

**RATING ACTION COMMENTARY**

# Fitch Rates the Town of Wake Forest NC's \$6.21MM GOs 'AAA'; Outlook Stable

Tue 11 May, 2021 - 11:55 AM ET

Fitch Ratings - New York - 11 May 2021: Fitch Ratings has assigned a 'AAA' rating to the following Town of Wake Forest, NC (the town) general obligation (GO) bonds:

--\$1.29 million GO public improvement bonds series 2021A;

--\$4.92 million GO public improvement bonds series 2021B.

Bond proceeds will be used to fund the costs of various streets, sidewalks, and greenway improvements for the town. The bonds are expected to sell via competitive bid on May 25.

In addition, Fitch has affirmed the following ratings at 'AAA':

--The town's Issuer Default Rating (IDR);

--Approximately \$15 million GO improvement bonds series 2018B.

The Rating Outlook Stable.

## **SECURITY**

The bonds constitute general obligations of the town, secured by a pledge of the full faith and credit and taxing power of the town.

## **ANALYTICAL CONCLUSION**

The 'AAA' IDR and GO ratings reflect the town's strong financial performance and growth prospects, a low long-term liability burden, and broad budgetary management tools enhanced by ample reserves.

## **ECONOMIC RESOURCE BASE**

Wake Forest is located in the northern part of Wake County and is part of the Research Triangle Park (RTP) area, which includes Raleigh, Durham and Chapel Hill. The town has ready access to employment centers like RTP and major transportation hubs, including US- 1 and NC-98 and Raleigh-Durham International Airport. Population growth has been very strong, increasing by 52% since 2010, with an estimated 2019 census population of 45,629.

## KEY RATING DRIVERS

### Revenue Framework: 'aaa'

Revenues have been rising at a pace above U.S. GDP growth and Fitch expects this trend to continue. The town has strong legal revenue raising flexibility as its current property tax rate is well within the statutory cap.

### Expenditure Framework: 'aa'

Fitch expects the natural pace of spending growth to remain marginally above the town's strong revenue growth. Moderate carrying costs and broad flexibility to manage labor-related costs allow the town solid leeway to adjust spending throughout economic cycles.

### Long-Term Liability Burden: 'aaa'

Long-term liabilities are low relative to personal income. Although future capital and issuance plans of the town and county are large relative to the amount of direct debt outstanding, rapid amortization, modest pension liabilities and growth in the resource base should keep the burden low.

### Operating Performance: 'aaa'

The town's superior budget flexibility and ample general fund balance allow it to comfortably manage through economic downturns without diminishing its overall financial flexibility.

## RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Not applicable for 'AAA' ratings.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A long-term reduction in the rate of growth of the town's property and income tax base, resulting in an extended decline in revenue growth;

--A sustained increase in the long-term liability burden over 10% of personal income.

## BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit

<https://www.fitchratings.com/site/re/10111579>.

## CURRENT DEVELOPMENTS

After a planned transfer out to the town's capital projects fund, the town ended fiscal 2020 with a minimal net operating deficit of \$1.4 million (about 3% of the budget). The fiscal 2020 unrestricted general fund balance totaled \$11.6 million or 24% of total spending. When including the \$3.6 million restricted for stabilization by state statute, total available reserves equaled \$15 million, roughly 31% of spending. According to the town's internal policy, the unrestricted general fund balance is to be maintained at a minimum between 20% and 25% of general fund expenditures and total fund balance at the close of each fiscal year should be at least 35% of general fund expenditures, which is significantly higher than what Fitch believes is superior financial resilience.

The \$57.7 million adopted fiscal 2021 general fund budget, 5% above the originally adopted fiscal 2020 budget, includes no tax rate increases and an appropriated fund balance of \$812,400. The revenue budget increase mostly reflects the reintroduction of the solid waste fee effective January 2021, and an expected increase in tax base growth following the most recent revaluation. The town received \$1.1 million in coronavirus relief funds through the CARES Act to cover public safety expenses, PPE, and other pandemic-related costs. YTD operations are positive and management is estimating a \$3.7 million operating surplus.

The \$61.6 million proposed fiscal 2022 general fund budget is approximately 7% above the originally adopted fiscal 2021 budget. The budget assumes property tax base growth of up to 4% and includes an appropriated fund balance of \$1.2 million (about 2% of total spending).

The recently enacted America Rescue Plan (ARP) will provide \$350 billion in direct aid to state and local governments and additional funding for transit systems and school districts (through the states), as well as a significant amount of economic stimulus that should have a positive near-term impact on state and local government revenues. Fitch does not expect the stimulus aid to alter the long-term credit fundamentals of state and local governments, but should bridge near-term fiscal gaps. For more information see "ARP Boosts State and Local Government Budgets," published March 11 and available on [www.fitchratings.com](http://www.fitchratings.com).

The town's allocation of ARP stimulus funds totals \$13.3 million. The town has not yet determined how the funds will be spent. The town expects to receive half of the funding by mid-June, with the remaining 50% to be received one year later.

## CREDIT PROFILE

Wake Forest is primarily located in Wake County (AAA/Stable) with a small portion located in Franklin County (AA+/Stable). The town is mostly residential and supported by several established retail centers; however, commercial growth is ongoing, with several projects in various stages of development. Despite having a geographical area of less than 20 square miles, the town is home to several advanced manufacturing and technology companies.

Employment and demographic data are very favorable. The town's workforce is well educated with 55% having a bachelor's degree or higher and the town consistently records an unemployment rate below the North Carolina and U.S. benchmarks. Both per capita and median household income exceed the state and national averages.

## REVENUE FRAMEWORK

The revenue base is dominated by property and intergovernmental revenues (primarily made up of local option sales tax and franchise taxes) at about 65% and 25%, respectively, of fiscal 2020 general fund revenues.

The town's general fund revenue growth has trended well above U.S. GDP growth, increasing at a 10-year CAGR of 5% through fiscal 2020. The town's property is reassessed every four years. According to the town, current projections show an increase in taxable assessed value (TAV) growth by about 20% to \$6.8 billion due to the reassessment. Growth in assessed value incorporates continuous land annexations; future town limits could increase up to 27.12 square miles. Sales tax revenue growth has also been robust at a 10-year CAGR of nearly 7%.

Due to the revaluation, the property tax rate for fiscal 2021 was lowered to \$0.495 from \$0.52. The town maintains healthy capacity under the statutory property tax cap of \$1.50 per \$100 of assessed value.

## **EXPENDITURE FRAMEWORK**

The town's largest spending area is public safety, which makes up about 43% of general fund spending, followed by general government spending.

Fitch expects the natural pace of spending growth to remain in line with or marginally above revenue growth, as growth-driven demands are expected to be supported by new development and increases in consumption-based charges. Despite notable population growth, Fitch expects management to continue to maintain spending growth marginally above revenue growth.

The town's expenditure flexibility is aided by a workforce environment that is favorable to management. Employment terms are not subject to collective bargaining. As such, management has strong control over compensation and work rules.

Carrying costs associated with debt service, actuarially determined pension payments and actual OPEB contributions totaled about 19% of fiscal 2020 governmental spending. Although the town's capital improvement plan (CIP) includes a sizable amount of additional debt, expenditure flexibility is expected to remain solid.

The town makes annual contributions for capital projects. The proposed fiscal 2022 budget includes a transfer of about \$1 million or about 1.6% of general fund spending, adding additional budgetary flexibility.

## **LONG-TERM LIABILITY BURDEN**

The town's long-term liability burden is 5% of personal income after the current issuance. Outstanding direct debt will total about \$39 million after this issuance accounting for less than 2% of personal income; overlapping debt of Wake County represents the bulk of total liabilities. The town's five-year capital improvement plan totals a sizable \$130.9 million. The main spending areas are transportation, general government and asset maintenance. The plan includes about \$40 million in additional GO debt. However, given the town's rapid amortization rate of nearly 76% in 10 years (including the current issuance) and the expected growth in the underlying resource base, the long-term liability burden is expected to remain low.

Town employees participate in the Local Government Employees Retirement System (LGERS) administered by the state. Pensions represent less than 10% of the town's total liability burden. In fiscal 2020 the town's proportionate share of the LGERS liability is funded at 77.9% based on a Fitch adjusted 6% return assumption. The town also participates in the Law Enforcement Officers' Special Separation Allowance. Like most North Carolina localities, the plan is funded on a pay-go basis and the net pension liability is a minimal.

Currently, the town funds OPEB on a pay-go basis; however, the unfunded liability (about \$9.7 million as of fiscal year-end 2020) is less than 1% of personal income. The town budgets an annual transfer of about \$250,000 from the general fund to the OPEB trust.

## **OPERATING PERFORMANCE**

Fitch expects the town to manage through the remainder of the current disruption and future economic downturns with a superior level of fundamental financial flexibility given the consistency of its operating results and reserves through prior and current periods of stress.

The town proved its financial resilience and strong budget management through the coronavirus pandemic by deferring capital spending and implementing a hiring freeze. Fitch expects the town to make similar operational changes as needed during a future economic downturn.

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

#### REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

#### ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg).

#### RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Wake Forest (NC) [General Government]	LT IDR	AAA Rating Outlook Stable	Affirmed	AAA Rating Outlook Stable
● Wake Forest (NC) /General Obligation - Unlimited Tax/1 LT	LT	AAA Rating Outlook Stable	Affirmed	AAA Rating Outlook Stable

[VIEW ADDITIONAL RATING DETAILS](#)

#### FITCH RATINGS ANALYSTS

##### Lindsay Horne

Analyst

Primary Rating Analyst

+1 646 582 4462

Fitch Ratings, Inc.

Hearst Tower 300 W. 57th Street New York, NY 10019

##### Evette Caze

Director

Secondary Rating Analyst

+1 212 908 0376

##### Joanne Ferrigan

Senior Director

Committee Chairperson

+1 212 908 0723

## MEDIA CONTACTS

Sandro Scenga

New York

+1 212 908 0278

sandro.scenga@thefitchgroup.com

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

## APPLICABLE CRITERIA

[U.S. Public Finance Tax-Supported Rating Criteria \(pub. 04 May 2021\) \(including rating assumption sensitivity\)](#)

## APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

## ADDITIONAL DISCLOSURES

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Wake Forest

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