and use tax equivalent rate applied to the average annual price of regular unleaded motor fuel (less federal and state taxes) for the previous 12 months. If needed, net revenue -- calculated as all pledged taxes plus certain fees collected by the state and operating revenues from the Maryland Port Administration, the Maryland Transit Administration, and the Maryland Aviation Administration after expenses paid from the TTF -- are also available to pay debt service. The additional bonds test requires that both...
pledged taxes and net revenue for the last fiscal year provide 2x MADS coverage each, which we consider strong. There is currently no funded debt service reserve fund, but this is not a credit weakness in our view, due to the MDOT’s record of strong coverage levels and regular flow of revenues.

Pledged taxes increased 15% year-over-year in fiscal 2014 to $1.59 billion, primarily reflecting changes made in 2013 that indexed the motor fuel base tax rate to CPI and phased in increases to the sales and use tax equivalent rate applied against the average annual retail price of motor fuel. Also contributing to pledged tax growth was a higher 19.5% allocation of fiscal 2014 corporation income taxes compared with 9.5% in fiscal 2013. Pledged taxes have risen 6% per year, on average, since fiscal 2009 including a small year-over-year 1.71% decline in fiscal 2012. Net revenues also increased in fiscal 2014 to $866 million, rising 5% compared with fiscal 2013, and by an average 8% per year since fiscal 2009. Officials forecast 6.8% annual growth in total pledged taxes and 13.9% in net revenue in fiscal 2015. Fiscal 2014 pledged taxes cover pro forma MADS, including the series 2015 (second issue) bonds, by 5.4x, which we consider very strong, and forecast fiscal 2015 pledged taxes cover pro forma MADS by 5.8x. Available net receipts in fiscal 2014 covered pro forma MADS by 3.0x and estimated net revenues in fiscal 2015 would cover MADS by 3.4x.

Due primarily to a scheduled July 1, 2015 phased increase in the sales and use equivalent rate applied to motor fuel to 3% from 2%, pledged tax forecasts reflect a 10% year-over-year increase in fiscal 2016 to $1.87 billion. Pledged tax revenue forecasts also incorporate growth based on a 4% and 5% increase to the sales and use equivalent rate in fiscal 2016 and fiscal 2017, respectively, as built into legislation, assuming Congress doesn’t authorize states to collect online sales taxes. Although the base motor fuel tax rate won’t fluctuate with gas prices, the sales and use tax equivalent rate is calculated against annual average gas prices. The MDOT’s forecasts assume an annual average $2.89 price per gallon in fiscal 2016 rising to $3.48 in fiscal 2020. Even if long-term average annual gas prices fell below assumptions due to recent trends in oil prices, the scheduled increases in the sales and use equivalent tax rates should help to mitigate a portion of the lost forecast revenue based on lower gas prices. In addition to higher sales and use equivalent rates, the forecasts incorporate the indexing of the motor fuel base tax rate to CPI. There were no legislative changes in the 2015 session that materially affect projected pledged revenue. MDOT projects a minimal $2 million less in annual pledged revenue due to the reversion of a title certificate fee on rental vehicles to $50 through fiscal 2016 from a previously approved $100. Proposed legislation to repeal indexing and the sales and use equivalent tax rates did not pass.

The department has a significant $15.8 billion total consolidated transportation program (CTP) from 2015-2020, about 30% of which is expected to be funded by federal aid. The Transportation and Infrastructure Investment Act of 2013, which the legislature approved in 2013, significantly increases the state’s investment in transportation infrastructure and also enhanced the integrity of the fund’s trust fund resources in our view. Although the CTP projects state-supported debt will rise due to the increase in the allowable bond cap to $4.5 billion from $2.6 billion in 2013, we expect that the range of revenue enhancements as well as the declining debt service and rapid amortization of existing debt should ensure stable coverage levels over time. MDOT has typically issued bonds at least annually and officials similarly project issuing additional bonds over the next five to six years to reach the $4.5 billion cap for about $500 million pro forma MADS by fiscal 2020. With issuance of this debt and projected revenue increases due to recent legislative changes, projected MADS coverage by pledged taxes remains very strong, in our opinion, at more than 4x through 2020. Amortization of transportation bonds is very rapid, in our view, with more than 80% of principal retired.
within 10 years.

Following the changes in 2013, officials project the majority of the capital program will be funded with state sources of revenue rather than federal sources. We believe that future federal transportation funding and policy decisions could affect timely completion of the capital plan but greater reliance on state sources will mitigate some of the risk. To date, sequestration hasn’t presented major challenges to MDOT, as most federal highway and transit formula funds have been minimally reduced. Should future federal funding significantly lag projections, we understand MDOT officials would manage the capital program to focus on projects underway and delay federal projects as necessary.

For additional information on MDOT, please see the full analysis published Jan. 28, 2015, on RatingsDirect.

**Outlook**

The stable outlook is based on Standard & Poor’s expectation of MDOT’s continued steady growth in trust fund revenues and continued strong MADS coverage. We expect MADS coverage to remain above both 2x additional bonds tests, and likely to remain above 3x by pledged taxes, to provide cushion to offset any revenue volatility. The significant increase in state revenue sources to fund the long-term capital plan of MDOT is an offsetting consideration to the higher statutory bond cap. If revenues declined substantially and leverage accelerated rapidly lowering the coverage below MDOT’s target levels, this could negatively pressure the rating.

**Related Criteria And Research**

**Related Criteria**

- Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions, Nov. 19, 2013

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