FitchRatings

Fitch Rates Richmond, VA's $134.9MM GOs 'AA+'; Outlook Stable

Link to Fitch Ratings' Report(s): Richmond, Virginia

Fitch Ratings-New York-30 August 2019: Fitch Ratings has assigned a 'AA+' rating to the following general obligation (GO) bonds to be issued by the city of Richmond, Virginia:

--$134.9 million GO public improvement and refunding bonds, series 2019A.

Proceeds from the 2019A bonds will be used to refund the series 2009B for debt service savings and to permanently finance the GO line of credit bond anticipation note, series 2018B issued to fund phase 1 of the New School Investment Program. The bonds are expected to sell on a competitive basis on Sept. 26 2019.

Fitch has also affirmed the following Richmond ratings at 'AA+':

--The city's Issuer Default Rating (IDR);
--$687million of outstanding GO bonds.

The Rating Outlook is Stable.

SECURITY
The GO bonds are payable from the city's full faith and credit and unlimited tax pledge.

ANALYTICAL CONCLUSION

The 'AA+' IDR and GO bond rating reflect the city's sound operating performance, solid growth prospects for revenue, high level of independent revenue raising authority and moderate long-term liability burden, all of which are supported by a growing economic base.

Economic Resource Base
The City of Richmond, the state capital of Virginia, is situated on the Interstate 95 corridor at the midpoint of the eastern seaboard, 107 miles south of Washington, D.C., and 93 miles north of Norfolk. With a 2018 population of 228,783, the city's population has increased by approximately 12% since 2010, double the national average.

KEY RATING DRIVERS

Revenue Framework: 'aa'
General fund revenues are funded primarily from a mix of property, sales and other taxes, as well as intergovernmental revenues. Fitch expects natural revenue growth going forward to be solid, reflective of recent and projected economic activity. The city retains an unlimited legal ability to adjust the property tax rate, resulting in notable capacity to respond to budgetary challenges in an economic downturn scenario.

Expenditure Framework: 'aa'
Fitch expects expenditures to grow generally in line with the pace of revenue growth. Moderate carrying costs and broad flexibility to manage labor-related costs allow the city solid leeway to adjust spending throughout

economic cycles.

Long-Term Liability Burden: 'aa'
Overall debt combined with the Fitch-adjusted net pension liability is moderate at about 13% of the city's personal income. The overall liability burden is expected to increase over the next few years as the city implements an accelerated school construction plan, but the burden is expected to remain consistent with a 'aa' assessment.

Operating Performance: 'aaa'
Fitch expects the city's combination of revenue and expenditure flexibility, supplemented by reserve funding, to enable the maintenance of a high level of financial flexibility throughout the economic cycle.

RATING SENSITIVITIES
Increasing Liability Burden and Carrying Cost: The rating assumes maintenance of a moderate long-term liability burden and carrying costs relative to the city's economic resource base. The scale and timing of the additional expected debt issuance could increase both the long-term liability burden and carrying costs to levels inconsistent with the current expectations and put negative pressure on the rating.

CREDIT PROFILE

Richmond serves as the core of a growing metropolitan area and is a regional center for employment and cultural amenities. The economy, which has traditionally been dominated by the government sector, gains strength from education and health services, anchored by Virginia Commonwealth University (VCU) and eight other higher education institutions located in the city.

Economic development efforts are focused upon leveraging additional growth in the life-sciences sector, enhancing a solid financial services sector, and redeveloping select city neighborhoods. The proposed Navy Hill Project is a $1.5 billion mixed used multi-block development that is comprised of built-to-suit office, commercial and residential development centered around a new arena to replace the Richmond Coliseum. The proposal will be formally considered by the city council in early 2020.

The city's employment base continues to expand annually. The unemployment rate tends to be higher than the state norm but lower than the national average. Although economic activity in the city has improved, the city's poverty rate remains high at about 25% and wealth indicators are weak with median household income at just 62% and 74% of the state and national averages, respectively.

Revenue Framework
The city relies on a combination of property and other taxes, which equate to 49% and 22% of general fund revenues, respectively, as of fiscal 2018, as well as intergovernmental revenues, which make up 12% of revenues.

Fitch expects future general fund revenue growth to range between the rate of inflation and GDP over time. General fund revenues have grown below the rate of inflation over the 10 years through fiscal 2018. This period does not include any property tax rate adjustments although other tax revenue rates have been increased. After several years of stagnant or declining valuations, the city's taxable base has increased for the fourth consecutive year in fiscal 2018. According to the city's assessor, total assessed value was $27.8 billion, a notable nearly 9% increase over 2018. The real estate component on the assessed value is estimated to increase 7% between 2019 and 2020. Additional commercial, retail and residential projects planned or underway support the expectation for continued tax base growth. A history of low joblessness and improving income and poverty rates support Fitch's view on the city's long-term solid revenue growth outlook.

The city has broad legal control over revenues as it is not subject to any cap or limitation on its property tax rate or levy.

Expenditure Framework

The city's largest expenditure categories are public safety and education; public safety accounts for about a third and education a quarter of general fund expenditures. Virginia public schools are largely funded by a mix of state and local aid contributions. The amount of local contributions above the state requirement is determined by city management, and based on the state-determined performance standards for the school system.

Fitch expects the natural pace of spending growth to remain in line with to marginally above revenue growth in the absence of policy action.

The city's fixed-cost burden is moderate, with carrying costs for debt, pensions and other post-employment benefits (OPEB) totaling about 14% of fiscal 2018 governmental expenditures. Servicing of the city's direct debt accounts for roughly half of this figure and reflects an average principal amortization schedule of roughly 62% repayment in 10 years. Fitch expects fixed costs to remain moderate as manageable debt plans are in place for the near term. Pension contributions account for the other half, and are likely to see moderate annual increases due to current funded levels for its liabilities. The city makes the full actuarially determined contribution to the state and city administered pension plans. Given the city's notable additional debt plans and likely future increases in pension contributions, the carrying costs metric is vulnerable to an increase to a level that could negatively affect the current 'aa' subassessment for expenditure framework.

Long-Term Liability Burden

Overall net debt plus the city's and school's adjusted net pension liability (NPL) is moderate at about 13% of personal income. The city's five-year capital improvement plan (CIP) for 2020-2024 totals approximately $462.7 million and includes total borrowing of about $371.5 million (approximately 3% of personal income). The plan mostly funds school construction and transportation projects. The city intends to construct three new schools by 2020.

The preliminary finance plan of the aforementioned Navy Hill Project includes the estimated issuance of $350 million in revenue bonds. While the revenue bonds are not expected to include a GO or moral obligation commitment from the city, debt service is expected to be repaid from an increment financing area to be created around the arena. Fitch would view the proposed revenue bonds as part of the long-term liability burden of the city given tax revenues on the properties located within the increment financing area will be used to fund debt service on the bonds. The 'aa' assessment reflects the expectation that the long-term liability metric will remain below 20% of personal income.

City employees participate in one of two pension plans, the Virginia Retirement System (VRS) or the Richmond Retirement System (RRS), and may also participate in a deferred compensation plan. The aggregate NPL including the VRS cost-sharing liability for teachers totals an estimated $826 million, or approximately 7% of personal income when adjusted by Fitch to reflect a 6% discount rate, instead of the 7% rate reported by VRS and 7.5% rate used by RRS. The fiduciary net position covered roughly 62% of the total pension liability.

The city funds OPEB on a pay-as-you-go basis. As of the most recent valuation, the net OPEB liability was about $82.5 million or less than 1% of personal income.

Operating Performance

Fitch views the city's ability to respond to fiscal challenges in a moderate economic downturn as exceptionally strong. General fund revenues have been fairly stable through prior economic cycles adjusted for one-time revenue infusions. Revenue losses could be offset in part through the use of a portion of the city's unrestricted fund balance, which stood at $136 million or about 20% of spending in fiscal 2018.

The city has also demonstrated an ability to control spending over time and through economic cycles without resorting to drastic austerity measures. During the Great Recession, the city implemented a hiring freeze and reduced capital spending to control costs incurring a lone operating deficit of less than $14 million or roughly 2% of spending in fiscal 2009 before returning to surplus results in the ensuing fiscal years.

The fiscal 2019 budget was adopted at approximately $720 million, representing a roughly 4% increase from fiscal 2018. The budget maintains the property tax rate at $1.20 per $100 of assessed value and increases the meals tax to support higher school construction costs. The budget includes a $10 million increase in school funding, about $3 million toward a step-based salary increase for public safety employees and a 1% salary increase for general employees (estimated at $1 million), as well as $2 million in additional pension contributions over the actuarially determined contribution. According to the city's fourth quarter unaudited budget projections, the general fund is projected to have a surplus of $24.3 million prior to allocations or approximately $7 million after allocations.

The fiscal 2020 general fund revenue budget of $746 million is a 3.65% increase over the fiscal year 2019 adopted budget. The budget maintains the property tax rate at $1.20 per $100 of assessed value, establishes a new local cigarette tax and charges for trash collection services. The budget increase mostly funds a $19 million increase in recurring school funding, approximately $5 million to fund software upgrades, $7 million in additional public safety personnel costs and a 3% pay raise for general city employees.

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