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Ratings

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Summary:

Wake Forest, North Carolina; General Obligation

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Credit Profile		
US$4.92 mil GO imp bnds ser 2021B due 03/01/2041		
Long Term Rating	AAA/Stable	New
US$1.29 mil GO imp bnds ser 2021A due 03/01/2026		
Long Term Rating	AAA/Stable	New
Wake Forest GO		
Long Term Rating	AAA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating to Wake Forest, N.C.'s series 2021A and 2021B general obligation (GO) public improvement bonds. At the same, we affirmed our 'AAA' long-term rating on the town's GO debt outstanding. The outlook is stable.

Wake Forest's faith, credit, and unlimited ad valorem taxing power secures the bonds and GO debt outstanding. The series 2021A bond proceeds will fund various capital improvements, including streets, sidewalks, and greenways. The issuance will exhaust the remaining GO bonds authorized at a Nov. 4, 2014, referendum.

Credit overview

The town's location within the Raleigh, N.C., metropolitan statistical area that drives economic growth and its conservative management team underpins the 'AAA' GO rating. Furthermore, with property taxes providing more than 60% of general fund revenue, a significant portion of the budget is funded with a reliable source. As a result of these credit fundamentals, the town's budgetary performance in fiscal 2020 remained consistent with historical operations despite the onset of the pandemic. Furthermore, with positive revenue and expenditure variances in fiscal 2021 likely to lead to a substantial surplus, we believe the town's results will bolster the already ample flexibility of $11.6 million or 24% of expenditures (as of June 30, 2020). Although population and economic growth will lead to infrastructure requirements, we believe management will incrementally issue debt to maintain affordable fixed costs leading to stability in the credit rating over the outlook period.

Wake Forest's GO bonds are eligible to be rated above the sovereign because we believe the town can maintain better credit characteristics than the nation in a stress scenario, based on the locally derived sources that fund the town's budget and limited risk of negative sovereign intervention. The rating above the sovereign is based on our criteria "Ratings Above The Sovereign: Corporate And Government Ratings--Methodology And Assumptions," published Nov. 19, 2013, on RatingsDirect.

The 'AAA' rating reflects the town's:

- Strong economy, with access to a broad and diverse metropolitan statistical area;

- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with operating results in fiscal 2020 that reflect one-time expenditures that we do not expect for fiscal 2021;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2020 of 24% of operating expenditures;
- Very strong liquidity, with total government available cash at 31.3% of total governmental fund expenditures and 1.9x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability profile, with debt service carrying charges at 16.9% of expenditures and net direct debt that is 84.3% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 77.0% of debt scheduled to be retired in 10 years; and
- Very strong institutional framework score.

Environmental, social, and governance factors

We analyzed the town's environmental, social, and governance risks and opportunities relative to its economy, management, budgetary outcomes, and debt and liability profile, and view them as consistent with those of the sector. However, we view the town's approximately 76% population growth since 2010 as a social opportunity, as it provides underlying economic strength to drive tax base expansion and revenue raising flexibility, which we expect to outweigh additional costs to fund capital infrastructure projects and service demands resulting from the demographic trends.

Stable Outlook

Downside scenario

We could lower the rating if budgetary performance deteriorates on a sustained basis, if reserves materially decline, or if additional debt leads to fixed cost pressure.

Credit Opinion

Strong economy

We consider Wake Forest's economy strong. The town, with an estimated population of 50,244, is located in Franklin and Wake counties in the Raleigh metropolitan statistical area, which we consider broad and diverse. The town has a projected per capita effective buying income of 106.9% of the national level and per capita market value of $135,099. Overall, the town's market value grew by 19.9% over the past year to $6.8 billion in 2021 as a result of a revaluation. Although the town experienced an uptick in unemployment to 6.1% in 2020 from 3.3% in 2019, the January 2021 rate reflects a very low 4.6% relative to the state's 6.0% and the nation's 6.8%.

Wake Forest is located primarily in Wake County, adjacent to Raleigh, the state capital. The town is predominantly residential with favorable access to employment opportunities in Raleigh as well as in Research Triangle Park, an internationally prominent center for high-tech research and light manufacturing. Traffic congestion, a result of the region's population and employment growth, is a key concern that accelerates regional transportation initiatives, including a revision to the town's plan that supports a diversified transportation system and consideration of transit service expansion. We believe transportation planning will facilitate economic growth in conjunction with the stability provided by a significant higher education presence, including Southeastern Baptist Theological Seminary, arts and culture opportunities, and high-quality parks and recreation facilities. Furthermore, officials report various residential developments underway providing a wide range of dwelling types, and commercial development including the mixed-use Grove 98, which will feature a Wegmans and the Shoppes of Caveness Farms anchored by a Sam's Club and restaurants. We believe the town will experience economic expansion over the long term bolstered by completion of the 24 projects recently approved or under review through April 2021.

Very strong management

The town's management is very strong, with strong financial policies and practices under our financial management assessment, indicating our view of comprehensive planning that we believe is well embedded and likely sustainable.

Management utilizes conservative budgeting assumptions that review historical trends to formulate the upcoming year's revenue and expenditure forecast. The budget is regularly monitored with monthly budget-to-actual reports provided to elected officials. Long-term financial planning includes the town's current budget year, upcoming budget, and projections for the next three fiscal years. The financial forecast is comprehensive, contains detailed forecast assumptions, and is updated annually as part of the budget process. The town board utilizes the forecast to make financial decisions. Furthermore, long-term capital planning is identified through a five-year plan that is updated annually and includes sources and uses of funding. We also believe the town will adhere to its formal debt policy that requires tax-supported debt to remain no more than 2% of assessed value with the 10-year amortization targeted at 60%. Affordability metrics are monitored annually to ensure compliance with each threshold. Wake Forest enhanced the town's formal reserve policy to maintain a minimum unassigned general fund balance of 20% to 25% of general fund expenditures in case of unexpected expenditures and revenue shortfalls, and to provide for stable cash flows. In addition, total reserves at year end should be at least 35% of general fund expenditures and are typically appropriated only for one-time expenditures. The town's chief information officer is responsible for managing cybersecurity with requirements for multifactor authentication, regular employee training, and network backups with daily information stored in the data center and in the cloud.

Strong budgetary performance

Wake Forest's budgetary performance is strong, in our opinion, despite fiscal 2020 operating results that show a general fund deficit of 3.8% of expenditures resulting from one-time expenditures associated with fire station improvements and other capital costs. Favorably, the town's governmental funds operated with a 4.8% surplus. We adjust the town's audited results to account for transfers in and out of the general fund as well as to remove one-time capital expenditures funded with bond proceeds from the total governmental funds analysis.

The town's budget is primarily funded with property taxes (more than 62%), which performed well despite the onset of the pandemic in the final fiscal quarter of 2020. The stability of its main revenue source, coupled with sales tax collections of nearly $8.6 million (4.2% higher than fiscal 2019), led to a smaller use of fund balance of $1.5 million versus the $2.9 million budgeted. In addition, management conservatively implemented a hiring freeze given the uncertainty of the effect of the pandemic on the town's budget.

The fiscal 2021 adopted budget totaled $53.4 million and reflected a 12% increase in property tax revenue resulting from the revaluation as well as an increase in the revenue neutral tax rate of 1.95 cents. The town raised the tax rate to offset the costs of the merger between the town and the nonprofit that provided fire services before fiscal 2021. The consolidation was initiated in 2018 and will facilitate improved employee retention, equipment replacement, and generally enhance the town's fire services. In addition, the town received $1.1 million in Coronavirus Aid, Recovery, and Economic Security (CARES) Act funding to cover the costs of personal protective equipment purchases, cleaning and sanitizing, and public safety. Officials anticipate that the funding allocated to public safety, coupled with sales tax revenue trending nearly 12% higher year over year, will result in an increase to the fund balance at year end.

Officials are finalizing the fiscal 2022 budget and continue taking a conservative view of revenue trends, but expect to budget an increase in sales tax over the fiscal 2020 adopted budget as activity rebounds with the success in the U.S. vaccination efforts. We believe management will take steps to maintain strong budgetary performance over the next few fiscal years.

Very strong budgetary flexibility

Wake Forest's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2020 of 24% of operating expenditures, or $11.6 million.

In our view, Wake Forest maintains very strong reserves despite a modest use of fund balance in fiscal 2020 to fund one-time expenditures. Management expects that fiscal 2021 will end with a surplus, likely increasing reserves to a level similar to that prior to the draw in fiscal 2020. We also believe management will adhere to its formal fund balance policy to maintain unassigned general fund balance at a minimum of 20% to 25% of general fund expenditures. As a result, we believe budgetary flexibility will likely remain very strong over the next few fiscal years.

Very strong liquidity

In our opinion, Wake Forest's liquidity is very strong, with total government available cash at 31.3% of total governmental fund expenditures and 1.9x governmental debt service in 2020. In our view, the town has strong access to external liquidity if necessary given its regular issuance of debt over the past 20 years.

Although the state allows for what we view as aggressive investments, we believe the town has no investments we consider aggressive because the majority are in North Carolina capital management trust portfolios. The town has consistently had very strong liquidity, and we expect this to continue for the next few fiscal years.

The town entered into several private placement transactions, primarily for vehicle and equipment purchases. Although some agreements contain acceleration provisions, we believe the provisions of Section 160A-20 of the North Carolina statutes, which do not allow for deficiency judgments, partly mitigate the liquidity risks. In addition, upon review of these provisions and other terms of the agreements, we believe the events of default are remote and that potential liquidity risks are manageable.

Adequate debt and contingent liability profile

In our view, Wake Forest's debt and contingent liability profile is adequate. Total governmental fund debt service is 16.9% of total governmental fund expenditures, and net direct debt is 84.3% of total governmental fund revenue. Overall net debt is low at 1.5% of market value, and approximately 77.0% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

Following the series 2021A and 2021B transaction, the town's total net direct debt outstanding will total about $44.2 million (including installment purchase notes). The five-year capital improvement plan for fiscal years 2022 to 2026 totals about $131 million. The largest components of the plan are $23.5 million for general government projects, $19.6 million for public facilities, $31.6 million for transportation, and $22.7 million for asset maintenance. Various sources of funding are identified, including GO bonds expected to be authorized at a referendum expected in 2022. Given the rapid amortization of debt, we expect management to issue additional debt in a manner that considers affordability and does not lead to deterioration of the debt profile or create fiscal pressure.

Pension and other postemployment benefit (OPEB) liabilities

- We do not view pension and OPEB liabilities as an immediate source of credit pressure for Wake Forest, given our opinion of strong funding discipline and the largest plan's funded status that together limit escalating cost trajectory risk.
- The town's required pension and actual OPEB contributions totaled 3.7% of total governmental fund expenditures in 2020. The town made its full annual required pension contribution.
- OPEB liabilities are funded on a pay-as-you-go basis, which, given claims volatility and medical cost trends, could lead to escalating costs. However, all employees hired on or after July 1, 2018, are not eligible for benefits at retirement, and this resulted in a reduction in the liability that stood at about $9.7 million as of June 30, 2020, based on the most recent actuarial date of June 30, 2019.

As of June 30, 2020, the town participated in two defined benefit pension plans:

- Local Government Employees' Retirement System (LGERS), a state-administered plan that is about 91% funded, with the town's proportional share of the net pension liability equal to about $6.6 million
- Law Enforcement Officers' Special Separation Allowance, a single-employer plan that provides benefits to one retiree with 72 active employees in the plan. The plan is funded on a pay-as-you-go basis, had a funded ratio of 0% as of the most recent actuarial valuation date of Dec. 31, 2018, and carries a modest net liability outstanding of $3.5 million.

In general, we expect LGERS contributions to meet our view of minimum funding progress, partly as a result of the plan's closed, level-dollar, 12-year amortization that should result in timely funding progress. Furthermore, North Carolina local governments are required to pay 100% of the actuarially determined contribution as set annually by the LGERS Board of Trustees, and the town met 100% of its static funding requirement in 2020. Despite primarily good assumptions governing the plan, LGERS' discount rate of 7% could lead to some contribution volatility over the long term given that it surpasses our view of a conservative discount rate equal to 6% that we believe is a rate sufficient to absorb market shocks.

The law enforcement officers' special separation allowance is funded on a pay-as-you-go basis and provides benefits to qualified law enforcement officers. In fiscal 2020, the town paid slightly more than $268,000 toward plan beneficiaries. Although the plan is unfunded, the discount rate for this plan is 3.26% and the large active employee population will likely help keep annual contributions and the liability manageable over the long term.

Very strong institutional framework

The institutional framework score is very strong.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 2020 Update Of Institutional Framework For U.S. Local Governments