S&P Global
Ratings

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Summary:

Raleigh, North Carolina; Appropriations; General Obligation

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Credit Profile		
US$73.775 mil GO pub imp bnds ser 2017 due 02/01/2037		
Long Term Rating	AAA/Stable	New
Raleigh GO		
Long Term Rating	AAA/Stable	Affirmed

Rationale

S&P Global Ratings has assigned its 'AAA' long-term rating to the City of Raleigh, N.C.'s series 2017 general obligation (GO) public improvement bonds. At the same time, S&P Global Ratings affirmed its 'AAA' ratings and 'AA+' ratings on the city's respective GO and appropriation-backed obligations outstanding. The outlook on all ratings is stable.

S&P Global Ratings has also affirmed its 'AA+/A-1+' ratings on Raleigh's (Downtown Improvement project) series 2004A and 2005B-1 variable-rate certificates of participation (COPs), and its 'AA+/A-1' rating on the city's series 2005B-2 variable-rate COPs and series 2016A variable-rate limited obligation refunding bonds. The long-term component of the ratings is based on the rating on the obligor, Raleigh. The short-term components of the ratings are based on the short-term ratings on the issues' respective liquidity providers, which are Wells Fargo Bank N.A. (A-1+) for series 2004A and 2005B-1, and PNC Bank N.A. (A-1) for series 2005B-2 and 2016A.

Raleigh's GO bonds are eligible to be rated above the sovereign because we believe the city can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions" (published Nov. 19, 2013, on RatingsDirect), the city has a predominately locally derived revenue source, with 53% of governmental activity revenue derived from property taxes with independent taxing authority and independent treasury management from the federal government.

The city's full faith and credit pledge secures its GO bonds to levy on all property taxable by Raleigh's ad valorem taxes, without limitation as to rate or amount, as may be necessary for repayment of principal and interest. Proceeds from the sale of the series 2017 bonds will be used to meet the city's cash flow needs associated with authorized general purpose for both transportation and parks and recreation capital projects.

The 'AA+' long-term rating on the city's appropriation-supported debt reflects what we view as Raleigh's:

- General creditworthiness;
- Demonstrated commitment to repaying its appropriation-backed obligations; and
- Strong oversight provided by the North Carolina Local Government Commission.

The GO rating reflects what we consider the following credit characteristics for the city:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA) and a local stabilizing institutional influence;
- Very strong management, with "good" financial policies and practices under our financial management assessment (FMA) methodology and the ability to consistently maintain balanced operations;
- Strong budgetary performance, with an operating surplus in the general fund and break-even operating results at the total governmental fund level in fiscal 2016;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2016 of 50% of operating expenditures;
- Very strong liquidity, with total government available cash at 1.8x total governmental fund expenditures and 14.4x governmental debt service, and access to external liquidity we consider exceptional;
- Weak debt and contingent liability position, with debt service carrying charges at 12.4% of expenditures and net direct debt that is 194.2% of total governmental fund revenue, but low overall net debt at less than 3% of market value; and
- Very strong institutional framework score.

Very strong economy

We consider Raleigh's economy very strong. The city, with an estimated population of 444,192, is located mainly in Wake County, with a small area in Durham County, in the Raleigh and Durham-Chapel Hill MSAs, which we consider to be broad and diverse. The city also benefits, in our view, from a stabilizing institutional influence. The city has a projected per capita effective buying income of 105.1% of the national level and per capita market value of $129,239. Overall, the city's market value grew by 7.2% over the past year to $57.4 billion in 2017. The weight-averaged unemployment rate of the counties was 4.7% in 2015.

Raleigh serves as the state capital and Wake County seat. The city's population has nearly doubled in the past two decades. A major catalyst for the growth has been the Research Triangle Park (RTP), an internationally prominent center for high-technology research and light manufacturing that currently houses more than 170 companies—-both private and foundation or nonprofit--and approximately 40,000 full-time employees. In January 2014, the Research Triangle Foundation (RTF; developer and landlord to RTP) purchased an additional 100 acres in the heart of the existing RTP property for further development. The city serves as a point to the triangle--along with Chapel Hill and Durham--based on the park's strong relationship with the cities' educational institutions. Raleigh itself is home to North Carolina State University with more than 34,000 students. We believe that these institutions contribute to the city's economic stability.

Very strong management

We view the city's management as very strong, with "good" financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis. In addition, our assessment of management indicates the city's consistent maintenance of balanced operations. Over the past three years, general fund operating results have ranged from 2.7%-5.2%.

Practices include:

- The city uses at least five years of historical trend analysis, as well as financial modeling for non-property tax revenues and debt service. The use of external sources informs the city's planning related to consideration of economic cycles.

- Budget performance is monitored throughout the year by the city manager, who receives budget-to-actual reports. The city council is notified, as needed, regarding significant variances in budgetary performance.
- The city does not maintain formal long-range financial modeling for operational revenue or expenses, but is aided by modeling for its enterprise operations including water and sewer, parking, solid waste, and stormwater.
- The city annually approves and updates its five-year capital improvement plan with identified projects and funding sources for all years.
- Raleigh's investment policy is guided in large part by State Statute G. S. 159-30, whereby investments are limited to risk-adverse securities, and provides holdings reports throughout the year to council and State Treasurer's Office.
- The city has a comprehensive debt management policy in place, which allows for the use of swaps through regular monitoring and several quantitative and qualitative metrics that serve as a guide for debt issuance.
- The city has adopted a minimum fund balance policy for the general fund to maintain unassigned reserves at least equal to or greater than 14% of next year's budgeted expenditures. Management considers this level adequate to protect against emergencies and natural disasters and provide adequate cash flow so as to avoid short-term borrowing.

Strong budgetary performance

Raleigh's budgetary performance is strong in our opinion. The city had surplus operating results in the general fund of 3.6% of expenditures, and balanced results across all governmental funds of 0.3% in fiscal 2016. General fund operating results of the city have been stable over the last three years, with a result of 5.2% in 2015 and a result of 2.7% in 2014.

These results have been adjusted to include as part of expenditures the city's operational transfers between governmental funds and from governmental to enterprise funds (primarily the transit, solid waste, and convention center funds). In addition, we have adjusted for nonrecurring capital, or expenses funded through debt proceeds. The fiscal 2016 results were due to both higher-than-budgeted collections of property tax, franchise tax revenues, and sales tax due to a steadily improving economy and the generally typical positive variances in budgeted expenses due to conservative budgeting.

For fiscal 2017, the adopted budget is balanced and projects a 7.2% growth in revenues for fiscal year 2017. The property tax rate changed from to 41.83 cents from 42.10 cents per $100 of assessed valuation. The 2017 property tax rate follows a revaluation year and represents a revenue neutral rate of 39.83 plus a two-cent increase, one cent dedicated to affordable housing, and one cent to pay for new debt service on a major park land purchase. Currently, management does not expect any material changes in reserves at the end of the year and maintains a significant debt model reserve. Despite the positive trend, we do not expect general fund performance to exceed 5% of expenditures for the year, and therefore, we expect sustained strong budgetary performance.

Very strong budgetary flexibility

Raleigh's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2016 of 50% of operating expenditures, or $205.2 million. We expect the available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

We consider the city's general fund unassigned and assigned fund balance to be available, and this nominal amount has consecutively grown over the past three years. As per state statutes, Raleigh also has more than $52 million in its restricted general fund balance that is not included in our available fund balance. North Carolina requires that certain financial amounts (primarily associated with accounts receivable) be restricted from appropriation until they are realized as cash. Raleigh has historically maintained available reserves in excess of its policy. At year-end, the general fund should continue to have an unassigned fund balance above the 14% goal, as well as a significant debt model reserve and the restricted by state statute reserve. We expect available reserves to remain well above 30% of expenditures over the next two years.

Very strong liquidity

In our opinion, Raleigh's liquidity is very strong, with total government available cash at 1.8x total governmental fund expenditures and 14.4x governmental debt service in 2016. In our view, the city has exceptional access to external liquidity if necessary. Weakening the city's liquidity profile is an exposure to high refinancing risk.

We believe the city's exceptional access to external liquidity is supported by its frequent debt issuances, including GO, limited obligation, and revenue bonds. Although the state allows for what we view as permissive investments, we believe Raleigh does not currently have aggressive ones as the majority of its investments are in mutual funds and fixed-income securities. The city has consistently had very strong liquidity and we do not anticipate a change to these ratios.

About 20% of Raleigh's total debt outstanding (governmental and enterprise) is variable-rate debt obligations. The city maintains liquidity facilities on all of its variable-rate debt. The series 2005B-2 COP and the related swap agreement mature on Feb. 1, 2034. The swap notional amount of $173,370,000 matches the variable rates COP. Under the swap agreement, Raleigh pays the counterparty a fixed interest payment semi-annually at 4.36% of the notional amount and receives a variable interest payment equivalent to the Bond Market Association (BMA) Municipal Swap Index. At Dec. 27, 2016, the swap had a negative fair value to the city of $33 million. The utility system has two swaps outstanding: A Citibank N.A. swap relates to the 2008A bonds, while a Wells Fargo Bank N.A. swap relates to the 2008B bonds. Under the swap agreements, Raleigh pays the counterparties a fixed interest rate payment at 4.163% of the swap notional amount ($150 million) and receives a variable interest rate payment equivalent to the BMA. At Dec. 27, 2016, the swaps had a combined negative fair value to the city of $24.5 million. We consider the contingent liability risk related to these swaps low because of the wide differential between the current rating on the bonds and the rating that would trigger a collateral posting or swap termination events.

The city maintains liquidity facilities on all of its variable-rate debt. Under these agreements, the banks will remarket any obligation for which payment is demanded. If the obligation cannot be remarketed, the banks will purchase the obligation. Interest rates may change pursuant to the terms of the debt agreements based on market conditions. The interest rates, per the remarketing agreements, cannot set maximum step rates. The liquidity agreements contain certain events of default that we consider permissive and for which immediate acceleration is a remedy; however, the risk is partially mitigated, in our view, by the provisions of Section 160A-20 of the North Carolina statutes, which does not allow for deficiency judgments. The agreements do not contain cross-default provisions, and the city has historically extended these agreements on three-year terms.

Weak debt and contingent liability profile

In our view, Raleigh's debt and contingent liability profile is weak. Total governmental fund debt service is 12.4% of total governmental fund expenditures, and net direct debt is 194.2% of total governmental fund revenue. Overall net debt is low at 2.9% of market value, which is in our view a positive credit factor.

Debt supported through the city's enterprise fund has been adjusted in our calculations. We note, however, that the city's net direct debt calculation includes regional convention center COPs for which Raleigh is obligated, but is supported by dedicated interlocal revenues (hotel and motel occupancy taxes), which, consistent with our debt statement analysis criteria, we do not consider to be self-supporting. While the city does have variable-rate debt outstanding that is exposed term-out provisions in its liquidity facilities, which could increase debt service payments in the event of a failed remarketing, we do not consider this to be a credit concern given the current credit rating level on the issuer. Raleigh has additional debt plans of about $52 million expected through fiscal 2017, which we do not believe will materially impact our view of the city's debt profile. Despite the weakness in some debt metrics, we believe that Raleigh's profile is manageable given the strength of the city's debt policies, debt monitoring and oversight, and comprehensive capital planning.

Raleigh's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 6.8% of total governmental fund expenditures in 2016. Of that amount, 3.8% represented required contributions to pension obligations, and 3.1% represented OPEB payments. The city made 100% of its annual required pension contribution in 2016.

The city participates in two pension plans: the North Carolina Local Government Employees' Retirement System (LGERS), and the Law Enforcement Officers' Special Separation Allowance. According to Governmental Accounting Standards Board Statement No. 68, which the city implemented for financial statements ended June 30, 2015, employers with benefits administered through cost-sharing, multi-employer pension plans such as LGERS must report their proportionate share of the net pension liability. As of the most recent actuarial valuation, June 30, 2016, LGERS 98.1% funded. The city's proportion of the net LGERS liability was $16.8 million. The Law Enforcement Officers' Special Separation Allowance is a single-employer, defined-benefit pension plan that provides benefits to qualified law enforcement officers. The city funds this plan on an actuarial basis from the general fund. In fiscal 2016, Raleigh contributed $3 million to the plan, which had an unfunded actuarial accrued liability (UAAL) of $39.9 million at the end of 2015. The city also administers a single-employer, defined-benefit plan that provides postemployment health care benefits to retirees to the city on an actuarial basis. In fiscal 2016, the city contributed about $13.9 million to the plan, which had a UAAL of $166.8 million at the end of 2015.

Very strong institutional framework

The institutional framework score for North Carolina municipalities is very strong.

Outlook

The stable outlook reflects our view of Raleigh's very strong and stable economy serving as North Carolina's state capital, and its participation in the robust Research Triangle economy. The city's long history of strong financial performance, coupled with its comprehensive debt and capital planning, further supports the rating. While unlikely over the next two years, a significant increase in the risk associated with the city's debt and contingent liability profile, or substantial deterioration in flexibility and performance, could pressure the rating downward.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- 2016 Update Of Institutional Framework For U.S. Local Governments
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014

Ratings Detail (As Of January 13, 2017)		
Raleigh ltd oblig bnds ser 2016		
Long Term Rating	AA+/Stable	Affirmed
Raleigh var rt ltd oblig rfdg bnds ser 2016A due 06/01/2034		
Long Term Rating	AA+/A-1/Stable	Affirmed
Raleigh APPROP		
Long Term Rating	AA+/A-1+/Stable	Affirmed
Raleigh APPROP		
Long Term Rating	AA+/Stable	Affirmed
Raleigh APPROP		
Long Term Rating	AA+/Stable	Affirmed
Raleigh APPROP		
Long Term Rating	AA+/Stable	Affirmed
Raleigh ltd oblig		
Long Term Rating	AA+/Stable	Affirmed
Raleigh COPs		
Long Term Rating	AA+/Stable	Affirmed
Raleigh COPs VRDBs		
Long Term Rating	AA+/A-1+/Stable	Affirmed

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.