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RATINGS SERVICES
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State Review:
South Carolina

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Credit Profile

Go Debt

AA+/Stable; approximately $1.8 billion

Rationale

Standard & Poor's Ratings Services 'AA+' rating and stable outlook on the State of South Carolina's general obligation (GO) debt reflects our view of the state's:

- Growing economy, although growth has been historically cyclical in nature;
- Positive revenue trends and financial operations;
- Proactive budget adjustments to offset declining revenues in previous years;
- Maintenance of required budgetary reserves; and
- Low to moderate debt levels.

The aforementioned strengths are partly offset by our view South Carolina's large unfunded pension and other postemployment benefit (OPEB) liabilities.

The state's economy continues to show signs of recovery after the recession. After average annual unemployment rates increased to more than 11% in 2009 and 2010, South Carolina's fiscal 2013 average annual unemployment rate dropped to 7.6%, compared with the nation's 7.4%. In 2013, South Carolina's employment rose 1.6%, slightly higher than the nation's 1.5%. Preliminary seasonally unadjusted figures for March 2014 reflect continued improvement to 5.5%, versus the nation's 6.7% rate. According to projections by IHS Global Insight Inc., total employment in the state will grow about 2% annually between 2014 and 2018, which is higher than forecast annual average growth of 1.6% for the nation. Although IHS forecasts employment gains driven primarily by jobs in services, it also projects manufacturing employment to grow, as several manufacturers have announced large planned expansions in the state. Despite positive trends in real gross state product (GSP) that outpaced national growth in 2011 and 2012, GSP growth has not kept pace with national growth over the past decade, which contributes to somewhat low GSP per capita at 75% of the nation in fiscal 2012.

As of May 2014, Bureau of Economic Advisors (BEA) revenue estimates for fiscal 2014 were tracking about $170 million above budget at $7 billion, including $37 million in one-time settlement revenue received in fiscal 2014. Officials report fiscal 2014 expenditures are also tracking to budget, which is likely to result in an available budget surplus at fiscal year-end. Fiscal 2013 also ended with a $68 million unobligated budgetary surplus, which is available in a contingency reserve fund for fiscal 2015 appropriation. The fiscal 2014 budget provided for full funding of the general and capital reserves at $319 million and $127 million, or 5% and 2% of general revenue requirements, respectively, as of July 1, 2014.

The state legislature is currently in session through June 2014, working on the fiscal 2015 budget. Both the house and senate proposed budgets seek increased funding for education and employee base pay increases. Growth in proposed state funding for public education incorporates base student costs (which are increasing to $2,120 from $2,201 under the education financing act), distributes more funding to school districts with higher poverty levels and limited English proficiency, and provides funding for technology and reading coaches. In 2013, the legislature increased transportation funding to the South Carolina Department of Transportation by $50 million to replace nontax revenues used to support debt service on transportation infrastructure bank revenue bonds. The 2013 legislature also transferred a portion of general fund revenue generated from a sales tax on vehicles to the department of transportation. A recent bill this year to transfer the remaining vehicle sales tax revenue to the department for transportation needs did not pass.

South Carolina's GO debt is approximately $1.8 billion, including issuance in fiscal 2014. In our view, the tax-supported debt burden, including debt, a portion of transportation infrastructure bank revenue debt, and lease debt, is a moderate $519 per capita and a low 1.5% of 2013 personal income. Overall amortization, including pro forma fiscal 2014 debt service, is rapid, in our view, with about 60% of principal due to be retired in the next 10 years. We understand the state intends to issue another $60 million in GO bonds for economic development and state institutions in early 2015.

Standard & Poor's deems South Carolina's financial management practices "good" under its Financial Management Assessment (FMA) methodology, indicating that practices exist in most areas, although not all might be formalized or regularly monitored by governance officials.

Based on the analytical factors we evaluate for South Carolina, on a scale of '1.0' (strongest) to '4.0'(weakest), we assign a composite score of '1.7' to the state.

Outlook

The stable outlook reflects what we consider South Carolina's proactive management, contributing to improved financial performance in recent years. The outlook also reflects economic recovery after the recession, with an improved unemployment rate and state employment growth exceeding the national average. We believe South Carolina's revenue performance has exceeded projections, and that its conservative revenue estimates will allow it to maintain or improve reserve balances. We also view the state's adopted long-term financial planning and forecasting strategies and moderate debt levels positively. We do not expect to change the ratings within the two-year outlook horizon.

Affordable Care Act

The state has chosen to use a federally run exchange and to not expand Medicaid under the Affordable Care Act (ACA). The fiscal 2014 budget does not include funds for an expansion of Medicaid under the ACA, but instead includes a redirection of Medicaid spending under a new initiative that the state will implement upon receiving approval from the Centers for Medicare and Medicaid Services (CMS). The initiative strives to enhance support for rural hospitals and diverts patients from emergency rooms for routine care, with a goal to lower costs and improve health outcomes. The state has not received approval from CMS for this initiative, and the plan will not be implemented until approval is received.

Officials report revenues from an increase in the cigarette sales tax, tobacco settlement dollars, and general fund appropriations have been more than sufficient to cover Medicaid costs in fiscal 2014. The South Carolina Department of Health and Human Services (SCDHHS) has been working with providers to keep provider rates in line with estimates. Meanwhile, costs associated with increased enrollment in Medicaid tied to those currently eligible but not enrolled, yet who might enroll as a consequence of the exchanges (woodwork effect), were not as great as initially forecast. As a result, state officials estimate SCDHHS will have $300 million-$400 million in cash reserves that it could carry into fiscal 2015 to mitigate potential future costs related to Medicaid.

Government Framework

The general assembly recently passed the 2014 Restructuring Act, which makes changes to the organization and oversight of the state government, including the abolishment of the state budget and control board, effective fiscal 2016. Certain powers of the state budget and control board will be divided among the State Fiscal Accountability Authority (which will include the governor, state treasurer, comptroller, chairman of the house ways and means committee, and chairman of the senate finance committee) and the Department of Administration executive budget office within the executive branch of government. More important, if revenue estimates are below target, statutes still require and provide the executive budget office with the authority to make prompt uniform appropriation reductions across programs, except for contractual obligations. The act does, however, require legislative approval for targeted expenditure reductions. If the executive budget office identifies an agency deficit through its quarterly budget monitoring and is unable to work with the agency to develop a plan to avoid the deficit, the general assembly may recognize the deficit, which would be covered with either general and capital reserves or year-end surplus.

Article X., Section 7(a) of South Carolina's constitution requires the state to approve balanced budgets each fiscal year. To help manage its budget and maintain an adequate fund balance, should revenue decline from budgeted forecasts based on BEA estimates in the first three quarters of the year, the State Budget and Control Board (and the executive budget office after fiscal 2015) is empowered by statute to adjust spending across programs within a short period of the revenue shortfall. Effective fiscal 2016, should the estimated revenue shortfall exceed 3%, and should the general assembly fail to call a session within 20 days of this determination, the executive budget office must reduce appropriations uniformly across all programs. Such adjustments must be effected only after first providing adequate provision for payment of contractual obligations, including principal and interest on state bonds and notes according to their terms.

South Carolina also has considerable revenue-raising ability and can raise its income and sales tax rates and approve new revenues without need for voter approval or supermajority votes in the legislature. The state executive branch will continue to monitor the budget quarterly for deficits and make recommendations for adjustments to agency spending; however, the restructuring act eliminates the executive budget office's ability to reduce agency budgets, absent a revenue shortfall, without legislative approval. South Carolina is not a voter-initiative state.

Article X, Section 13 of the South Carolina constitution governs the issuance of bonded indebtedness. GO debt can only be incurred for public purpose, and all GO debt must mature within 30 years. Maximum annual debt service (MADS) on long-term GO debt incurred, excluding GO highway bonds or GO state institution bonds, cannot exceed 5% of state general fund revenues for the fiscal year next preceding (excluding revenues that are authorized to be pledged for state highway bonds and state institution bonds). The 5% rate may be reduced to 4% or be increased to 7% by legislative enactment passed by a two-thirds vote in both the house and senate. The rate was increased by 0.5% to 5.5% for economic development in 2002, and another 0.5% to 6.0% in 2004, for research university infrastructure for state research institutions. State officials report there is no consideration for raising the debt limit further in the 2014 legislative session at this time. For highway bonds, MADS cannot be higher than 15% of pledged highway revenues. For state institutions, it cannot be more than 90% of tuition fees. While these restrictions have helped the state maintain low debt levels, South Carolina still maintains flexibility to issue debt under its limits. The state estimates MADS on GO debt subject to constitutional limitations totaled $139 million as of December 2013, or about 44% of the limit. Statutes confirm payments on GO bonds as priority state expenditures.

Standard & Poor's assigns a score of '1.0' to South Carolina's government framework, on a scale of '1.0' (strongest) to '4.0' (weakest).

Financial Management Assessment: 'Good'

As mentioned above, Standard & Poor's deems South Carolina's financial management practices "good" under its FMA methodology, which is designed to measure policies and procedures used by the state's management as it oversees day-to-day operations. In our framework, an FMA of good indicates that practices exist in most areas, although not all are formalized or regularly monitored by governance officials.

Management's practices are as follows:

- The state derives revenue assumptions from an independent forecast through the BEA, which is and updated regularly. The general assembly is required to present a balanced budget, and deficit monitoring is performed by the executive budget office quarterly. The state has a history of making midyear adjustments and reducing appropriations in times of recession.
- South Carolina has a formal three-year financial forecast such that for each agency, department, institution, or entity receiving in aggregate more than 1% of the state's general fund appropriation, that entity will present a three-year forecast to the Office of State Budget. This data, in conjunction with the BEA's long-term revenue estimate, must be updated annually and presented in the second quarter of each fiscal year.
- The state has a five-year capital improvement plan. The first year has funding in place, while projects for years two through five are identified, with funding requested from the general assembly.
- South Carolina has a well-defined investment policy that complies with statutory provisions. The treasurer reports on non-retirement investment portfolio characteristics and performance quarterly. The state retirement system investment commission provides quarterly reports on retirement asset holdings and earnings.
- In terms of debt management policy, there is a constitutional debt limit and a maximum 30-year amortization requirement for GO bonds. While derivatives and variable-rate debt is permitted, the state has avoided such transactions associated with GO bonds in favor of fixed-rate debt. However, the state has entered into floating-to-fixed-rate swaps related to its state transportation infrastructure bank debt.
- In terms of liquidity and reserve policies, South Carolina's policies are set by the constitution. The general fund

reserve must be funded at 5% of general fund revenue for the latest completed fiscal year. This requirement was raised from 3% in 2010, and the state reached its 5% general reserves target in fiscal 2011, two years ahead of schedule. The general reserve might be drawn on for operating deficits, but it must be replenished within three fiscal years. There is also a capital reserve fund, which must equal 2% of the previous year's general fund revenues.

Once the budget is approved, the state monitors both revenue and expenditure performance regularly and reports results coupled with an economic update. Budget adjustments have historically been implemented regularly on a timely basis. The State Budget and Control Board and the director of the Office of State Budget have historically had authority to adjust the budget and have a track record of doing so. Effective fiscal 2016, the state executive budget office has the authority and is required to make uniform reductions across programs should a revenue shortfall occur. If agency deficits persist after making spending reductions and depleting the general and capital reserves as established by statute, the deficit may be carried into the next fiscal year but must be fully addressed in the next budget.

On a scale ranging from '1.0' (strongest) to '4.0' (weakest), Standard & Poor's assigns a '1.5' score to South Carolina's financial management.

Economy

The state's population grew 1% between 2012 and 2013 to 4.77 million, in line with a relatively strong population growth rate of 1.4% per year, on average, between 2000 and 2010, or 155% the rate of population growth nationwide for that period. IHS Global Insight continues to forecast annual population growth at slightly above 1% for the next five years. This growth has been driven primarily by domestic net migration into the state. South Carolina's age dependency ratio increased to 60.2%, or 0.9% above the U.S. average, in 2012, and IHS Global Insight forecasts this trend will continue with relatively higher growth among residents over 65 years of age who are drawn to the state's relatively low cost of living and mild climate.

According to the Bureau of Labor Statistics, leading employment sectors include trade, transportation, and utilities, representing about 19% of total nonfarm employment, and 18.5% of government employment. Professional and business services jobs represent 12.6% of total employment. Manufacturing represents 11.9% of total state employment, somewhat higher than the respective 8.8% for the nation. The state's share of fabricated metal and machinery manufacturing employment has grown in the past decade, as textile manufacturing has waned from concentrated levels. Tourism in the state has also grown gradually in the past decade, with 11.8% of total nonfarm jobs in the leisure and hospitality and hospitality industries in 2013. IHS Global Insight forecasts employment growth slightly above the national growth forecast between 2014 and 2018, due primarily to job gains in professional and business services and health services.

The South Carolina Department of Commerce continues to develop economic programs and work with companies to attract new business to the state. In 2013, the department helped recruit 15,457 new jobs and $5.41 billion in new capital investment to the state, including $1 billion in planned capital investment and at least 2,000 jobs by Boeing Co. for its 787 aircraft production facility in North Charleston. In addition, Google Inc. has announced another $600 million expansion of its data center operations in Berkeley County.

On a scale of '1.0' (strongest) to '4.0' (weakest) , Standard & Poor's assigns a score of '2.2' to South Carolina's economy.

Table 1

South Carolina -- Economic Data								
(000s)	**2010**	**2011**	**2012**	**2013**	**2014p**	**2015p**	**2016p**	**2017p**
Real GSP (bil. $)	143	147	151	155	159	165	171	176
Employment	1812	1832	1859	1890	1931	1982	2031	2074
Unemployment rate (%)	11.2	10.4	9.1	7.9	6.6	6.2	5.7	5.3
Personal income (bil. $)	152	160	166	169	177	186	196	207
Personal income growth (%)	2.0	5.4	3.6	2.2	4.4	5.4	5.5	5.6
Population	4641	4681	4730	4781	4833	4884	4936	4988
Net migration	24	28	36	37	37	37	37	37
Housing starts, private single-family	14	13	16	20	21	25	26	26
Housing starts, private Multifamily	1	2	3	3	4	5	6	7
New vehicle registrations	135	155	176	193	194	198	204	202

GSP--Gross state product. p--Projected.

Budgetary Performance

In our view, South Carolina has consistently had well-defined financial management policies and a commitment to reserves despite budget challenges. Surpluses are regularly recorded in periods of positive economic growth. In periods of economic decline, a focus on addressing budget imbalance includes structural solutions, primarily from across-the-board budget cuts. There is a formal reserve set at 5% (up from 3%) that must be replenished within three years of being drawn upon. There is also a 2% capital reserve that is funded each year and can only be used for capital or to lower debt for the following year if it is not needed to cover any operating deficits. The state's general and capital reserve funds are currently fully funded at the required amounts. To help manage its budget and maintain adequate fund balances despite revenue drops, state statute currently empowers the State Budget and Control Board and director of the Office of State Budget to adjust spending as needed within a short period of any projected revenue shortfalls based on the first three quarters of BEA revenue estimates. Beginning in fiscal 2016, the executive budget office must reduce appropriations uniformly within three days of up to a 3% revenue shortfall being identified by the BEA. If the revenue forecast is reduced by more than 3%, the President Pro Tempore of the Senate and the Speaker of the House of Representatives may call each respective house into session to avoid a year-end deficit. If the General Assembly does not take action within 20 days, the Director of the Executive Budget Office must make across-the-board reductions to general fund appropriations. Such adjustments must be made only after first providing adequate provision for payment of principal and interest on state bonds and notes, according to their terms.

In terms of revenue structure, the state relies on individual income tax and sales tax revenues for 45% and 39% of its budgeted general fund revenues, respectively, while corporation income tax proceeds comprise only 4% of general fund revenue. Various other taxes on cigarettes, alcohol, vending machines, insurance, and admission to places of amusement comprise the bulk of general fund revenue. In our view, the state's liquidity position is stable, and no short-term borrowing for general fund cash flow has been required.

Audited fiscal 2013

On a generally accepted accounting principles basis, the state closed fiscal 2013 with $9.9 billion in revenues and $8.8 billion in expenditures. The state posted a $1 billion surplus before transfers and other sources and uses. After accounting for transfers and other sources and uses, the surplus is $915 million. The general fund closed fiscal 2013 with a $2.8 billion total general fund balance, up from $1.89 billion in fiscal 2012. The assigned general fund balance was recorded at $997 million, up from $495 million in fiscal 2012. The unassigned balance totaled $792 million, or 9% of expenditures, down from $945 million in fiscal 2012. Combined assigned and unassigned balances rose to 20% of expenditures, from 17% in the previous year. In our view, general fund liquidity is good, with $3 billion in cash and cash equivalents as of fiscal year-end 2013.

Fiscal 2014 budget

The fiscal 2014 general fund budget totaled $6.378 billion, a 4.78% increase from fiscal 2013. Total education funding, including kindergarten through Grade 12 (K-12) and higher education, was budgeted at $2.9 billion and accounts for 46% of the budget. Appropriations for K-12 total $2.35 billion, a $182 million (or 8.41%) increase from fiscal 2013 appropriations. This increase reflects growth in enrollment ($17 million), and an increase to the per pupil funding formula ($56 million) to $2,101 from $2,012. The health and social rehabilitation appropriation increased by $46 million to $1.694 billion, a $46 million (or 2.81%) increase. The appropriation also increased transportation funding to the South Carolina Department of Transportation by $50 million; this represents funding to replace nontax revenues transferred for debt service on state infrastructure bank bonds issued for state bridge replacements, rehabilitation projects, and expansion and improvements to mainline interstates. Total year-to-date general fund revenues as of April 2014 are 0.4% ahead of collections versus the same period in fiscal 2013. Sales tax revenue collections through April are 3.1% ahead of fiscal 2013 and individual income revenue collections are 0.6% behind fiscal 2013.

Fiscal 2015 budget

The Nov. 18, 2013, BEA general fund revenue estimate totaled $7.2 billion, or a projected 3.7% year-over-year revenue increase compared to fiscal 2014 estimates. Total fiscal 2015 individual income tax revenues are projected at $3.5 billion, or 3.3% above estimated fiscal 2014 collections. The retail sales tax -- the state's second-largest revenue source -- is projected to increase 3.3% to $2.56 billion from estimated fiscal 2014 revenue. Both the senate and the house have approved their respective fiscal 2015 budget bills built on the BEA's November estimates (totaling about $7 billion, respectively), and they will deliberate over the next month to enact the final budget.

Standard & Poor's assigns a score of '1.3' on a '1.0' (strongest) to '4.0' s(weakest) to South Carolina's budgetary performance.

Debt And Liability Profile

Given South Carolina's historically conservative stance toward debt issuance, in our view, the tax-supported debt burden, including a portion of transportation infrastructure bank revenue bonds and lease debt, is moderate at $519 per capita and low at about 1.5% of personal income. A combination of state, local, and federal highway revenue sources secure the transportation infrastructure bank revenue bonds; debt ratios incorporate about half of such principal outstanding, equal to the proportion of pledged state transportation revenue. The state constitution, which governs debt issuance, places restrictions on debt levels and bond amortization. Bond maturities on GO debt cannot exceed 30 years. As mentioned above, total revenue and GO debt, including fiscal 2014 pro forma debt service, is amortized rapidly, with about 60% of principal due to be retired in the next 10 years. Based on fiscal 2013 audited financials, total fiscal 2013 debt service was $471 million, or a moderate 4% of total governmental expenditures. The state has historically not borrowed short-term for general fund cash flow.

Out of $120 million authorized for economic development under subsection C, about $50 million of authorization remains unissued. These bonds could be issued in calendar 2014 or early 2015, with issuance dependent on project scheduling. Meanwhile, out of $170 million for economic development authorized in 2009 under subsection B, there is currently no authorization for new debt remaining. South Carolina also expects to issue additional state institution GO debt; this debt is supported by tuition fees in practice and is not subject to the statutory limit.

South Carolina has five statutorily established pension plans, with the Teachers' and State Employees' Retirement System being the largest. The total aggregate pension funded ratio is 65.4% for all five systems, which we consider below average among all states. The total unfunded liability is calculated at $15.6 billion. The state typically funds its annual required contribution (ARC) in full for all systems. Unfunded state pension liabilities per capita are $3,277, and pension liabilities to personal income are weak at 9.24%, in our opinion.

South Carolina regularly evaluates the cost of retiree health care (OPEB) benefits. These benefits are funded on a pay-as-you-go basis, with minimal additional fund accumulation to pay retiree health benefits. The unfunded actuarial accrued liability for retiree health and dental insurance benefits and long-term disability insurance benefits earned as of June 30, 2012, was an estimated $9.7 billion, down $10.1 billion from June 30, 2011. The fiscal 2013 OPEB ARC was $828 million, which South Carolina funded at 50%, a decline from 53.5% in fiscal 2012. The state established an OPEB trust fund in 2008, and the general assembly has incorporated a recurring $2.4 million annual appropriation into its budget. Additionally funded with a payroll surcharge and investment income, the OPEB trust balance totaled $669 million as of fiscal year-end 2013.

Standard & Poor's assigns a score of '2.5' to South Carolina's debt and liability profile (on a scale of '1.0' (strongest) to '4.0' (weakest).

Table 2

South Carolina -- Financial And Debt Data					
	--Audited June 30--				
(Mil. $)	2013	2012	2011	2010	2009
Population	4.8	4.7	4.7	4.6	4.6

Table 2

South Carolina -- Financial And Debt Data (cont.)					
Total personalIincome	169.1	165.5	159.7	151.5	148.6
Finances (GAAP basis)					
General fund revenues	9,875	9,509	8,871	5,908	6,229
General fund expenditures	8,824	8,938	7,923	4,785	5,230
Net transfers and other adjustments	(136)	(761)	(572)	(1,080)	(1,225)
Net general fund operating surplus (deficit)	915	350	376	43	(227)
Total general fund balance	2,844	1,894	1,499	148	105
Assigned and unassigned	1,778	1,441	828	N/A	N/A
Net surplus (deficit) % of general fund expenditures	10.4	4.2	4.7	0.9	(4.3)
Debt					
Direct GO debt	1,318	1,965	2,183	2,301	2,200
Appropriation debt	114	105	110	70	8
Gas/transportation tax debt*	1,974	2,074	2,136	1,981	2,037
Net tax-supported debt	2,477	3,161	3,425	3,639	3,288
Net tax-supported debt per capita	519	669	733	785	716
Net tax-supported debt as % of total personal income	1.5	1.9	2.1	2.4	2.2

*Represents a portion of total transportation debt with state revenue support. GAAP--Generally accepted accounting principles. GO--General obligation. N/A--Not applicable.