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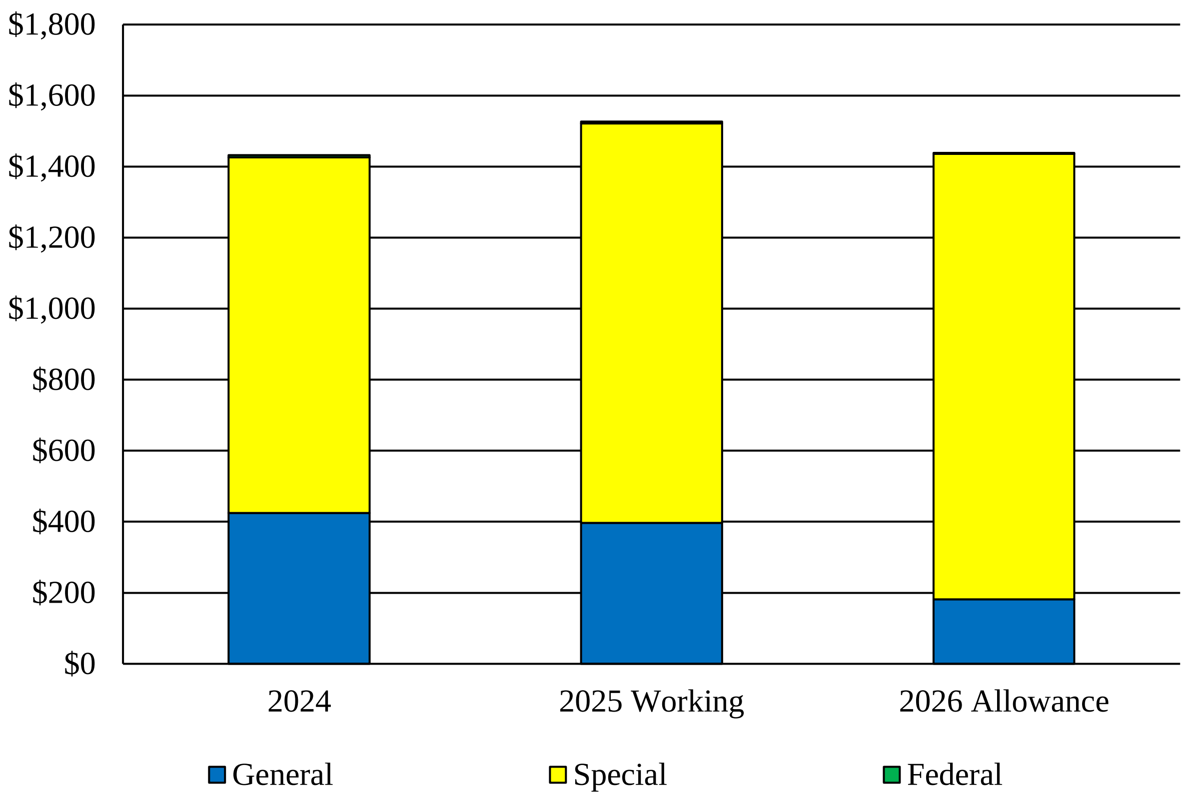
Public Debt

Executive Summary

The Public Debt program appropriates funds for general obligation (GO) bonds' debt service principal and interest payments. GO bonds support the State's general construction program. GO bonds do not pledge specific revenues but rather pledge the State's full faith and credit. Debt service payments are supported by the Annuity Bond Fund (ABF), whose largest revenue source is the State property tax. At the current State property tax rate of $0.112 per $100 of assessable base, property tax revenues are insufficient to fund all debt service costs, so general funds are also appropriated.

Operating Budget Summary

Fiscal 2026 Budget Decreases $88.3 Million, or 5.8%, to $1,438.4 Million
($ in Millions)



Note: Numbers may not sum due to rounding.

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Key Observations

- ***Moody's Investors Service Assigns Negative Outlook to Maryland GO Bonds:*** Prior to the June 2024 GO bond sale, Maryland received AAA bond ratings from all three major rating agencies, Moody's Investors Service (Moody's), S&P Global Ratings (S&P), and Fitch Ratings (Fitch). However, Moody's changed Maryland's outlook from stable to negative. Reasons cited were projected structural budget deficits and anticipated reductions in general fund reserves. Issue 1 reviews rating agency comments and State debt.

- ***June 2025 Bond Sale Outlook:*** The State Treasurer's Office (STO) advises that a $900 million par value bond sale is anticipated in June 2025. The December 2024 estimate projected that the coupon rate would be 5%. The high coupon rate is expected to generate $134 million in net premium after deducting transaction costs. STO also anticipates that the State could reduce debt service costs by refunding previously issued bonds. The December 2024 estimate projects $30 million in fiscal 2026 savings, or $5.4 million annually from fiscal 2026 to 2030. Issue 2 examines market conditions and analyzes the sale's risks and opportunities.

Operating Budget Recommended Actions

		Funds
1.	Reduce general obligation bond debt service to be consistent with a $900 million June 2025 bond sale.	-$ 2,900,000
2.	Adopt narrative updating policies to return to having multiple general obligation bond sales annually.	
3.	Adopt narrative to evaluate general obligation bond issuance assumptions.	
	Total Net Change	**-$ 2,900,000**

Operating Budget Analysis

Program Description

The Public Debt program appropriates funds for GO bonds' debt service payments. This includes principal and interest payments. The Capital Debt Affordability Committee (CDAC) develops State debt policies and recommends limits on State debt. The Spending Affordability Committee (SAC) advises the legislature on debt policies. GO bonds support the State's general construction program, which includes grants to local public- school construction, other grants to local jurisdictions and nonprofit organizations, higher education facilities, and State facilities. GO bonds do not pledge specific revenues but rather pledge the State's full faith and credit. Past issuances include:

- tax-exempt bonds sold to institutional investors;
- tax-exempt bonds sold to retail investors;
- taxable bonds sold to institutional investors;
- Build America Bonds (BAB) that are taxable bonds for which the State receives a direct subsidy from the federal government;
- Qualified Zone Academy Bonds (QZAB) that support specific education projects. Depending on the date of issuance, these bonds have received federal tax credits or direct federal subsidies;
- Qualified School Construction Bonds (QSCB) that supported specific education projects. Depending on the date of issuance, these bonds have received federal tax credits or direct federal subsidies; and
- Qualified Energy Conservation Bonds (QECB) that are direct federal subsidy bonds that support energy efficiency capital expenditures in public buildings, renewable energy production, and other related projects.

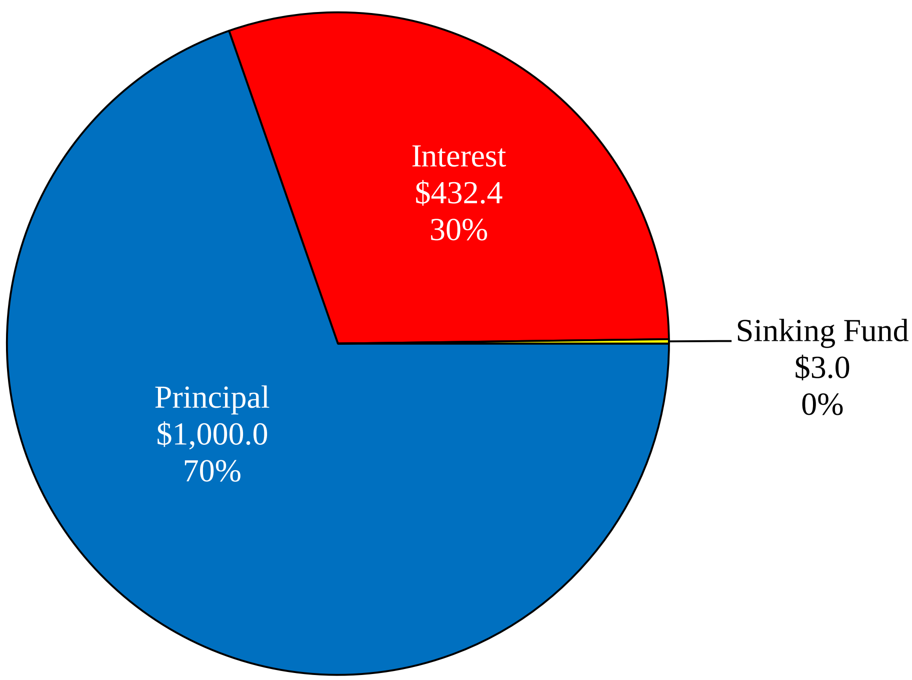
GO bond debt service payments are supported by the ABF. ABF revenues include State property tax revenues; federal subsidies; bond sale premiums; and repayments from certain State agencies, subdivisions, and private organizations. General funds may subsidize debt service if these funds are insufficient.

The State usually issues tax-exempt GO bonds to institutional investors twice a year. Other bonds are issued as they become authorized as needed (taxable) or as they are in demand (retail bonds). Each issuance's goal is to minimize the bonds' debt service costs.

Fiscal 2026 Overview of Agency Spending

Exhibit 1 shows that 70% of debt service costs are principal payments. This is an uncommonly high level of principal payments and is attributable to Maryland GO bonds' relatively short maturities. The State constitution does not allow for any State debts to mature in more than 15 years. To level out debt service payments, each issuance sells tranches of bonds that mature between 3 and 15 years with an average maturity of 10 years. This means that Maryland tends to have higher debt service payments for the level of debt that is outstanding and retires debt more quickly.

Exhibit 1
Overview of Agency Spending
Fiscal 2026 Allowance
($ in Millions)



Source: Comptroller's Office; Department of Budget and Management; Department of Legislative Services

Exhibit 2 shows that just over 97% of the fiscal 2026 debt service cost is for debt that has already been issued, most of which is fixed-rate, tax-exempt bonds sold to institutional investors. The State has also issued taxable bonds and has $376 million taxable debt outstanding at the beginning of fiscal 2026, of which $124 million will be retired during the year. BAB, QZAB, QSCB, and QECB issuances are structured to take advantage of federal tax credits or subsidies. Debt service payments for these issuances are less than traditional GO bonds. At the beginning of fiscal 2026, $76 million of the State's GO debt outstanding is attributable to these bonds.

Exhibit 2
Debt Service Costs
Fiscal 2026
($ in Millions)

Type of Debt	Principal	Interest	Sinking Fund	Total	Share of Total
Previously Issued Debt					
GO Bonds Sold to Institutional Investors	$854.8	$379.0	$0.0	$1,233.8	86.0%
Taxable Bonds	124.0	14.0	0.0	138.0	9.6%
Build America Bonds	19.6	0.4	0.0	20.0	1.4%
Qualified Zone Academy Bonds	1.6	1.2	0.0	2.8	0.2%
Qualified School Construction Bonds	0.0	1.0	3.0	4.0	0.3%
Qualified Energy Conservation Bonds	0.0	0.3	0.0	0.3	0.0%
Subtotal	***$1,000.0***	***$395.9***	***$3.0***	***$1,398.9***	***97.5%***
Debt to be Issued					
June 2025 New Debt Bond Sale	$0.0	$42.0	$0.0	$42.0	2.9%
June 2025 Refunding Bond Sale	0.0	-5.4	0.0	-5.4	-0.4%
Total	**$1,000.0**	**$432.4**	**$3.0**	**$1,435.4**	**100.0%**

GO: general obligation

Sources: Department of Budget and Management; State Treasurer's Office; State Comptroller's Office

The Department of Legislative Services (DLS) fiscal 2026 allowance estimate is $2.9 million less than what the Department of Budget Management (DBM) has in the allowance, which totals $1,438.3 million. **Exhibit 3** shows that the differences are attributable to:

- ***Different Par Value Assumptions for the New Bond Issuance:*** DBM assumes that $1,390 million is issued, and DLS assumes that $900 million is issued. STO advises that the fall estimate, $1,390 million, has been revised downward to $900 million; and

- ***Different Refunding Bonds' Debt Service Payments:*** DBM assumes upfront savings so that savings are only realized in fiscal 2026, and DLS assumes level savings so that $32.6 million in savings are realized from fiscal 2026 to 2031. Total level savings are greater than upfront savings. The refunding bonds are discussed in more detail with the bond sale outlook in Issue 2.

Exhibit 3
Differences between DBM and DLS Allowance Estimates
June 2025
($ in Millions)

	DBM	DLS	Difference
June 2025 New Bonds' Debt Service	$69,500	$42,000	-$27,500
June 2025 Refunding Bonds' Savings	-30,030	-5,434	24,596
Total	**$39,470**	**$36,566**	**-$2,904**

DBM: Department of Budget and Management
DLS: Department of Legislative Services

Source: DBM; DLS

Operating Budget Annuity Bond Fund Forecast

Exhibit 4 presents the six-year annuity debt service forecast. The exhibit shows that most of the revenues supporting GO bond debt service are derived from State property taxes. Regarding fiscal 2026 debt service costs, this uses the DLS estimate discussed in Exhibit 3, which is $2.9 million less than the DBM estimate. Like that of DBM, the DLS forecast provides a $10 million closing balance at the end of each fiscal year.

Exhibit 4
Revenues Supporting Debt Service
Fiscal 2025-2030
($ in Millions)

	2025	**2026**	**2027**	**2028**	**2029**	**2030**
Special Fund Revenues						
Prior-year ABF Fund Balance Transferred	$179	$79	$13	$10	$10	$10
State Property Tax Receipts	1,049	1,114	1,138	1,161	1,186	1,212
Other Revenues	136	2	2	2	2	2
Bond Premium Capitalized Interest Expenditures	241	208	0	0	0	0
Reserve for Future Capitalized Interest Expenditures	-208	0	0	0	0	0
Capital Authorizations[1]	-224	-140	0	0	0	0
Subtotal	***$1,174***	***$1,262***	***$1,152***	***$1,173***	***$1,198***	***$1,224***
General Funds	397	182	374	382	442	525
Transfer Tax Special Funds	7	2	0	0	0	0
Federal Funds	5	2	1	0	0	0
Total Revenues	**$1,583**	**$1,448**	**$1,527**	**$1,555**	**$1,640**	**$1,749**
Debt Service Expenditures	**$1,504**	**$1,435**	**$1,517**	**$1,545**	**$1,630**	**$1,739**
End-of-year ABF Balance	**$79**	**$13**	**$10**	**$10**	**$10**	**$10**

[1] Bond proceeds from premiums that support capital projects.

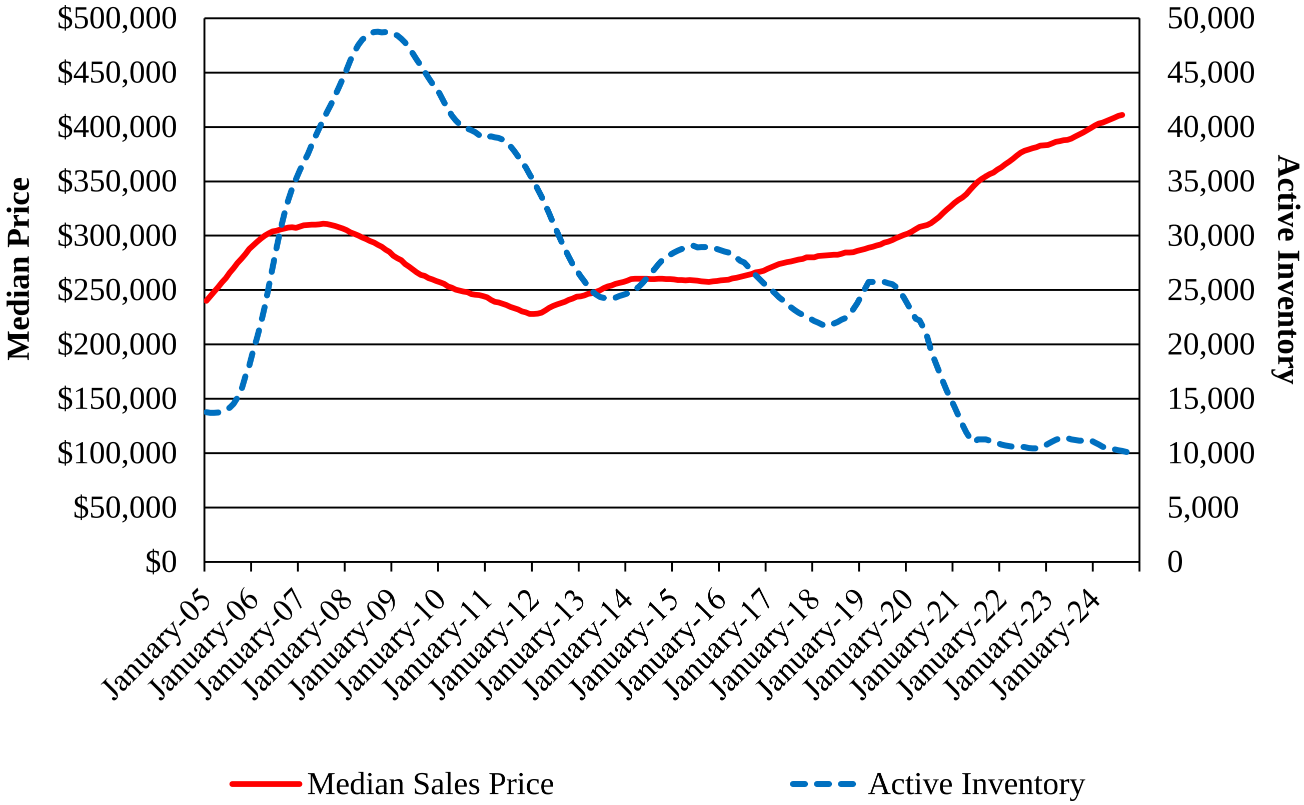
ABF: Annuity Bond Fund

Source: Department of Legislative Services

Annuity Bond Fund Six-year Forecast

State property tax collections are influenced by trends in the housing market. **Exhibit 5** shows that the median home price has increased steadily since calendar 2012, with prices increasing more sharply in calendar 2020 and 2021. Even more pronounced is the decline in the inventory of houses for sale. Inventories since September 2021 have been lower than the number of inventories since before calendar 2000. DLS notes that inventories have been revised upward modestly in recent years, so the decline in calendar 2024 may not be as pronounced as the data suggests. Home sales in Maryland have also declined substantially since calendar 2021 from approximately 107,400 sales in calendar 2021 to 68,900 in calendar 2024. One hypothesis about slowing sales is that homeowners with low interest rate mortgages are reluctant to sell their home and lose a mortgage that is now below market rates.

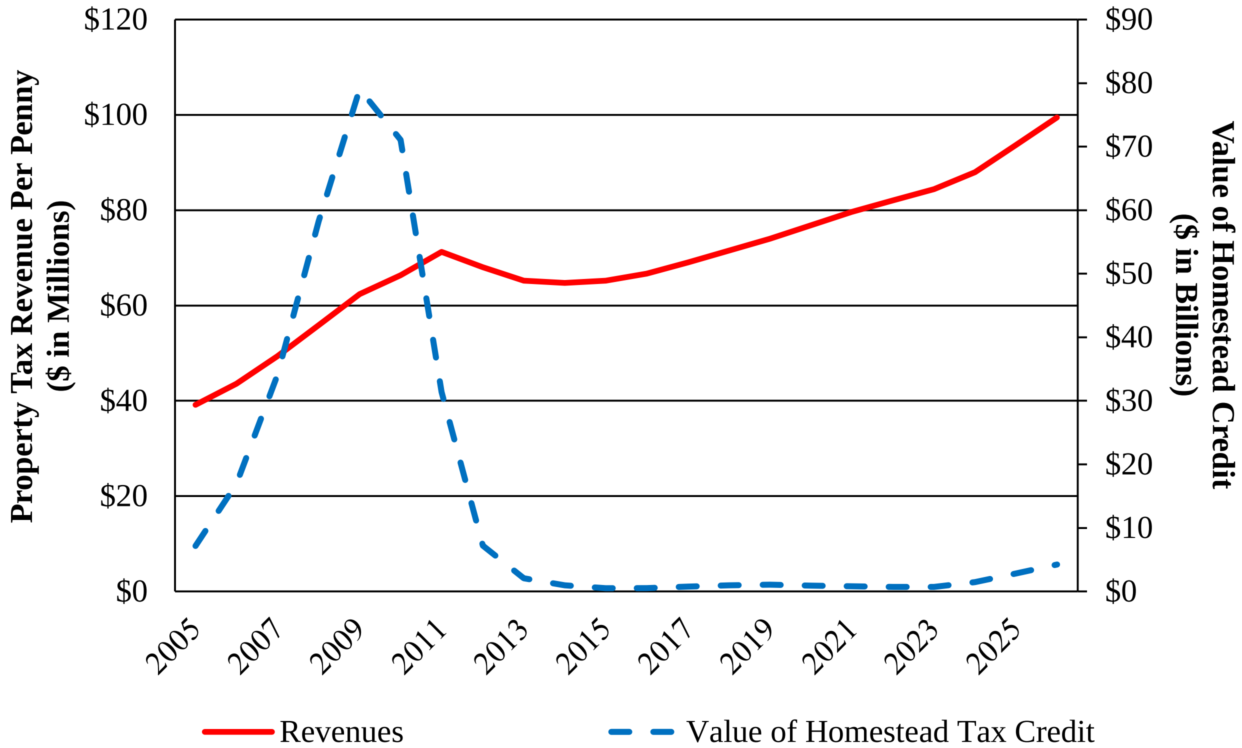
Exhibit 5
Maryland Housing – Median Prices and Active Inventory
12-month Moving Average
January 2005 to December 2024



Source: Maryland Association of Realtors; Department of Legislative Services

Exhibit 6 shows how much revenue one cent on the State property tax has generated since fiscal 2005. State property tax receipts generated per one cent of tax increased through fiscal 2011, even as home values peaked in fiscal 2007. Revenues declined from fiscal 2012 to 2014 but have generally increased since fiscal 2015. The recent increase is more modest than during the housing boom. Revenues would have grown faster during the housing boom if not for the Homestead Tax Credit (HTC), which moderated the growth in State property tax revenues.

Exhibit 6
State Property Tax Homestead Tax Credits and Property Tax Receipts
Fiscal 2005-2026



Source: State Department of Assessments and Taxation; Department of Budget and Management; Department of Legislative Services

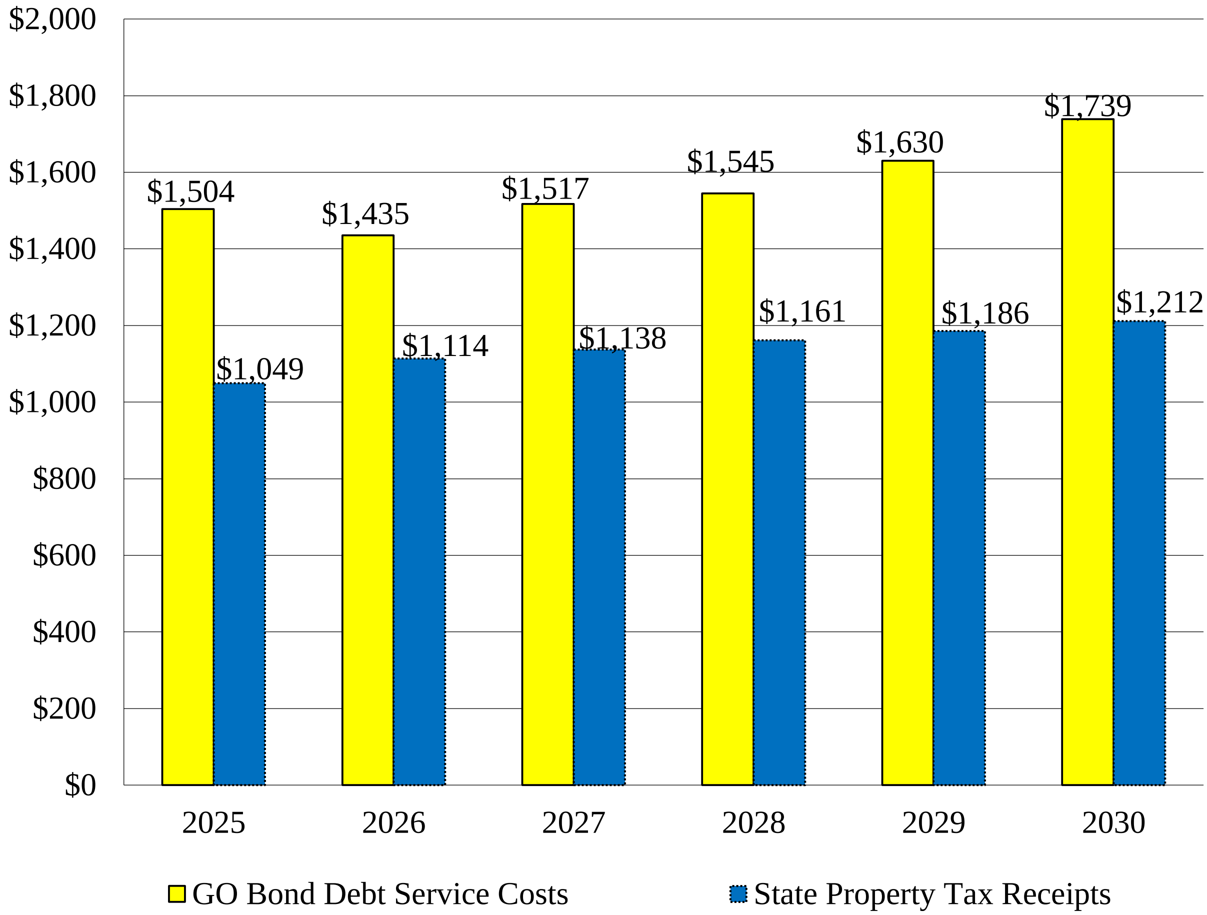
Assessment policies and HTC account for the lag between changes in the real estate market and tax receipts. Property values are assessed every three years, and increases are phased in over three years. For example, if a value increases by 9%, the increase would be 3% in the first year, 6% in the second year, and 9% in the third year. Having three years between assessments also moderates fluctuations in State property taxes. Properties assessed in calendar 2024 will have last been assessed in calendar 2021. Home values have increased steadily, which has increased the value of HTC.

HTC limits the annual increase in State property assessments subject to the property tax to 10%. If reassessing a resident's assessed property value results in an increase that exceeds 10%, the homeowner receives a credit for any amount above 10%. This limits revenue growth when property values rise quickly. Taken together, the three-year assessment process and HTC slowed the revenue increases during the real estate boom and delayed the peak until after the decline in property values. Current market conditions suggest that State property tax receipts should be stable over the next few years, even if home values slow or decline modestly.

General Fund Appropriation Is Necessary to Avoid State Property Tax Increases

State property tax revenues are estimated to increase annually at a 2.9% rate from fiscal 2025 to 2030. An increase of 6.2% from fiscal 2025 to 2026 is anticipated. State property tax rates have been $0.112 per $100 of assessable base since fiscal 2007. This policy keeps taxes low but requires general fund appropriations to fund GO bond debt service. **Exhibit 7** shows that steady increases in State property tax revenues and debt service costs are projected and that debt service will continue to exceed State property tax revenues.

Exhibit 7
GO Bond Debt Service Costs and State Property Tax Revenue Collections
Fiscal 2025-2030
($ in Millions)



GO: general obligation

Source: State Department of Assessments and Taxation; Department of Legislative Services

Issues

1. Moody's Investors Service Assigns Negative Outlook to Maryland General Obligation Bonds

Prior to the June 2024 GO bond sale, Maryland received AAA bond ratings from all three major rating agencies, Moody's, S&P, and Fitch. However, Moody's changed Maryland's outlook from stable to negative. Reasons cited were projected structural budget deficits and anticipated reductions in general fund reserves.

Moody's revised its ratings methodology in July 2024, and S&P revised its methodology in September 2024. Both agencies are moving toward more quantitative approaches so that data measuring economic and financial performance, liabilities, and reserves are now a larger share of the rating evaluation.

In its November 2024 briefing to SAC, DLS estimated that the State's structural deficit will be $2.7 billion in fiscal 2026, increasing to $5.7 billion by fiscal 2030. Moody's noted that a factor that could lead to a downgrade is continued structural operating deficits that cause reserve draws beyond fiscal 2025 without a plan for replenishment. The State has had structural deficits in prior years and resolved them. Moody's comments suggest that resolving structural deficits again is required to avoid a downgrade.

Effect of Negative Outlook on Interest Costs Is Unclear

This is not the first time that Moody's has placed Maryland GO bonds on negative outlook. Prior to the July 2011 sale, Moody's placed five states, including Maryland, on a negative credit outlook. This was during a federal government shutdown when there were concerns that there would be a federal default. Each of the five states had an unusually high dependance on federal spending. The resolution from this shutdown was federal sequestration of funds. At the time, DLS estimated that the negative outlook added 0.23% to the true interest cost (TIC) but that the effect faded quickly and did not affect other bond sales. After the most recent sale, DLS again estimated if there were any additional costs, but the analysis was inconclusive. DLS will continue to monitor this.

Maryland Is a High-debt State

Each year, Moody's compares State debt levels. Two of the measures estimated by Moody's are measures that the State uses when evaluating debt – debt outstanding to personal income and debt service to revenues. Among states rated AAA by the three major rating agencies (Moody's, S&P, and Fitch), Maryland has the second highest debt service to revenues ratio and debt outstanding to personal income ratios. **Exhibit 8** shows that Maryland also has the highest net pension liability and total liabilities.

Exhibit 8
Ranking AAA-rated States' Long-term Liabilities
Fiscal 2023

State	Total Long-term Liabilities to Revenues	State Debt to Personal Income	Implied Debt Service to Revenues	Pension Liability to Personal Income	OPEB Liability to Personal Income	Capital Asset Depreciation Ratio
Maryland	7	12	7	9	10	4
Delaware	8	4	10	14	1	29
South Carolina	13	41	40	10	18	42
Texas	15	34	30	20	13	48
Missouri	23	42	37	25	19	20
Ohio	31	22	14	38	33	13
Georgia	33	27	19	34	33	11
Virginia	34	18	16	42	32	46
Florida	36	34	28	47	30	23
Indiana	38	42	42	29	42	2
Minnesota	39	24	25	32	33	16
North Carolina	40	34	32	42	22	50
Utah	45	33	32	45	42	42
Tennessee	47	47	47	47	30	38
Iowa	49	42	42	47	33	20

OPEB: Other Postemployment Benefits

Note: Rankings compare 50 states and do not include the District of Columbia or territories. Lower rankings signify higher liabilities. Maryland and AAA-rated states ranked higher than Maryland are shaded. Moody's Investor Services includes debt supported by lottery revenues in its state debt comparisons. Implied debt service normalizes debt service costs so that all debt is amortized over 20 years. Pension liabilities are normalized with a standard discount rate.

Source: Moody's Investor Services, September 2024

States polices can vary substantially, making comparisons difficult. In some cases, like when assuming a lower pension rate of return, assuming a lower rate is prudent but leads to a higher unfunded liability. This penalizes states for responsibly estimating pension liabilities. To have the data be comparable and avoid exaggerating the liabilities of states with responsible polices, Moody's made the following adjustments:

- Bonds supported by lottery revenues are classified as State debt. Moody's does this because lottery revenues support State priorities, like education, that would otherwise be supported by State revenues. Lottery revenues take pressure off of other State revenues and thus serve the same purpose as State revenues. Recent Maryland Stadium Authority (MSA) authorizations supported by lottery bonds, like the Orioles and Ravens stadiums and Prince George's County Blue Line Corridor, and the Sports and Entertainment Facilities Financing Fund, are not classified as State debt by CDAC.

- To calculate implied debt service to revenues, debt service costs are amortized over 20 years. This normalizes the data so that debt service costs are comparable. Since Maryland bonds' maturities cannot exceed 15 years, Maryland's debt service payments are reduced in Moody's ratios. Conversely, states with debt service payments of debt exceeding 20 years have higher implied debt service costs. Even with this favorable adjustment, Maryland's debt service to revenue ratio is the second highest among AAA-rated states.

- A standard discount rate is used to compare unfunded pension liabilities. It is common for different pension plans to use different discount rates when estimating unfunded pension liabilities. The Maryland State Retirement System uses a 6.8% rate, which is slightly below commonly used rates.

Maryland Has Authorized Large Amounts of Stadium Authority Debt Since Calendar 2019

In addition to the GO bond program, the State authorizes revenue bonds to support various non-State assets. Since calendar 2019, the General Assembly has authorized over $4.5 billion in MSA debt to support the following projects:

- $2.2 billion for Built to Learn school construction projects;

- $1.2 billion for stadium improvements to the Baltimore Orioles and Ravens' stadiums;

- $400 million for constructing and renovating Blue Line Corridor projects in Prince George's County;

- $375 million for improvements to horse racing at Pimlico and Laurel Park;

- $220 million for minor league sports stadiums and entertainment facilities;
- $59.5 million for constructing the Hagerstown Multi-Use Sports and Events Facility;
- $55 million for renovating and expanding the Baltimore City Convention Center;
- $25 million for a Supplemental Facilities Fund; and
- $24.5 million for renovating and expanding the Ocean City Convention Center.

Prior to fiscal 2010, MSA bonds supported by lottery revenues were classified as State debt. Bond counsel advised that this debt can be structured so that it is not State debt if the Comptroller's Office deposits the lottery funds with a trustee for the bondholders. Stadium bond sales in calendar 2013 and 2014 were structured as non-State sales. Of MSA's $5.7 billion in total authorized debt, $5.5 billion is counted by the State as non-State debt.

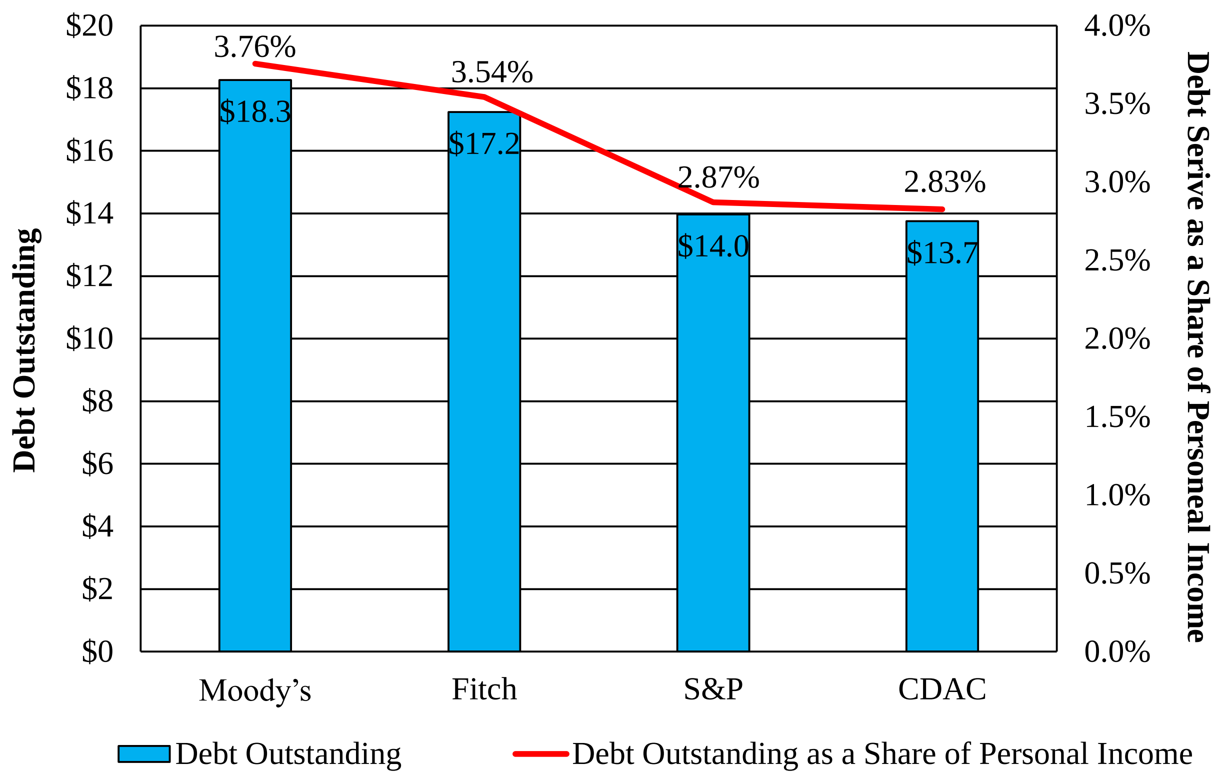
What Is Classified as State Debt Varies Across Rating Agencies, but All Agencies Include More Liabilities than Maryland Does

CDAC and State law determine what liabilities are State debt. The guiding principle is that debt supported by State taxes is State debt. This includes debt supported by general funds, transportation gas tax and vehicle excise taxes, and the bay restoration fee. Toll revenues are not a tax, so bonds issued by the Maryland Transportation Authority are not State debt.

Although these examples are easy to define, some revenue sources are less easily defined. For example, how to define lottery revenue is less obvious. Before fiscal 2010, MSA bonds supported by lottery revenues were State debt. After deductions, lottery revenues are deposited into the General Fund to support the State budget. Since fiscal 2010, MSA has issued Sports Facilities Taxable Lease Revenue Bonds to fund capital improvement projects at the Camden Yards Sports Complex. The bonds have been secured by lottery revenues and, in the opinion of bond counsel, did not constitute tax-supported debt. An agreement with the Comptroller ensures that lottery proceeds are deposited with a trustee for the benefit of the holders of the bonds. Rating agencies consider much of this debt to be State debt, even though the State no longer classifies this as State debt.

Exhibit 9 shows that CDAC's State debt calculation, which totals $13.7 billion, is less than any of the rating agency calculations, which range from $14.0 billion to $18.3 billion. In all cases, debt outstanding is less than the 4% threshold, but in the case of Moody's and Fitch, Maryland is less than half of a percent below the limit.

Exhibit 9
Comparing CDAC Debt Outstanding with Rating Agency Estimates
Fiscal 2024
($ in Billions)



CDAC: Capital Debt Affordability Committee
S&P: S&P Global Ratings

Source: Moody's Investors Service, S&P Global Ratings, Fitch Ratings, State Treasurer's Office, Department of Legislative Services

Rating agencies' higher debt outstanding calculations are attributable to the agencies classifying liabilities in their calculations that the State does not include in its State debt calculations. For example:

- Fitch includes $2.5 billion in public-private partnership commitments;
- Moody's includes $1.9 billion to reflect net premiums and discounts, which is already factored into CDAC's calculations. STO advises that they have asked Moody's for an explanation as to why debt that CDAC already includes in the calculation is increased beyond what the State's liability is;

- Moody's includes $1.1 billion in capital leases consistent with Governmental Accounting Standard Board Statement 87;[1]

- Moody's and Fitch include $0.5 billion to $1 billion in Baltimore City school debt supported by lottery revenues;

- Moody's includes approximately $700 million, and Fitch, approximately $620 million in Built to Learn bonds supported by Education Trust Fund revenues;

- Fitch includes $650 million in nonschool MSA debt supported by lottery revenues;

- Moody's includes $410 million in special transportation project bonds; and

- S&P includes over $200 million in financing agreements.

Recommendations

To address concerns raised by Moody's in the most recent credit evaluation, DLS recommends that:

- **the operating budget comply with the SAC goal to eliminate the structural deficit in fiscal 2026;**

- **the State avoid adding large, new capital budget commitments; and**

- **CDAC should consider reviewing State debt to determine if some non-State debt is more appropriately classified as State debt. Since rating agencies themselves do not agree on how to classify all bonds, there is clearly ambiguity regarding these definitions.**

STO should review its recent practice to require that coupon rates[2] for GO bonds not be less than 5.00% to maximize bond sale premiums that are used to support debt service. DLS estimates that this adds 0.53% (53 basis points) the GO bonds' TIC. Although a case can be made that the TIC approach may undervalue the call provisions that come with GO

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[1] The new statement considers almost all multi-year leases to be capital leases. CDAC uses the previous definition, which required that certain long-term leases are capital and does not track all multi-year leases due to high administrative costs. A lease review identified hundreds of small leases with multi-year amortization tables that cannot be tracked in accounting systems without substantial administrative cost increases.

[2] The coupon rate is the interest rate that is paid to the bondholders on the par value of the bonds. Par value is the nominal value of the bond as indicated by the Official Statement. As interest rates change, bonds can be sold for more or less than par value. If the market rate is below the coupon rate, bonds sell at a premium and proceeds exceed par value. In recent years, the State has been selling bonds at a premium and using the funds to support debt service. This has short-term benefits but has increased GO bonds outstanding by hundreds of millions of dollars.

bonds, the State should not pay too much for the call provisions. The State Treasurer should be prepared to brief the committees on how debt service costs are minimized over the life of the bonds.

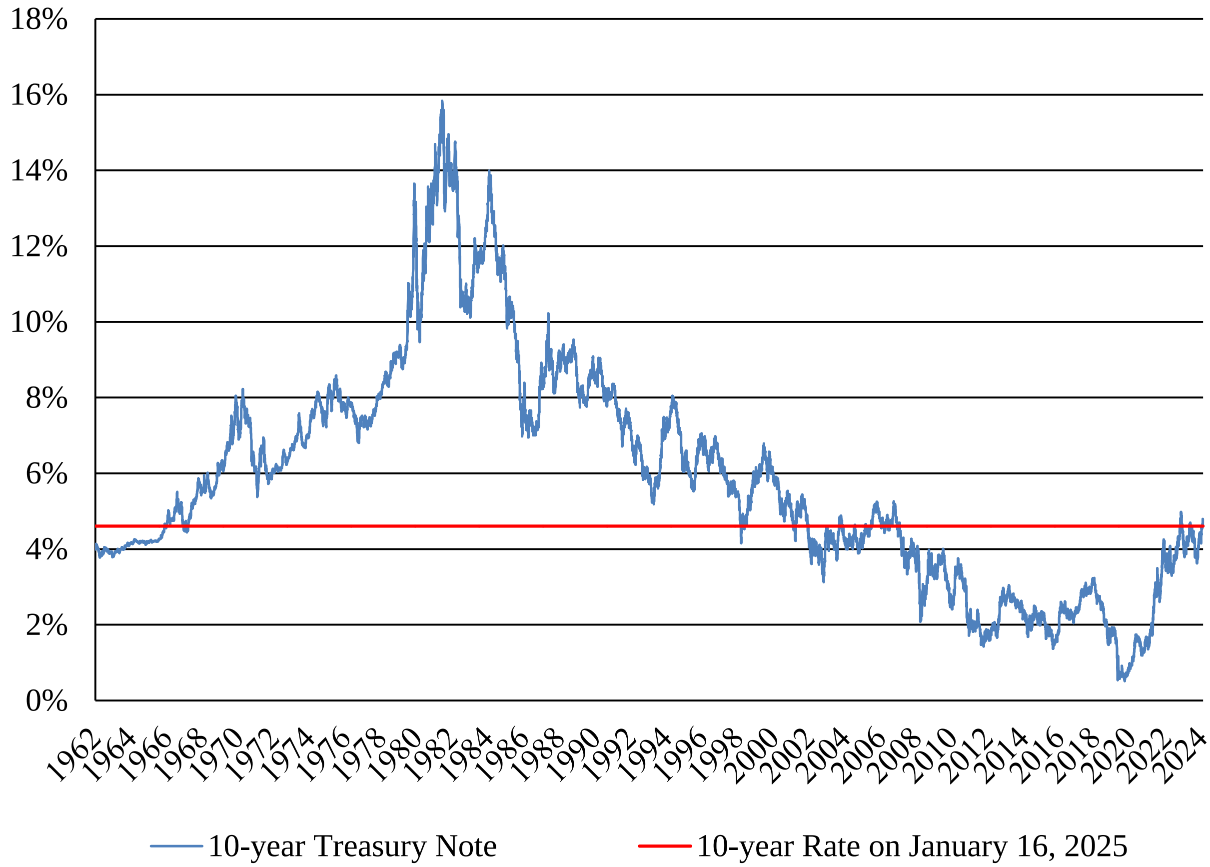
2. June 2025 Bond Sale Outlook

STO advises that a $900 million par value bond sale is anticipated in June 2025. The December 2024 estimate projected that the coupon rate would be 5%. The high coupon rate is expected to generate $134 million in net premium after deducting transaction costs. STO also anticipates that the State could reduce debt service costs by refunding previously issued bonds. The December 2024 estimate projects $30 million in fiscal 2026 savings, or $5.4 million annually from fiscal 2026 to 2030.

Interest Rates Are No Longer Unusually Low but Are Still Below the Coupon Rates

Although recent increases in interest rates are above what the economy is accustomed to since the Great Recession, interest rates are low when compared to rates over the last 63 years. State GO bonds are structured to mature between 3 and 15 years after issuance. The average maturity is 9.8 years, which is common. As such, DLS uses 10-year maturity indices when evaluating bonds. **Exhibit 10** shows U.S. Treasury Note yields since 1962, which is the longest data set available, as well as the yield on January 16, 2025, the most recent day that data was available when this analysis was prepared. Over this period, 63% of yields exceeded the rate on January 16, 2025. Almost all hyper-low yields were after the Great Recession. It is unclear how interest rates will change moving forward, but it is reasonable to expect that they will not return to the unusually low rates experienced over the last 16 years.

Exhibit 10
Interest Rates for 10-year U.S. Treasury Notes
January 1962 to January 2025

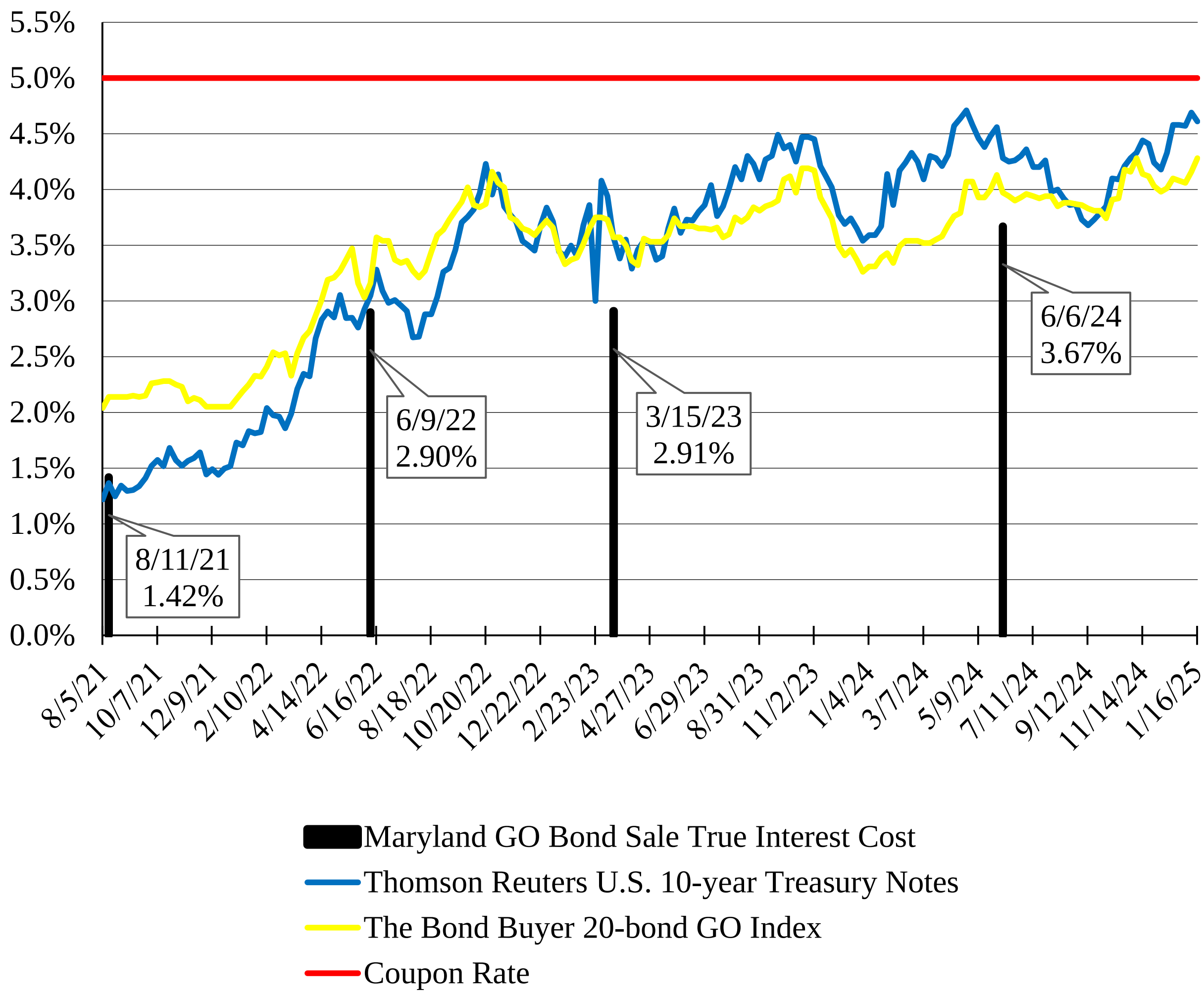


Source: Board of Governors of the Federal Reserve System

Bond sales since calendar 2020 have offered a 5.00% coupon rate, and this rate is assumed in the out-years. **Exhibit 11** shows that U.S. Treasury Notes' interest rate peaked at 4.49% in September 2023 and The Bond Buyer 20-bond Index[3] is as high as it has been since the end of the COVID-19 pandemic. Although rates have been uneven, interest rate peaks have trended higher in recent years.

[3] The Bond Buyer 20-bond Index includes GO bonds maturing in 20 years, with an average rating equivalent to Moody's Aa2 and S&P's AA.

Exhibit 11
Interest Rates and General Obligation Bond's True Interest Cost
August 2021 to January 2025



GO: general obligation

Source: The Bond Buyer

Interest Rate Volatility Suggests Risks to June 2025 Bond Sale Budget Estimates

The June 2025 bond sale has three components: (1) ongoing debt service costs; (2) additional bond proceeds from premiums; and (3) refunding savings.

Ongoing GO Bond Debt Service Costs

The anticipated sale is $900 million in par value with a coupon rate of 5%. Exhibit 11 shows that rates have been below 5% in recent years. High coupon rates and low interest rates suggest that debt service costs are unlikely to exceed budget estimates.

Bond Sale Premiums

Bond sale premium estimates are exceptionally volatile. In calendar 2019, DLS estimated that a $520 million bond sale's premium is reduced $12.5 million if interest rates increase by 0.25% (25 basis points). This suggests that each basis point changes the amount of premium by almost $1 million. DBM advises that $44 million of the projected $134 million in net premiums will support debt service. The capital budget authorizes the State Treasurer to determine how premiums are allocated. The State Treasurer can reduce allocations for capital programs if premiums are less than budgeted.

Refunding Bonds

Maryland issues callable GO bonds. STO monitors interest rates and refunds bonds when rates are low. DBM advises that the State plans to refund $693.4 million in callable bonds in June 2025. The final amount of bonds called will be determined shortly before the sale; it will depend on interest rates. Should rates be higher than anticipated, less or no bonds could be refunded. **Exhibit 12** shows that the three approaches to structuring the proposed refunding that DBM has examined realize $26.2 to $32.6 million in savings. The structures are:

- ***Level Savings:*** Maryland's most common structure is to spread savings evenly over a period of years, which realizes the most total savings. This structure also has the highest present value savings at 2.78%.

- ***Upfront Savings:*** The July 2020 bond sale was structured to maximize savings in the fiscal year with debt service costs. This was done with the July 2021 refunding. That sale realized $60.9 million in fiscal 2021 savings, $0.2 million in fiscal 2022 savings, and less than $100,000 in annual savings after fiscal 2022. Though uncommon, this offers the most short-term savings in times when cash flow concerns are acute, as was the case early in the COVID-19 pandemic in July 2020.

- ***Deferred Amortization:*** Refunding bonds could also be structured to yield extraordinary savings in the early years and increase costs in later years. Maryland has not used this approach. This approach would exacerbate the substantial out-year structural deficit already forecast.

Exhibit 12
Savings from Three Approaches to Structuring Refunding Bonds
Fiscal 2026-2031
($ in Thousands)

Fiscal Year	Level Savings[1]	Upfront Savings	Deferred Amortization
2026	-$5,434	-$30,030	-$30,005
2027	-5,439	-5	-30,008
2028	-5,438	-2	-30,006
2029	-5,434	-2	21,278
2030	-5,439	-3	21,279
2031	-5,435	-3	21,282
Total	**-$32,619**	**-$30,045**	**-$26,180**

[1] Level savings has the highest present value savings at 2.78%.

Source: Department of Budget and Management, December 2024

DBM’s budget assumes that the refunding will realize upfront savings. The exhibit shows that this provides the most savings in fiscal 2026, which is compelling in a year with a budget deficit. However, there are benefits to level funding savings, such as:

- ***More Total and Present Value Savings:*** The exhibit shows that level funded savings exceed upfront savings by $2.6 million and 2.78% present value savings, so level funded has the highest savings of the three options.

- ***Structural Deficit Is a Multi-year Problem:*** SAC recommends that the budget eliminate the structural deficit in fiscal 2026. Upfront savings only provides relief in fiscal 2026, while level savings addresses the structural deficit. Level savings is a gift that keeps on giving.

- ***Spreading Savings Over Six Years Minimizes Fiscal 2026 Budget Risk:*** Refunding bonds will not be issued until June 2025. Interest rates could be quite different in June 2025 than what was forecast in December 2024. Assuming upfront savings now puts all interest rate risks in fiscal 2026. For example, if rates increase and savings are $12 million less than budgeted, all $12 million in additional costs will be in fiscal 2026. Level savings would spread the risk, so that only $2 million would be unrealized in fiscal 2026.

- ***Level Savings Estimate Is Less Than the $10 million Annuity Bond Fund Balance:*** The ABF forecast assumes a $10 million ending balance each year. If refunding savings are less than projected, the fund can absorb the cost without requiring additional appropriations.

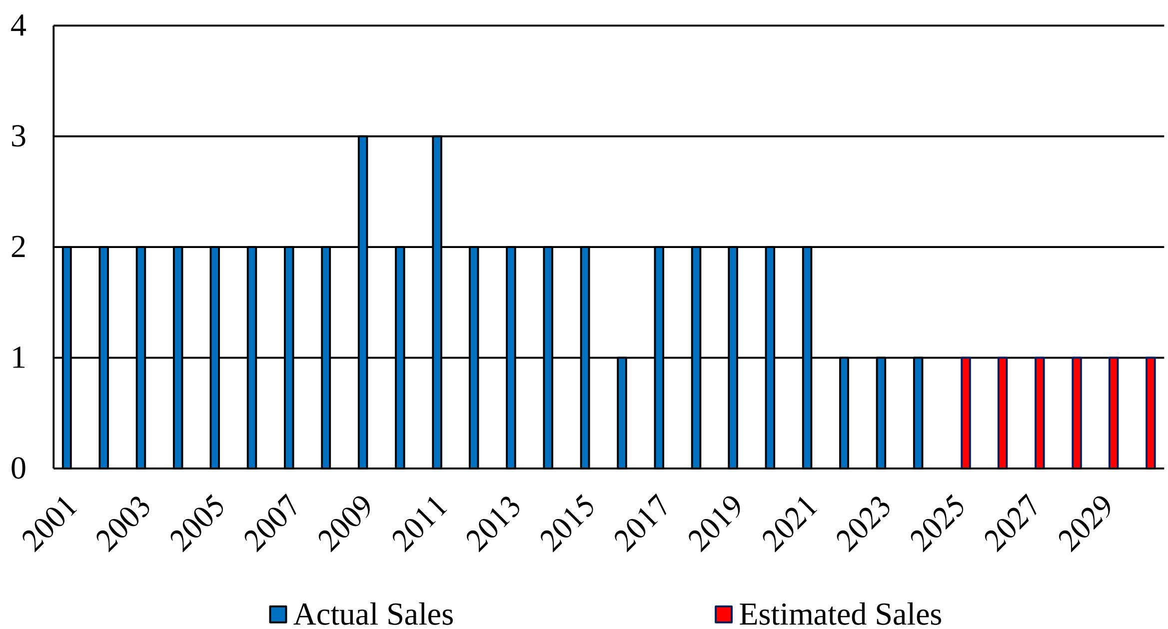
DLS recommends that the proposed June 2025 refunding be structured to realize level savings.

3. State Should Readopt the Policy of Having Two Annual General Obligation 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, 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 bond sales into multiple sales in each year. **Exhibit 13** shows that from fiscal 2001 to 2021, Maryland had two sales in every calendar year except calendar 2009 and 2011 when there were three sales, and calendar 2016 when there was one sale. The calendar 2016 issuance coincided with STO rebidding financial advisors and merging the winter and summer sales into one large sale in June.

Exhibit 13
General Obligation Bond Sales
Calendar 2001-2024 Actual and 2025 to 2030 Estimated



Source: State Treasurer's Office

Readopting the policy to have multiple bond sales each year has the following advantages:

- ***Smaller Bond Sale Size Reduces Interest Costs:*** Maryland generally has large bond sales, and underwriters purchasing GO bonds must sell a substantial amount of debt on the secondary market when buying Maryland bonds. Since larger bond sales are more difficult to sell in the secondary market, larger sales tend to push up interest rates. GO bond sales have ranged from $400 million to over $1.1 billion since calendar 2008. DLS' statistical analysis of bond sales suggests that increasing the size of GO bond issuances increases the interest rate paid. In a 2009 study, DLS estimated that every $100 million in par value adds 0.06% to the TIC. To reduce the size of sales, STO divides bond sales into bidding groups to make sales more competitive. It seems reducing the size by moving a share of the bonds to another day could potentially strengthen the State's market power even more.

- ***More Bond Sales Reduce Risk Associated with the Timing of Sales:*** Bond yields fluctuate daily and are heavily influenced by current events that are difficult to predict. The timing of a sale can be fortunate or unfortunate. Maryland sold $777 million in par values on March 4, 2020. The yield was, at the time, the lowest 15-year maturity TIC on record. However, this was shortly before effects of the COVID-19 pandemic were felt. At the time, DLS asked STO how the bond sale would have been handled if it had been planned later that month when markets were unstable. STO's response was that the sale would have been delayed until markets stabilized. Another example is the July 2011 sale, which occurred within weeks of Moody's placing Maryland on negative credit outlook. At the time, DLS estimated that this added 0.23% to the TIC but that the effect faded quickly and did not affect other bond sales. Under current plans to issue all bonds in the last month of the fiscal year, the State has less flexibility regarding the timing of the sales. Having more and smaller sales reduces the market timing risk and gives the State more flexibility when issuing bonds.

- ***Inconsistent Estimates in the Fiscal 2026 Allowance for the June 2025 GO Bond Sale Highlight Advantages of Having Bond Sales Earlier in the Fiscal Year:*** To be cautious, DBM's estimated fiscal 2026 appropriations use two different assumptions regarding the size of the June 2025 bond sale. In each case, it is the less aggressive assumption. For the new bonds, DBM assumes the amount estimated by STO in fall 2024, $1,390 million in par value, which has a higher fiscal 2026 debt service estimate. When estimating premiums, DBM assumes that the issuance will be $900 million, which has a lower estimated premium. Issuing bonds twice each fiscal year, in summer (early in the fiscal year) and again in late February or early March, debt service costs are known when the budget is prepared.

Having two smaller bond sales earlier in the fiscal year instead of one larger bond sale at the end of the fiscal is expected to decrease costs. It also provides more certainty when the budget is enacted. **DLS recommends that committee adopt narrative that clarifies that State policy is to issue bond twice if total annual issuances for new debt exceed $700 million. When possible, second bond sale's competitive bids should be opened before the second week of**

March so that the budget process has time to adjust the operating budget to reflect the actual debt service costs.

4. Reevaluating Issuance Assumptions in Response to Slower Project Spending

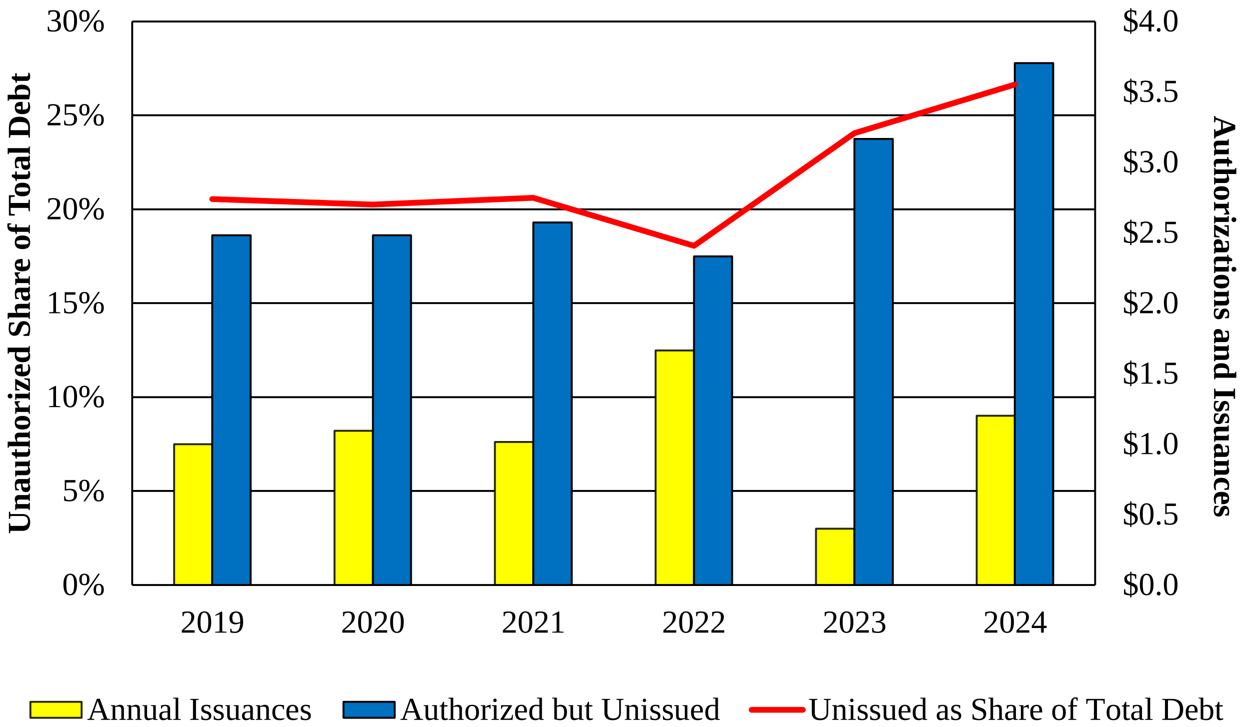
The budget bill authorizes GO bonds. There are no costs to these authorizations until bonds are sold. Capital projects often take years to complete, so there has been a consistent level of authorized but unissued debt. To estimate out-year costs, the State uses a formula that estimates how quickly bonds will be sold. Considerable effort is taken to issue an appropriate amount of bonds. To avoid federal arbitrage[4] rebates, bonds should not be issued too early, but funds must be available to pay contractors, so bonds should also not be sold too late.

The formula used to estimate GO bond issuances was developed more than three decades ago. It assumes that (1) 31% of bonds are issued in the first year, (2) 25% are issued in the second year, (3) 20% are issued in the third year, (4) 15% are issued in the fourth year, and (5) 9% are issued in the fifth year. The capital program's composition and policies have changed since the formula was developed. Recent bills authorize substantial amounts of non-State debt that support local governments and nonprofit institutions. The capital budget also cash flows more projects, whereby a partial authorization is made preauthorizing the remaining funds, rather than authorizing the full amount for each project in the initial authorization. STO advises that monthly GO bond proceed spending declined in fiscal 2024, resulting in increasing amounts of authorized but unissued debt. This suggests that issuance patterns may be changing.

The pace of capital spending seems to have slowed in recent years. **Exhibit 14** shows that the amount of authorized but unissued debt, which has been about 20% of all authorized debt, increased to 24% at the end of fiscal 2023 and 27% at the end of fiscal 2024.

[4] Federal government arbitrage regulations require the expenditure of tax-exempt bond proceeds soon after issuance. Every six months, a share of proceeds must be spent so that all proceeds are spent within two or three years, depending on the issuance. To avoid paying arbitrage rebates, bonds are issued when project and program funds are needed. A common question asked when interest rates are low is: why not issue more than needed to take advantage of low rates? The answer is that arbitrage rebates will nullify benefits.

Exhibit 14
Authorized but Unissued Debt Is Increasing
Fiscal 2019-2024
($ in Billions)



Source: Comptroller's Office; State Treasurer's Office; Department of Legislative Services

Changes in the capital program since the current issuance formula was developed decades ago and increasing levels of authorized but unissued debt suggest that it may be time to reevaluate the issuance formula. **DLS recommends that STO evaluate whether the State should revise the current GO bond issuance formula. This review should include other agencies that brief CDAC regarding GO bonds.**

Operating Budget Recommended Actions

		Amount Change	
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 $900 million will be issued, so the allowance overbudgets debt service costs. Savings from the smaller bond sale are partially offset by the assumption that the State will maximize the present value of savings from a refunding issuance by spreading the savings out over multiple years rather than front loading the savings.	-$ 2,900,000	GF

2. Adopt the following narrative:

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.

3. Adopt the following narrative:

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.

Information Request	Author	Due Date
Review GO bond issuance formulas	STO	October 1, 2025

Total General Fund Net Change	**-$ 2,900,000**

Appendix 1
Object/Fund Difference Report
Public Debt

Object/Fund	FY 24 Actual	FY 25 Working Appropriation	FY 26 Allowance	FY 25 - FY 26 Amount Change	Percent Change
Objects					
13 Fixed Charges	$ 1,432,654,078	$ 1,526,700,000	$ 1,438,400,000	-$ 88,300,000	-5.8%
Total Objects	**$ 1,432,654,078**	**$ 1,526,700,000**	**$ 1,438,400,000**	**-$ 88,300,000**	**-5.8%**
Funds					
01 General Fund	$ 425,100,000	$ 397,100,000	$ 181,700,000	-$ 215,400,000	-54.2%
03 Special Fund	1,001,184,674	1,124,700,000	1,254,100,000	129,400,000	11.5%
05 Federal Fund	6,369,404	4,900,000	2,600,000	-2,300,000	-46.9%
Total Funds	**$ 1,432,654,078**	**$ 1,526,700,000**	**$ 1,438,400,000**	**-$ 88,300,000**	**-5.8%**

Note: The fiscal 2025 appropriation does not include deficiencies, targeted revenues, or across-the-board reductions. The fiscal 2026 allowance does not include contingent reductions or cost-of-living adjustments.