FitchRatings

FITCH RATES SOUTH CAROLINA'S $129MM GOS 'AAA'; OUTLOOK STABLE

Fitch Ratings-New York-14 May 2014: Fitch Ratings assigns an 'AAA' rating to approximately $128.565 million of State of South Carolina general obligation (GO) bonds, consisting of:

--$16.735 million GO state institution bonds (issued on behalf of the University of South Carolina), series 2014A;
--$36.395 million GO state institution bonds (issued on behalf of Clemson University), series 2014B; and
--$75.435 million GO state highway refunding bonds, series 2014A.

The bonds are expected to sell competitively on May 20, 2014.

In addition, Fitch affirms the following ratings:

--Approximately $1.8 billion in outstanding GO bonds at 'AAA';
--Approximately $10.3 million in outstanding lease revenue bonds issued by the South Carolina State Budget and Control Board at 'AA+'.

The Rating Outlook is Stable.

SECURITY
The bonds are GOs of the state, secured by a pledge of South Carolina's full faith, credit, and taxing power. By statute, state institution bonds are also secured by tuition fees received by the university.

KEY RATING DRIVERS

STRONG FISCAL MANAGEMENT: South Carolina has a proven ability and willingness to support fiscal balance, and Fitch believes this commitment will be maintained through a reorganization of fiscal oversight responsibilities following the elimination of the state's longstanding Budget and Control Board (BCB), effective July 1, 2015. The state's careful approach to financial operations and solid revenue growth has resulted in the restoration of reserves following their depletion during the recession.

DIVERSIFYING ECONOMIC BASE WITH SIZABLE MANUFACTURING COMPONENT: The state's economic base continues to expand into the services industry, and the largest share of employment has moved into the trade, transportation, and utilities sectors. Renewed growth in the state's large manufacturing sector, which experienced significant losses in the recession, has aided in lowering unemployment rates below the nation.

MANAGEABLE DEBT AND PENSION OBLIGATIONS: Debt obligations are in the lower moderate range from infrequent borrowing and rapid amortization. Outstanding debt has declined from more elevated levels related to transportation infrastructure bank issuance. On a combined basis, debt and unfunded pension liabilities are a manageable burden on state resources.

RATING SENSITIVITIES
The rating is sensitive to shifts in fundamental credit characteristics, including the state's proactive financial management and commitment to reserve funding.

CREDIT PROFILE

South Carolina's 'AAA' rating rests on the state's proven ability and willingness to support fiscal balance. The state's mandate to take prompt corrective action to maintain balanced operations is expected to be maintained as it transitions to the oversight of the director of the newly established executive budget office (EBO) in the new department of administration, created by the state's 2014 Restructuring Act. The act, which was signed into law by the governor in January 2014 and will take effect on July 1, 2015, served to reallocate the administrative and fiscal oversight responsibilities currently housed with the BCB, and included the creation of a new state Fiscal Accountability Authority that will assume all of the authority and responsibilities of the BCB relating to bond authorization and issuance. Stability in the state's financial operations is additionally aided by constitutional reserve requirements and established replenishment provisions.

The state's debt levels have moderated from limited additional issuance and amortization of GO bonds is rapid. The state's large manufacturing sector, which quickly reflects changing economic conditions, has shown renewed growth following recessionary losses. Unemployment rates have recently been curtailed and while wealth levels remain low, the state's recent economic performance is significantly improved from the downturn.

STRONG FISCAL MANAGEMENT AND IMPROVED FINANCIAL OPERATIONS

An improving revenue situation and strong budgeting procedures combined with constitutional and statutory changes designed to strengthen reserve funding provided for successive additions to the state's reserves in fiscal years 2010 to 2013. Fiscal 2013 ended with general fund revenues of $6.4 billion, up $301.6 million or 5% from the original board of economic advisors' (BEA) forecast, and 9.1% above revenues received in fiscal 2012. Components of the increase in revenues included individual income (PIT) tax (up 9.7% from fiscal 2012), corporate incomes (CIT) taxes (up 65.4% from fiscal 2012) and sales tax (up 4% from fiscal 2012). Income tax results reflected some push forward of income into calendar year 2012 due to federal tax law changes. The state was able to bolster its reserve position by depositing $98 million to the general reserve fund (increase to $281.6 million, the constitutional full funding level) and a net $8 million to the capital reserve fund (increase to $112.7 million, constitutional full funding). Reserves combined with the undesignated, unreserved general fund budgetary balance were equal to 10.7% of expenditures in fiscal 2013.

The fiscal 2014 enacted budget was based on BEA certified general fund (GF) budgetary revenues of $6.38 billion, incorporating conservative forecast increases in operating revenue from actual collections in fiscal 2013. PIT revenue was forecast to grow 0.1% from fiscal 2013 collections, CIT revenue was forecast to decline by 29%, and sales tax revenue was expected to grow by 1% from fiscal 2013 collections. The state anticipated total GF revenues to decrease by 0.2% from fiscal 2013 and the total budget, including federal sources and other dedications, to decline by 3.6% from fiscal 2013; the total decline incorporated an over 12% reduction in federal funds due to an accounting change related to the federal food stamp program. The state budget fully funded required deposits to its reserve funds to maintain the funds at the constitutionally required amounts.

The BEA's February 2014 update of the forecast improved the growth expectation for both PIT and sales tax receipts to 2.1% and 2%, respectively, while the expected decline in CIT revenue decreased to 21%. Overall, GF revenues are now forecast to increase 1.8% from fiscal 2013. Year to date through March 2014, revenues in the GF are running 1.9% higher yoy and are 1.3% ahead of the February forecast; the PIT is up 1.7% yoy and 1.2% ahead of forecast; the sales tax is up 2.7% yoy and 0.6% ahead of forecast; and the CIT is down 7.7% yoy and 10.3% ahead of forecast. The state is currently forecasting an operating surplus for the fiscal year.

The governor's proposed budget for fiscal 2015 was based on the BEA's projection of 3.7% revenue growth from the enacted fiscal 2014 budget and included growth in appropriations of 3.7%. The budget proposal included additional aid to K-12 education and Medicaid, while fully funding the state's reserve funds to a required $447 million. To date, the state house of representatives has passed

a budget bill that contains many of the governor's spending priorities and the state senate is currently considering the proposal.

The budgetary controls in place under the BCB have been adjusted as part of the Restructuring Act. While previously the BCB was mandated to take action to avoid a deficit within seven days if quarterly revenue collections were 2% or more below projections, effective as of July 1, 2015, if the BEA reduces the revenue forecast for the fiscal year by 3% or less from projections, the director of the new EBO must reduce GF appropriations by the requisite amount to avoid a deficit. If the revenue estimate is revised downward by more than 3%, the legislature would be called into session to take action to avoid a year-end deficit. Should the legislature fail to approve measures to avoid a deficit within twenty days of the session's start, the director of the EBO is required to reduce GF appropriations. Fitch believes these new measures continue to provide for strong fiscal oversight.

DIVERSIFYING ECONOMIC BASE WITH SIZABLE MANUFACTURING PRESENCE

As in prior downturns, the state's economy performed worse than that of the nation in the most recent downturn; the state lost 7.1% of its jobs between 2008 and 2010 as compared to 5.6% for the U.S. More positively, since 2010 the state has steadily added jobs at a pace that has exceeded that of the nation with 2013 employment growth of 2% compared to 1.7% national employment growth. Year over year (yoy) in March 2014, the state's employment growth continued at a solid rate of 2.1% compared to the U.S. at 1.6%. Jobs increased by 39,000, although pre-recessionary peak employment has yet to be reached. The sectors showing the strongest yoy growth were professional and business services at 3.4%; leisure and hospitality at 5.3%; education and health services at 2.8%; and manufacturing at 2.3%.

The yoy growth in manufacturing employment continued the improvement in this sector first began in February 2010 but at an accelerated rate. The aerospace, automobile, and tire manufacturing industries have been growing sources of employment over the past few years, but overall annual manufacturing employment in 2013 remained 49,900 jobs below a peak of 274,900 reached in 2003.

Unemployment levels have historically trended above national averages though March 2014 proved to be the exception at 5.5% compared to the U.S. rate of 6.7%. The lower state figure (down from 8% in March 2013) was a function of both a decline in labor force participation as well as yoy growth in employment.

South Carolina's wealth levels are below average, with personal income per capita in 2013 ranking 48th among the states at 80% of the U.S. Reflecting the renewed economic growth, the state's personal income has grown more strongly over the past two quarters than both the U.S. and the region; 1.8% compared to 1.4% and 1.3%, respectively.

MANAGEABLE DEBT AND OTHER LIABILITIES

State tax-supported debt, which increased notably earlier in the last decade due to transportation infrastructure bank issuance, has since declined and debt now equates to a manageable 2.2% of 2013 personal income, not inclusive of the current issue. Debt of the transportation infrastructure bank, created in 1997, accounts for just over half of the state's net tax-supported debt. Principal amortization is rapid, with 90% of GO bond principal repaid in 10 years.

The reported funding level of the state employee retirement system (SCRS) was 64.7% as of June 30, 2013, a decrease from the prior fiscal year due to the continued recognition of deferred investment losses from 2008. For fiscal 2012, the state's enactment of various pension reform measures improved the funded ratio from fiscal 2011; reforms addressed cost of living increases, investment return assumptions, and benefit assumptions. Using Fitch's more conservative 7% discount rate assumption, the retirement system's funded ratio for fiscal 2013 would be 61.4%. On a combined basis, the burden of the state's net tax-supported debt and adjusted unfunded pension (UAAL) obligations equals a manageable 5.5% of 2013 personal income, below the median of 6.1%.

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In addition to the sources of information identified in Fitch's report 'Tax-Supported Rating Criteria', this action was additionally informed by information from IHS Global Insight.

Applicable Criteria and Related Research:
--'Tax-Supported Rating Criteria', Aug. 14, 2012;
--'U.S. State Government Tax-Supported Rating Criteria', Aug. 14, 2012.

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Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. State Government Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686033

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