

Global Credit Research - 18 Mar 2011

APPROXIMATELY \$2.2 BILLION OF DEBT OUTSTANDING

County
NC

Opinion

NEW YORK, Mar 18, 2011 -- Moody's Investors Service has affirmed Mecklenburg County's (NC) Aaa general obligation bond rating, affecting \$1.6 billion of outstanding parity debt. Concurrently, we have affirmed the Aa1 rating on the county's \$522 million of outstanding certificates of participation (COPs). The county's G.O. bonds are secured by an unlimited tax pledge and the COPs are secured by installment payments from the county subject to annual appropriation

RATINGS RATIONALE

Affirmation of the county's Aaa rating incorporates the county's still-healthy financial position despite recent reserve reductions. The rating also factors in recent actions taken by management to stabilize and improve reserve levels and reduce the county's above average debt profile. The county continues to benefit from a large and increasingly diversified tax base which is slowly recovering following a deep economic downturn.

Credit Strengths:

- Effective financial management during economic downturns, particularly a willingness to promptly identify and close budget gaps
- Budget reserves that still provide an adequate cushion, although a reduced one
- Substantial tax base with healthy wealth indices

Credit Challenges:

- Managing expenditure pressures in a lower revenue environment, although sales tax collections have begun to stabilize
- Above average unemployment persists
- High debt and debt service levels

RECENT DEVELOPMENTS

The county's financial position remains healthy despite General Fund balance reductions over the past two fiscal years. Looking ahead, the county's financial position is expected to stabilize given aggressive efforts to restore structural balance, largely through expenditure reductions.

The county ended fiscal 2010 with a lower than projected General Fund balance reduction of \$30 million. The county was able to partially replenish its \$45 million budgeted fund balance appropriation through better than projected revenues and \$20 million of mid-year budget reductions. At year-end, total General Fund balance declined to \$329 million or a still strong 26.8% of revenues, a level that remains consistent with similarly rated municipalities. The fiscal 2011 budget is 5% lower than the fiscal 2010 budget. The budget includes the elimination of 571 positions, a sales tax reduction of 17% and continues a pay-freeze for the second consecutive year. While the budget includes a lower \$22.7 million fund balance appropriation for debt service, it also incorporates a \$14.6 million appropriation to restore reserve levels. Year-to-date figures indicate the possibility of a slight fund balance reduction, however, operations remain structurally balanced when factoring in the county's \$29.3 million transfer for capital, of which the county only anticipates spending down \$13 million. The fiscal 2012 budget remains under development. Positively, however, the county expects to completely eliminate its use of fund balance as a revenue source.

The county's debt profile remains above average with debt service comprising a high 18.4% of expenditures in fiscal 2010. In an effort to slow the rate of borrowing, the county has temporarily put a hold on debt issuance. The county's management is currently recommending the establishment of a new Debt Service Fund. Dedicated revenues, including 22 cents of the tax rate, would go to the fund with the goal of limiting the issuance of debt to what can be supported by the dedicated revenues. Excess fund balance will be used for pay-as-you-go capital projects. As currently modeled, the fund would be able to support approximately \$100 million of new money borrowing annually, beginning in fiscal 2012.

Approximately 29% of county's outstanding debt is variable rate, 52% of which has been swapped to fixed. The county's strong liquidity levels, conservative budgeting for variable rate debt service, and track record of active debt management continues to mitigate potential volatility associated with the variable rate portion of the county's debt portfolio.

The county's most recent property revaluation will take effect in fiscal 2012. The county anticipates a 10.4% increase in values due to the revaluation. Additionally, the county's unemployment rate remains slightly elevated compared to state and national levels, at 10% as of December 2010.

What could make the rating change - DOWN

- Protracted structural budget imbalance driven by a deeper and/or prolonged economic downturn
- Significant reduction of General Fund balance
- Increased leveraging of the county's resources to pay debt service

--Unbudgeted fiscal pressure resulting from volatility associated with the county's variable rate debt

KEY STATISTICS

2007 Population: 876,067

2011 Full Valuation: \$100.3 billion

Full Value Per Capita: \$115,692

Debt Burden: 3.9% (2.2% direct debt burden)

Payout of Principal (all tax-backed debt): 72%

Unemployment Rate (12/2010): 10%

FY10 General Fund Balance: \$329.4 million (26.8% of General Fund Revenues)

Median Family Income as a % of state: 130.8% (121.1% of the US)

Per Capita Income as a % of state: 134.7% (126.7% of the US)

G.O. debt outstanding: \$1.6 billion

The principal methodology used in this rating was General Obligation Bonds Issued by U.S. Local Governments published in October 2009.

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