

FITCH RATES SOUTH CAROLINA'S \$273MM GOS 'AAA'; OUTLOOK STABLE

Fitch Ratings-New York-05 April 2012: Fitch Ratings assigns an 'AAA' rating to approximately \$273.6 million of State of South Carolina general obligation (GO) bonds, consisting of:

- \$36 million GO state school facilities refunding bonds, series 2012A;
- \$55 million GO state capital improvement refunding bonds, series 2012A;
- \$42 million GO state economic development refunding bonds series 2012A;
- \$35 million GO state transportation infrastructure refunding bonds, series 2012A;
- \$42 million GO state institution bonds (issued on behalf of the University of South Carolina), series 2012A;
- \$15 million GO state institution bonds (issued on behalf of the Medical University of South Carolina), series 2012B;
- \$24 million GO state institution bonds (issued on behalf of Clemson University), series 2012C;
- \$22 million GO state institution bonds (issued on behalf of the Winthrop University), series 2012D;
- \$2.6 million GO state institution bonds (issued on behalf of Winthrop University), series 2012E.

The bonds are expected to sell competitively on April 11, 2012.

In addition, Fitch affirms the following ratings:

- Approximately \$2.1 billion in outstanding GO bonds at 'AAA';
- Approximately \$12.1 million in outstanding lease revenue bonds issued by the South Carolina 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.

RATING DRIVERS

STRONG FISCAL MANAGEMENT: South Carolina has a proven ability and willingness to support fiscal balance (generally through spending cuts), with a budget and control board providing centralized and autonomous fiscal oversight. The state's careful approach to financial operations has resulted in the restoration of reserves following a period of declining revenues due to economic weakness.

DIVERSIFYING ECONOMIC BASE WITH SIZABLE MANUFACTURING COMPONENT: The state's economic base continues to expand from growth in the services industry while the largest share of employment is concentrated in the trade, transportation, and utilities sector. The state's large manufacturing presence, which experienced significant losses in the recession, reflected in the state's high unemployment rates, is stabilizing. Wealth levels remain low.

DEBT LEVELS REMAIN MANAGEABLE: Debt levels are in the moderate range, having increased in the last decade due to transportation infrastructure bank issuance, which represents almost half of net tax-supported debt. Pension funding levels are low, although the state has a demonstrated commitment to funding its annual actuarial required contribution and improving funded ratios.

CREDIT PROFILE

South Carolina's 'AAA' rating rests on the state's proven ability and willingness to support fiscal

balance. The state's centralized and autonomous budget and control board (BCB) is mandated to take prompt corrective action to maintain balanced operations, and constitutional reserve requirements benefit from established replenishment provisions. Debt levels remain moderate and amortization of GO bonds is rapid. The state's large manufacturing sector, which quickly reflects changing economic conditions, remains a vulnerability, yet some offset has been found in the growing services industry. Unemployment is high and wealth levels remain low, although the state's recent economic performance is significantly improved from the downturn.

Weak revenue results in the downturn, reflecting both underlying economic factors and the impact of tax cuts, resulted in large reductions in revenue estimates that the state responded to quickly with large budget cuts. Operating results in fiscal year (FY) 2011 were stronger, and the state successfully closed an \$877 million forecast budget gap for FY 2012 primarily through expenditure reductions. The state increased its revenue forecast for the current fiscal year in November 2011 and revenue growth is forecast to continue into fiscal 2013.

South Carolina's strong budgeting and reserve funding practices were both recently augmented. In November 2010, voters approved amendments to the state constitution that increased the funding of the general reserve fund from 3% to 5% of state general fund revenue and changed the first priority of the capital reserve fund, which is funded at 2% of general fund revenue, to replenishing the general reserve fund; the capital reserve formerly was drawn down before any midyear budget cuts in the event of revenue shortfalls. In addition, pursuant to 2010 legislation, the BCB is now required to take action to avoid a deficit within seven days if quarterly revenue collections are 2% or more below projections; before this change, the threshold for action was 4% and the period to address the shortfall was 15 days.

South Carolina's economy and revenues weakened significantly in the downturn. Fiscal 2009 general fund revenues were 12.5% below the prior year and well below budget estimates, and the year closed with a \$98.2 million budgetary deficit in the general fund, even after the use of reserves and sizable expenditure cuts. Fiscal 2010 revenues fell short of budget estimates again, although by a lesser degree than in fiscal 2009, and the state again responded with use of the capital reserve and across-the-board spending cuts. Inclusive of funding the fiscal 2009 deficit, fiscal 2010 ended with a \$71 million budgetary surplus. General fund revenues were down 5.3% year-over-year, with the sales tax down 2.6% and the individual income tax down 5%.

Revenues improved in fiscal 2011, and the year ended with general fund revenues up \$512.4 million or 9.1% from the original board of economic advisors' (BEA) forecast and 6.4% above revenues received in fiscal 2010. Components of the increase in revenues included individual income tax (up 10.4% from fiscal 2010) and sales tax (up 2.5% from fiscal 2010). The state was able to apply \$55.4 million of the \$296.5 million surplus to boost the general reserve fund to \$166 million while the available \$107.7 million in the capital reserve fund was appropriated into the fiscal 2012 budget.

The fiscal 2012 enacted budget closed an initial budget gap estimated at \$877 million largely related to the absence of \$837 million in federal stimulus funds that supported the budget in fiscal 2011. Actions to close the gap included Medicaid service reductions and changes to reimbursement rates; not replacing lapsed federal stimulus funding to higher education institutions; an increase in the cigarette tax to support the Medicaid program; and a later revision to the revenue forecast for fiscal 2012. The \$6 billion general fund revenue estimate was revised in November 2011 by the BEA to \$6.29 billion, which together with expenditures that remain on budget, provide for the state's estimate of a \$377.7 million operating surplus in fiscal 2012.

In revising the revenue estimate for fiscal 2012, the BEA also certified \$6.5 billion available for appropriation in fiscal 2013; a 3.9% increase from fiscal 2012. The fiscal 2013 budget, as currently passed by one chamber of the legislature and under consideration by the other, contemplates the application of almost \$1 billion in additional revenue from fiscal 2012; \$377.7 million operating surplus from fiscal 2012, \$104.8 million remaining in the capital reserve fund, and \$535 million in forecast growth in general revenues.

As in prior downturns, the state's economy performed worse than that of the nation in the recent

downturn. After exceeding national growth rates from 2004 through 2007, the state's nonfarm employment dropped year-over-year in every month since June 2008 through April 2010. Matching the national trend, the state's nonfarm employment for 2011 was up 1.1% from 2010. Recent performance has also matched that of the nation, as the state's nonfarm employment improved 1.6% year-over-year as of February 2012. South Carolina's wealth levels are below average, with personal income per capita in 2011 ranking 46th among the states at 81% of the U.S.

State tax-supported debt, which increased notably earlier in the last decade due to transportation infrastructure bank issuance, has since leveled off. The debt burden remains in the moderate range; including the current bonds, net tax supported debt of \$4.3 billion equals 2.8% of 2011 personal income. Debt of the transportation infrastructure bank, created in 1997, accounts for almost half of the state's net tax-supported debt. The funding level of the state employee retirement system was 65.5% as of the July 1, 2011 valuation. Although the state's unfunded liability has increased significantly in the last 10 years, South Carolina has consistently funded its actuarial required contributions and is considering several reform measures to improve funding ratios.

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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. 15, 2011;
--'U.S. State Government Tax-Supported Rating Criteria', Aug. 15, 2011.

Applicable Criteria and Related Research:

Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=648898
U.S. State Government Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=648897

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