Summary:
Cary, North Carolina; Appropriations; General Obligation

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Credit Profile

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<td>AAA/ Stable</td>
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Rationale

S&P Global Ratings assigned its 'AAA' rating to the Town of Cary, N.C.'s series 2019 general obligation (GO) public improvement bonds. At the same time S&P Global Ratings affirmed its 'AAA' long-term rating on the town's GO debt, its 'AA+' long-term rating on Cary's appropriation-backed obligations outstanding, and its 'AAA/A-1+' on the town's series 2006 variable rate bonds. The outlook is stable.

Security and use of proceeds

The Series 2019 debt constitutes a general obligation of the town, secured by a pledge of its faith and credit and taxing power. Officials expect to use the proceeds for fire projects, parks and recreation and transportation projects.

The long-term component of the dual rating on the series 2006 bonds is based on the rating on the obligor, Cary. The short-term component of the rating is based on the short term rating on the liquidity provider, JPMorgan Chase.

The 'AA+' appropriation rating is on the series 2010 limited obligation refunding bonds. The bonds are secured by installment payments according to an installment financing agreement between the Cary Economic Development Corporation and the Town of Cary. The payments are subject to appropriation within the sole discretion of the Town Council. We rate this obligation one notch lower than the town's general creditworthiness (as reflected in the GO rating/ICR) to reflect the appropriation risk associated with the annual payment. We view these bonds as having a strong relationship to the obligor.

Credit overview

Located directly west of Raleigh and the Research Triangle, Cary has experienced consistent economic growth, both commercial and residential. As a result, the town has increased capital expenditures in recent years, but still has maintained very strong performance, due to growing revenues and very strong financial management. The town plans to approach voters with a $225 million bond referendum this fall, and also expects to increase its pension contributions. Given Cary's recent financial performance and very strong budgetary flexibility, we believe the town will continue to maintain its financial position in the near term.

The rating reflects our view of the town's:
• Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);

• Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;

• Very strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2018;

• Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 41% of operating expenditures;

• Very strong liquidity, with total government available cash at 82.8% of total governmental fund expenditures and 9.6x governmental debt service, and access to external liquidity we consider strong;

• Adequate debt and contingent liability profile, with debt service carrying charges at 8.6% of expenditures and net direct debt that is 73.1% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value; and

• Very strong institutional framework score.

**Very strong economy**

We consider Cary’s economy very strong. The town, with an estimated population of 160,139, is located in Chatham and Wake counties in the Durham-Chapel Hill and Raleigh MSAs, which we consider to be broad and diverse. The town has a projected per capita effective buying income of 149% of the national level and per capita market value of $172,694. Overall, the town’s market value grew by 3.5% over the past year to $27.7 billion in 2020. The weight-averaged unemployment rate of the counties was 3.4% in 2018.

Cary is adjacent to Raleigh, the state capital, on the eastern boundary. The town is the seventh-largest municipality in the state. Cary’s northern borders neighbor Research Triangle Park (RTP), which is the largest research park in the nation and one of the largest in the world. RTP employs almost 50,000 workers at over 250 global firms. Some of the largest employers include IBM, Cisco Systems, Fidelity Investments, and GlaxoSmithKline. Cary originally grew as a residential community for people employed at RTP and in state government, but has developed a significant commercial and industrial base and now imports more workers into the town than the outgoing workforce.

SAS Institute, a leading markets analytics software company, is the town’s largest taxpayer and largest employer, with over 5,600 employees. SAS’s assessed value (AV) has almost doubled in the past decade, but only represents 2.1% of the town’s overall AV.

Most of the development in Cary has traditionally been greenfield, but as space becomes more limited, officials are seeing more redevelopment. They estimate that approximately 14%-17% of the land in the town is available for development.

Overall, AV has steadily grown, increasing 2.2% in 2018, and 9.3% in fiscal 2017 after reassessment. Officials said that the town’s tax base will be reassessed every four years, rather than eight in the future. In addition, they said that almost every year the town annexes small tracts of land, based entirely on a voluntary basis. Officials expect AV to grow 3%-3.5% in the future. Based on ongoing economic development within the town and throughout the MSA, we expect Cary’s economic base to remain very strong over the next two years.
**Very strong management**
We view the town's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Cary 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 town's planning related to consideration of economic cycles and future developments.

Budget performance is monitored throughout the year by the management team, which reviews budget-to-actual reports on a monthly basis. The town council is notified, as needed, regarding significant variances in budgetary performance and can then make amendments.

Cary maintains a long-range financial model (five years) for its operating fund, but the forecast is primarily based on straight-line projections to estimate budgeted capital transfers and show changes in fund balance as it relates to the town's reserve policy. Officials maintain a more extensive long-range model (10 years) for the town's utility system.

Cary annually approves and updates a 1-year capital improvement plan (CIP) with identified projects and a 20-year capital improvement budget which identifies funding sources for the first five years.

Cary's investment policy is guided, in large part, by state statutes, and investments are limited to less risky securities. Management provides holdings reports throughout the year to council and the state treasurer's office.

Officials said they have cyber-security insurance, and increased coverage in the past year. In addition, the information technology department is aware of recent vulnerabilities that cyberattackers have used and has made adjustments to its systems to patch vulnerabilities.

**Very strong budgetary performance**
Cary's budgetary performance is very strong, in our opinion. The town had operating surpluses of 6.5% of expenditures in the general fund and of 6.2% across all governmental funds in fiscal 2018.

Our calculations are adjusted to account for recurring transfers out of the general fund to the special revenue funds. We also adjust for non-recurring capital expenses in the town's capital project fund and for transfers to the capital project fund from the general fund. Based on conversations with management, we believe the transfers to the capital project fund are based on surplus revenues and are considered discretionary.

Cary's five-year capital improvement plan (CIP) includes $52.5 million in fiscal 2019 from the general fund. We believe the majority of this cash will be used for one-time projects—like transportation and sewer projects—and those projects could be delayed, or financed through debt proceeds, should general operating revenues not be available annually as planned. The fiscal 2019 and fiscal 2020 budgets include a $5 million drawdown of reserves for capital projects. However, in previous years, when comparing budget-to-actuals for both expenditures and revenues, the town has come in between $17 million-$20 million under budget. Given this historical performance and conservative budgeting, we believe that the town will likely out-perform the initial budget for fiscal 2019 and fiscal 2020 and not need to reduce fund balances.
As a result of these adjustments, the town's budgetary performance in its general fund and across all governmental funds has been what we consider to be very strong over the past three years, with net operating surpluses of more than 5%. We believe the town has been successful in posting these surpluses due to its conservative budgeting practices, some of which include: budgeting for minimal year-over-year sales tax revenue growth, full employment, and a higher interest rate on the town's variable-rate debt than current interest costs.

In fiscal 2018, the town transferred $24.5 million out of the general fund for capital projects, as part of a total $30 million allocated for capital projects. When excluding one-time adjustments for capital projects, we view the town's performance still as very strong, as evidenced by an overall increase in total governmental funds to $248.6 million from $228.2 million. Officials said that general fund results are in line with projections, and when excluding capital projects, have shown similar performance to that in previous years.

Property taxes account for 56% of total revenues. Overall, total revenues have grown significantly since fiscal 2014, increasing by more than 19%. At the same time, transfers out for capital projects have also increased year of year since fiscal 2014. Officials expect to continue drawing down for capital projects, but as the town becomes built out and infrastructure matures, they expect capital expenditures to transition from new projects to more maintenance expenditures. As this process occurs, officials plan to maintain higher reserve levels than what is required by their reserve target policy, and to set parameters around future capital transfers.

**Very strong budgetary flexibility**

Cary's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 41% of operating expenditures, or $63.4 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 town's general fund unassigned and assigned fund balances to be available. The fund balances have declined in the past two years due to capital projects and budget documents show further transfers out for one-time capital projects, but management said that the town will maintain total fund balances above its reserve target of 40% of budgeted general fund expenditures. As per state statutes, Cary also has more than $18.9 million in its restricted general fund balance that is not included in our available fund balance. North Carolina requires that certain financial amounts be restricted from appropriation until they are realized as cash. Therefore, this balance is not included in the town's overall available fund balance, but we recognize that it adds additional flexibility. Based on year-end results for fiscal 2018 and previous performance, we believe the town's budgetary flexibility will remain very strong and above management's target of 40% of general fund expenditures, although fund balances may decrease slightly during the next two years.

**Very strong liquidity**

In our opinion, Cary's liquidity is very strong, with total government available cash at 82.8% of total governmental fund expenditures and 9.6x governmental debt service in 2018. In our view, the town has strong access to external liquidity if necessary.

We believe the town's strong 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 Cary does not have aggressive ones because the majority of its investments are in treasuries and agency
fixed-income securities. The town has consistently had very strong liquidity and we do not anticipate a change to these ratios.

Officials disclosed a 2018 bank loan for a fire station and upgrades to the fire engine fleet. The $8.5 million loan contains a default provision stating that a violation of a covenant could lead to a default, which we do not consider as standard, and there is also an acceleration clause for the entire principal upon default. However, given the town's sizable fund balances and liquidity position, we do not view this obligation as a financial pressure at this time.

Cary maintains a liquidity facility on its existing variable-rate debt. Under the agreement, the bank will remarket any obligation for which payment is demanded. If the obligation cannot be remarketed, the bank will purchase the obligation. Interest rates may change pursuant to the terms of the debt agreement based on market conditions. The interest rates, per the remarketing agreement, cannot exceed maximum step rates.

**Adequate debt and contingent liability profile**

In our view, Cary's debt and contingent liability profile is adequate. Total governmental fund debt service is 8.6% of total governmental fund expenditures, and net direct debt is 73.1% of total governmental fund revenue. Overall net debt is low at 1.7% of market value, which is, in our view, a positive credit factor.

The town plans to hold a bond referendum for $225 million on Oct. 8, 2019. If successful, the town will use $113 million for transportation projects and $112 million for parks and recreation. Officials plan to issue the debt over seven-10 years. Depending on the timing of the issuance, the additional debt could affect our assessment of Cary's debt, and we could revise our current assessment of adequate to weak or very weak.

Debt supported through the town's enterprise fund has been adjusted in our calculations. While the town does have variable-rate debt outstanding that is exposed to term-out provisions in its liquidity facility, 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 rating level on the issuer. The town's CIP calls for $301.2 million to be spent over the next five years; however, the bulk of those expenses will be funded through dedicated transit tax revenues and transfers from the general fund.

Cary's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 4.1% of total governmental fund expenditures in 2018. Of that amount, 3.3% represented required contributions to pension obligations, and 0.8% represented OPEB payments. The town made 108% of its annual required pension contribution in 2018.

The town participates in two pension plans: the North Carolina Local Government Employees' Retirement System (LGERS), and the Law Enforcement Officers' Special Separation Allowance. As of the most recent actuarial valuation (June 30, 2016), LGERS was 91.6% funded. The town's proportion of the LGERS net pension liability was $19.5 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 town funds this plan on an actuarial basis from the general fund. In fiscal 2018, Cary contributed $500,000 to the plan, which had an unfunded actuarial accrued liability (UAAL) of $10.9 million at the end of 2018. The UAAL is being amortized as a level percentage of projected payroll on a closed basis. The town also administers a single-employer, defined-benefit plan that provides postemployment health care benefits to retirees. In fiscal 2018, the town contributed about $1.3 million to the plan,
which had a UAAL of $146.3 million at the end of 2018.

Cary's total pension and OPEB contributions are less than 5% of expenditures, but the state has increased the contributions required by municipalities, starting in fiscal 2020. Given the town's history of strong financial performance, we do not see the pending increase as a significant financial pressure in the next two years.

Officials disclosed an $8.5 million bank loan for a first station and a replacement aerial ladder truck. The documentation states that violation of any covenant in the document is an event of default, which we do not consider standard. In addition, the full principal of the loan can be accelerated in the event of the default. However, given the Town's very strong budgetary flexibility, with over $60 million in unassigned and assigned reserves, as well as the $18.8 million set aside for contingency purposes, we do not view this loan as a contingent liability that could pressure the town.

**Very strong institutional framework**
The institutional framework score is very strong.

**Outlook**
The stable outlook reflects our view of the town's very strong economy and performance, supported by very strong management policies and practices. We do not expect to change our rating within the two-year outlook period. However, should the town significantly draw on its reserves, or if long-term liabilities and future debt issuances grow and become a financial pressure, we could lower the rating.

**Related Research**

- 2018 Update Of Institutional Framework For U.S. Local Governments
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014

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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.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings’ public website at www.standardandpoors.com. Use the Ratings search box located in the left column.