S&P Global Ratings

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Summary:

Spotsylvania County, Virginia; Appropriations; General Obligation

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Summary:

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Credit Profile		
US$54.32 mil GO pub imp bnds ser 2019A dtd 08/28/2019 due 01/15/2039		
Long Term Rating	AAA/Stable	New
Spotsylvania Cnty GO		
Long Term Rating	AAA/Stable	Upgraded
Spotsylvania Cnty Econ Dev Auth, Virginia		
Spotsylvania Cnty, Virginia		
Spotsylvania Cnty Econ Dev Auth (Spotsylvania Cnty) APPROP		
Long Term Rating	AA+/Stable	Upgraded
Spotsylvania Cnty Econ Dev Auth (Spotsylvania Cnty) APPROP		
Long Term Rating	AA+/Stable	Upgraded
Spotsylvania Cnty Econ Dev Auth (Spotsylvania Cnty) APPROP		
Long Term Rating	AA+/Stable	Upgraded
Spotsylvania Cnty Econ Dev Auth (Spotsylvania Cnty) (Pub Bldg & Equip Proj)		
Long Term Rating	AA+/Stable	Upgraded
Spotsylvania Cnty Indl Dev Auth, Virginia		
Spotsylvania Cnty, Virginia		
Spotsylvania Cnty Indl Dev Auth pub fac rev bnds (Spotsylvania Sch Fac Proj)		
Unenhanced Rating	AA+(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings raised its long-term rating on Spotsylvania County, Va.'s general obligation (GO) debt to 'AAA' from 'AA+' as well as its long-term rating on the county's appropriation-backed debt outstanding to 'AA+' from 'AA'. The outlook is stable.

At the same time, S&P Global Ratings assigned its 'AAA' rating, with a stable outlook, to the county's series 2019 GO public improvement and refunding bonds.

We base the upgrade on the county's long-term history of strong financial operations supported by very strong management policies and practices, including five consecutive years of audited operating surpluses through fiscal 2018. Management regularly reviews and updates its policies in order to maintain best practices, with frequent updates to its policies by the board of supervisors. In addition, despite below-average income levels relative that of similarly rated peers, the county's strong economic base with access to the Washington D.C. metropolitan statistical area (MSA) supports the county's very strong general creditworthiness. We believe Spotsylvania County's ongoing developments will help expand the county's already large and diverse tax base and provide additional revenue-raising flexibility, which should help the county maintain its long track record of positive financial operations and very strong reserve levels. In addition, we believe the county's fixed costs and retirement liabilities should remain manageable and not add significant pressure to the budget.

The county's pledge of its full faith and credit to levy and collect an annual ad-valorem tax on all locally taxable property secures the series 2019 bonds and GO bonds outstanding. Proceeds will finance various public school, transportation, and public safety capital projects, and will refund a portion of the previously issued bonds.

Spotsylvania County's appropriation bonds are secured by annual payments and basic rent payments made by the county. We rate these obligations one notch lower than the county's general creditworthiness, as reflected in the GO rating, to account for the appropriation risk associated with the payments.

The county's GO debt is eligible to be rated above the sovereign because we believe Spotsylvania County can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions" (published Nov. 19, 2013). The county has a predominantly locally derived revenue source, with approximately 81% of general fund revenue coming from property and other local taxes in fiscal 2018. Spotsylvania County also has independent taxing authority and independent treasury management from the federal government.

The GO rating reflects our view of the county's:

- Strong economy, with access to a broad and diverse MSA;
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2018;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 45% of operating expenditures after accounting for committed reserves as well as unrestricted reserves held in the county's capital and transportation funds that could be used for general expenses, if necessary, following board approval;
- Very strong liquidity, with total government available cash at 80.5% of total governmental fund expenditures and 5.5x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability profile, with debt service carrying charges at 14.5% of expenditures and net direct debt that is 108.0% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of market value and rapid amortization, with nearly 80.0% of debt scheduled to be retired in 10 years; and
- Very strong institutional framework score.

Strong economy

We consider the county's economy strong. Spotsylvania County, with an estimated population of 133,215, is located in the Washington-Arlington-Alexandria MSA, which we consider to be broad and diverse. The county has a projected per capita effective buying income of 104.5% of the national level and per capita market value of $123,830. Overall, the county's market value grew by 2.3% in 2018 to $16.5 billion in 2019. The county unemployment rate was 3.1% in 2018.

Spotsylvania County is located about halfway between Washington, D.C., and Richmond, Va., and residents benefit from access to a strong regional economy with many job opportunities. While nearly three-fourths of the county's labor force commute outside the county for employment, Spotsylvania County continues to expand and diversify its employment base, targeting growth in health care, manufacturing, defense/IT/cyber, and tourism. Notable economic developments include the Atlantic Gateway Project transportation project, which consists of improvements to Interstate 95, as well as a number of mixed-use developments.

Leading local employers include:

- Spotsylvania County Schools;
- Spotsylvania County government;
- HCA Virginia Health System;
- Wal-Mart; and
- CVS Health Corp., a distribution warehouse.

The county's population has increased about 7.3% in the past 10 years, with steadily increasing assessed value (AV) in the same period. The county reassesses every other year, with the most recent completed in 2018, resulting in an 8.2% increase to residential values and a 5.7% increase to commercial values. Officials note the county continues to see a strong housing market with median home price increases of 25% over the past five years. We anticipate the county's already very diverse economy will continue to expand slowly and steadily in the near term. The top 10 taxpayers account for just 5.0% of AV.

Very strong management

We view the county's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Highlights of the assessment include the following:

- Conservative revenue and expenditure assumptions that incorporate historical as well as long-range financial forecasting.
- Budget performance reports are presented quarterly and include budget-to-actual and year-to-date benchmarks; the budget may be amended throughout the year.
- Spotsylvania County maintains annually updated five-year financial forecasts for all of its major funds with varying assumptions and identifiable risks in the out years.
- The county maintains a five-year rolling capital improvement plan (CIP) of identified projects, costs, and funding sources.
- Spotsylvania County has a formally adopted investment policy with earnings and holdings that it reviews at least quarterly.

- The formal debt management policy targets net debt at no more than 3% of estimated market value, and the ratio of debt service expenditures as a percentage of governmental fund expenditures should not exceed 12%, with a goal of lowering this to 10% by the end of 2025.
- A comprehensive reserve policy tied to liquidity and contingency planning needs.

Strong budgetary performance

Spotsylvania County's budgetary performance is strong in our opinion. The county had operating surpluses of 3.9% of expenditures in the general fund and of 2.4% across all governmental funds in fiscal 2018.

For analytic consistency, we have adjusted data to include recurring transfers, in and out, as revenues and expenditures, as well as for one-time revenues and expenditures, particularly bond-funded capital needs.

In fiscal 2018, audited results indicate revenues increased by 4.0% for the year, while expenses rose by 4.5%. Overall, the county generated a $9.6 million positive variance relative to budget. Management attributes fiscal 2018 results to revenues exceeding expectations (largely from real estate and personal property) and expenditures coming in less than projected, primarily due to conservative budgeting and unexpended budgeted expenditures.

The fiscal 2019 budget totaled $280.2 million in general fund expenses and included the appropriation of $9.7 million, consisting mostly of an $8.6 million transfer to the capital projects fund. Management indicates that, as of the third quarter in fiscal 2019, unaudited results show positive variances in revenue as well as slightly higher-than-expected expense. Specifically, general fund revenues are currently projected to exceed budget by $5.3 million, primarily due to better-than-expected real estate taxes. Expenses are projected to be $4.4 million above budget mostly due to increased fire and rescue overtime costs. Nevertheless, we understand that management expects to end the year without a material change to reserves.

The fiscal 2020 adopted general fund expense budget totals $290.4 million, representing a 3.7% increase over the fiscal 2019 adopted budget. Real property tax rates increased slightly by 1.4 cents for the year but remain well below average compared to other counties in the commonwealth. The budget includes use of approximately $5.2 million of the general fund balance, driven by continued pay-as-you-go capital funding, which is consistent with previous years. However, given the county's history of strong performance stemming from conservative budgeting, we expect performance will remain strong and reserves will be replenished.

Property taxes are the county's primary source of general fund revenue, accounting for about two-thirds of revenue. Other taxes, including local sales and meals taxes and fuel taxes account for about 16% of revenues. We note the county's real property tax rate of 84.7 cents for fiscal 2020 is one of the lowest compared to that of other counties in the commonwealth, providing ample financial flexibility.

Very strong budgetary flexibility

Spotsylvania County's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 45% of operating expenditures, or $115.6 million. We expect the available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

The available fund balance includes $86.3 million (33.3% of expenditures) in the general fund and $29.3 million (11.3%

of expenditures) that is outside the general fund but legally available for operations. Specifically, the county maintains $25.9 million in its capital projects fund and $3.4 million in its transportation fund that we understand is completely unrestricted and has been accumulated through general fund transfers. Management indicates these reserves could be reclassified if necessary with board approval.

As part of the annual budget process, the county appropriates a contingency equal to 0.25% of general fund expenses. This contingency is meant to cover unforeseen expenditures of a nonrecurring nature that arise during the course of the fiscal year, or to meet relatively minor increases in service-delivery costs. Spotsylvania maintains comprehensive policies governing its reserves.

Highlights of these policies include:

- Designating the fiscal stability reserves as a committed reserve and increasing the required reserve level to 11% of general fund and school operating fund revenues projected for the subsequent fiscal year. We include these reserves in our analysis of available reserves as officials confirm they can be made available by the board;
- A budget stabilization reserve to address potential revenue declines or other economic stress placed on the budget, which the county funded with a balance of $1 million in fiscal 2016, with 0.25% of general fund and school operating fund revenues projected for the subsequent fiscal year budget to be added until the fund reaches $5 million. At the end of fiscal 2018, it stood at $4.2 million;
- Formalizing the health insurance reserve to equal incurred, but not reported, claims plus three months of average claims, with a balance totaling $4.4 million; and
- A $2 million economic opportunities reserve, fully funded, for the purpose of funding matches to state grants and to provide incentives as necessary.

The county has added to available reserves (assigned and unassigned) annually, and expects to do so again in fiscal 2019. Given projections, we expect flexibility will remain very strong.

Very strong liquidity

In our opinion, Spotsylvania County's liquidity is very strong, with total government available cash at 80.5% of total governmental fund expenditures and 5.5x governmental debt service in 2018. In our view, the county has strong access to external liquidity if necessary.

We believe the county's strong access to external liquidity is supported by its frequent debt issuances, including GO bonds. Although the state allows for investments that we view as permissive, the majority of Spotsylvania County's investments are in highly rated and liquid mutual funds and fixed income securities, which we do not view as aggressive. The county has consistently had very strong liquidity and we do not anticipate this will diminish.

In 2013, Spotsylvania County issued privately placed fixed rate GO debt and economic development authority lease revenue debt. We have reviewed the terms and conditions and do not believe they pose a risk to liquidity.

Strong debt and contingent liability profile

In our view, Spotsylvania County's debt and contingent liability profile is strong. Total governmental fund debt service is 14.5% of total governmental fund expenditures, and net direct debt is 108.0% of total governmental fund revenue.

Overall net debt is low at 1.8% of market value, and nearly 80.0% of the direct debt is scheduled to be repaid within 10 years, which are in our view positive credit factors.

The county's five-year CIP (fiscal 2020-2024) totals $422.2 million, consisting of $138.2 million in general government facilities, $121.5 million in school capital projects, and $162.5 million in utility capital projects. We understand Spotsylvania County expects to cash-fund about $80.7 million of its general capital projects, or nearly $16.0 million annually. The CIP identifies about $61 million in potential projects funded through debt issuances for general capital and school projects in the next two years, as well $47 million for utility projects. However, any potential issuance is offset by Spotsylvania County's rapid debt amortization. Given the county's strong debt management policies, we do not expect to see any material changes to its debt profile.

Spotsylvania County's combined required pension and actual other postemployment benefits (OPEB) contributions were 1.8% of total governmental fund expenditures in 2018. The county made its full annual required pension contribution in 2018.

The county and school board participate in the Virginia Retirement System, a defined benefit pension plan that includes a multi-employer agent plan for county and school board employees and a cost-sharing, multiple-employer teacher retirement plan. The school board is responsible for paying for the school board and teacher retirement plans. The funded ratios calculated using a 7.00% discount rate were 91.60% for the county plan, 98.80% for the school-board plan, and 68.28% for the teacher retirement plan as of June 30, 2018. Spotsylvania County pays 100% of its contractually required contribution. The net pension liability for the county's plan stands at $14.3 million.

Spotsylvania County also administers a single-employer defined benefit plan that provides health and dental insurance during retirement for eligible retirees and their dependents. The plan is funded on a pay-as-you-go basis, with an unfunded liability of $121.6 million at the end of fiscal 2018.

Very strong institutional framework

The institutional framework score for Virginia counties is very strong.

Outlook

The stable outlook reflects S&P Global Ratings' opinion of the county's strong performance and very strong management conditions. Furthermore, the county has successfully maintained its very strong budgetary flexibility and liquidity despite cash-funding a substantial portion of capital needs. The strong and growing local economy with access to the greater Washington, D.C., MSA provides further stability. Therefore, we do not expect to lower the rating within the outlook's two-year period. Although not expected, if the county significantly and unexpectedly drew down reserves due to fiscal imbalance, this could pressure the rating.

Related Criteria Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local

Government GO Criteria, Sept. 2, 2015

- 2018 Update Of Institutional Framework For U.S. Local Governments