

## **FITCH RATES THE CITY OF RALEIGH, NC'S \$73.775MM GOS 'AAA'; OUTLOOK STABLE**

Fitch Ratings-New York-13 January 2017: Fitch Ratings has assigned a 'AAA' rating to the following city of Raleigh, NC general obligation bonds (GOs):

--\$73.775 million GO public improvement bonds, series 2017.

The bonds are being issued to pay for transportation and parks and recreation projects for the city. The bonds are scheduled for sale on Jan. 24 via competitive bid.

Fitch has affirmed the following Raleigh, NC (the city) ratings:

-- Issuer Default Rating IDR at 'AAA';

--\$304 million GO bonds at 'AAA';

--\$200 million limited obligation bonds LOBs at 'AA+';

--\$229.6 million downtown improvement projects certificates of participation (COPs) at 'AA+'.

The Rating Outlook is Stable.

### **SECURITY**

The GO bonds are secured by the city's full faith and credit and unlimited tax pledge.

The COPs and LOBs are secured by annual payments made by the city subject to appropriation and a deed of trust on certain governmental property.

### **KEY RATING DRIVERS**

The city's strong economic base, supporting historically strong operating performance and a solid revenue framework, coupled with a moderately low liability burden and solid spending flexibility support the 'AAA' IDR.

#### **Economic Resource Base**

Raleigh is located in Wake County (Fitch IDR of 'AAA') in the north-central portion of the state. The city's population has increased by an average annual rate of 2% since 2010. This growth has been due in part to the presence of Research Triangle Park (RTP).

#### **Revenue Framework: 'aaa' factor assessment**

The city has strong revenue flexibility given the current property tax rate is less than half of the cap. Steady assessed value (AV) appreciation has generated natural revenue growth and Fitch expects this trend to continue given solid economic prospects.

#### **Expenditure Framework: 'aa' factor assessment**

The city has significant control over spending, including the legal ability to decide on terms of labor given the absence of collective bargaining. Additional flexibility can be found in pay-go spending and employee vacancies.

#### **Long-Term Liability Burden: 'aaa' factor assessment**

Debt levels are moderately low at about 8% of personal income.

## Operating Performance: 'aaa' factor assessment

The city's historical operating performance shows resilience. Reserves remained robust during and after the recession. Given the city's revenue and expenditure flexibility and ample reserves, the city is poised to perform exceptionally well in an economic downturn.

## RATING SENSITIVITIES

The rating is sensitive to shifts in fundamental credit characteristics, most notably the city's continued strong fiscal health. The Stable Outlook reflects Fitch's expectation that such shifts are highly unlikely in the foreseeable future.

## CREDIT PROFILE

Raleigh is located adjacent to the successful RTP, which serves as an important economic engine. The city has a highly skilled labor force and an employment base concentrated in service sector jobs related to government, education, technology, healthcare, and other professional services. Strong population growth, an expanding technology and medicine niche, and a surging professional and businesses service sector bode well for a strong future. Further strengthening the attractiveness of the city will be the completion of Union Station, scheduled for 2018. Union Station will ultimately provide a multi-modal complex servicing Amtrak rail, commuter rail, and regional and local bus operations within the city's Warehouse District.

The employment base continues to expand at a pace well above the state and nation, which is reflected in the city's low unemployment rate. Wealth levels are above the state average.

### Revenue Framework

The revenue base is dominated by property and sales tax taxes at about 55% and 21%, respectively, of fiscal 2016 general fund revenues.

The city's general fund revenue growth has trended above inflation and U.S. GDP growth. While growth does include some adjustment to the real property tax rate, growth in AV has been robust, increasing at a compound average annual growth rate (CAGR) of over 5% over the past 10 years ending 2016. Sale tax growth has also been solid at a CAGR of nearly 4% over the same time period. AV growth has been modest since the last revaluation in 2009 but Zillow data on home values indicates future AV trends are likely to be robust. Home values have fully recovered and are approximately 115% of precession levels. Preliminary results of the 2017 revaluation show an 8% increase in AV, reflecting mostly appreciation in the commercial real estate sector. Ongoing investment capital investment throughout the city is expected to generate new revenues.

The city maintains healthy capacity under the statutory cap of \$1.50 per \$100 of AV given the fiscal 2017 tax rate of \$.4183.

### Expenditure Framework

The city maintains healthy expenditures flexibility with affordable spending associated with fixed carrying costs.

Fitch expects the natural pace of spending growth to remain at or below revenue growth based on historical operations, moderate population growth, and a lack of significant expenditure pressures.

The city's expenditure flexibility is aided by the favorable workforce environment that prohibits labor contracts and gives management independent control of compensation and work rules. Carrying costs associated with debt service, actuarially determined pension payments, and OPEB actual contributions total 17% of governmental spending of which debt service accounts for 11%.

### Long-Term Liability Burden

Debt levels are low at about 8% of personal income. The city's variable rate exposure (approximately \$257 million of which \$173 million is synthetically fixed with a BMA swap), excluding enterprise and self-supporting parking debt, is 28% of net direct debt.

The current fiscal 2017 to 2021 five-year capital improvement plan (CIP) totals \$1.2 billion. Water and sewer enterprise projects (revenue bonds rated 'AAA'/Outlook Stable) account for the majority of the plan at 55%. The plan is 51% debt-funded. The city's near-term new money issuances include \$10 million-\$12 million for construction or renovation of general government facilities and upgrades to the convention center complex and \$30 million \$40 million for fiscal 2017-2018 rolling stock needs.

Pension and other post-employment benefits (OPEB) continue to be well managed. The city is a member of the statewide cost-sharing multi-employer defined benefit Local Government Employees' Retirement System (LGERS). The city's fiduciary net position of the system's total pension liability is 96% funded, adjusted for a 7% investment return assumption. The city also participates in the Law Enforcement Officers' Special Separation Allowance plan. While the city has been overfunding the actuarially required contribution recently, the funded ratio is just 8%, but the unfunded liability is minimal at less than 1% of personal income. For OPEB, the city has set up an irrevocable trust. The unfunded liability as of the December 2014 valuation was about \$167 million, which represents a very low 0.8% of personal income.

#### Operating Performance

In a moderate economic decline scenario Fitch believes the city would maintain an operating reserve cushion well above the level needed for an 'aaa' financial resilience assessment given the city's superior revenue and spending control. The city proved its financial resilience and strong budget management through the most recent recession by eliminating vacant positions, suspending its merit pay program, reducing pay-go spending and increasing fees.

The city's budget management demonstrates a strong commitment to maintaining a robust reserve cushion. Despite annually budgeting a portion of fund balance, the city has recorded an operating surplus in each fiscal year for over a decade and has added to unrestricted/unreserved fund balance.

The unrestricted general fund balance of \$208.1 million was an ample 50.7% of spending at year-end 2016. The city's reserve required by state statute, which is primarily to offset accounts receivable, is an additional source of financial flexibility (\$51.2 million) and increases reserves to over \$260 million or 63.5% of spending. The city has a target unassigned fund balance policy of 14% which it is comfortably exceeding.

The adopted fiscal 2017 budget is a 7.1% increase over fiscal 2016. The budget appropriates \$13 million in fund balance and includes a property tax rate reduction to \$0.4183. The budget provides additional funding for low-income housing, improvements to the economic development system, and park and public safety staff among other cost increases. Based on the city's historical financial performance, Fitch expects operations to remain positive and reserves ample.

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In addition to the sources of information identified in the applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

### Applicable Criteria

U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016)  
<https://www.fitchratings.com/site/re/879478>

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