

Rating Update: Moody's Upgrades the Town of Clayton, NC's GO to Aa2 from Aa3

Global Credit Research - 11 Sep 2014

Upgrade affects \$6.2M of rated debt

CLAYTON (TOWN OF) NC
Cities (including Towns, Villages and Townships)
NC

Opinion

NEW YORK, September 11, 2014 --Moody's Investors Service has upgraded to Aa2 from Aa3/positive outlook the rating on the Town of Clayton, NC's general obligation debt. This action affects \$6.2 million of outstanding general obligation debt. The bonds are secured by the Town's unlimited ad valorem tax pledge.

SUMMARY RATING RATIONALE

The upgrade to Aa2 primarily reflects the town's ample and improving reserve position with a strong commitment from management to continue to maintain sound reserves, a growing and diversifying tax base due to its location near Raleigh and the Research Triangle Park, and below average pensions. The Aa2 also captures the Town's slightly above average and improving wealth positions, moderate dependence on economically sensitive revenues, and elevated but manageable debt burden.

STRENGTHS

- Growing tax base near Raleigh
- Balanced operations and projected to have continued surpluses
- Below average pensions

CHALLENGES

- Moderate dependence on an economically sensitive revenue stream
- Slightly elevated debt burden

DETAILED CREDIT DISCUSSION

PROXIMITY TO RALEIGH, NC AND RESEARCH TRIANGLE PARK CREATE DIVERSE AND IMPROVING LOCAL ECONOMY

Clayton's tax base is expected to experience ongoing growth given its favorable location in Johnston County (GO rated Aa2/positive), directly bordering Wake County (GO rated Aaa) with proximity to Raleigh (Aaa) and the Research Triangle Park (RTP). The tax base grew to over \$1.6 billion in 2014, a 6.5% increase from the previous year. There are several projects that have been completed that have attracted new residents, including the construction of a new inpatient residential wing of the Johnston Memorial Hospital, the top employer in the Town. Additionally, there are 14 single family and multifamily home projects approved for 2014 and 2015 to accommodate the inflow of people. The Town added over \$15 million of commercial construction and over \$12 million of residential construction in 2014.

The Town is also a hub for growing international pharmaceutical companies, most notably Grifols SA (Ba2/Negative), which recently invested in a \$400 million expansion, Novo Nordisk A/S (A1/Stable), and Hospira, inc. (Ba1/Negative). These three companies together employ around 2000 people. Officials report that the Town's employment base includes approximately 10% of all biopharmaceutical jobs in the State. The Town also has a special purpose Research and Training Zone, which is an economic development and training district that supports local pharmaceutical industries. The top ten tax payers have also become increasingly more diverse. Caterpillar inc. (A2/Stable), a large manufacturing employer, became one of the top ten tax payers in 2014. The top

ten taxpayers represent approximately 11.9% of the town's total assessed value. The wealth levels continue to improve with MFI at 113.6% of the US in 2012 (compared to 100% in 2010) and unemployment at 5.8%. Going forward, the Town expects the tax base to continue to grow and wealth levels to improve.

IMPROVING FINANCIAL POSITION WITH BALANCED BUDGET AND CONTINUED EXPECTATION FOR GENERAL FUND SURPLUSES

The Town's sound financial position is marked by the conservative management strategy, balanced operations, and growing fund balance. The Town has a policy to maintain an unassigned fund balance of at least 20% of annual operating budget. The Town has continuously exceeded this threshold and in 2013 available fund balance as a percent of revenues totaled 41.3%. The Town's general fund revenues grew by 9.7% in 2013 largely because of permits, fees, and sales tax revenue, all indications of a growing economy.

The Town expects to make two cash purchases of properties in 2014, one for \$1.2 million and another for \$570,000. The Town does not anticipate that these purchases will have any material effect on the fund balance. Both purchases will decrease available fund balance to about 34% of revenues. Unrestricted cash is expected to increase in 2014 to \$7.8 million, a 5% increase from 2013. Going forward, Moody's will monitor the town's ability to maintain currently strong reserves and preserve financial flexibility.

SLIGHTLY ELEVATED DEBT BURDEN WITH BELOW AVERAGE PAYOUT

The Town's debt burden is slightly elevated given direct debt as a percent of full value of 1.34% compared to state and national medians of 0.6% and 0.9%, respectively. There is a below average payout of 62.5% in 10 years. The Town is dedicated to managing their debt burden by limiting the amount of debt they issue and cash funding smaller capital items. The Town has no variable rate debt nor is it a party to any derivative agreements.

Clayton participates in the North Carolina Local Government Employees Retirement System, multi-employer, defined benefit retirement plan sponsored by the State of North Carolina (GO rated Aaa/stable). The Town also has its own Law Enforcement Separation Allowance system. The Town's 3-year average combined adjusted net pension liability, under Moody's methodology for adjusting reported pension data, is \$10.5 million or approximately a modest .61 times Operating Fund revenues. Moody's uses the adjusted net pension liability to improve comparability of reported pension liabilities. The adjustments are not intended to replace the Town's reported liability information, but to improve comparability with other rated entities. We determined the Town's share of liability for the state-run plan in proportion to its contributions to the plan.

WHAT COULD MAKE THE RATING GO UP:

- Material improvement in the Town's wealth characteristics and tax base
- Improved financial position through accumulation of larger reserves and operating surpluses

WHAT COULD MAKE THE RATING GO DOWN:

- Declining financial position resulting in substantial draws on reserves
- Deterioration of the Town's tax base
- Material increase in debt levels

KEY STATISTICS

2013 Population: 17,694

2014 Full Valuation: \$1.6 billion

Full Value Per Capita: \$95,368

Median Family Income as a % of US and NC (2012 American Community Survey): 128.4% and 113.6%

2013 Fund Balance as a % of Revenues: 41.29%

5-Year Dollar Change in Fund Balance as a % of Revenues: +7.61%

2013 Cash Balance as a % of Revenues: 47.05%

5-Year Dollar Change in Cash Balance as a % of Revenues: 3.64%

Institutional Framework: "Aaa"

5-Year Average of Operating Revenues / Operating Expenditures: 0.99 times

Net Direct Debt as a % of Full Value: 1.34%

Net Direct Debt / Operating Revenues: 1.28 times

3-Year Average of Moody's Adjusted Net Pension Liability / Full Value: 0.64%

3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues: 0.61x

RATING METHODOLOGY

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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