

Virginia GFOA 2017 Spring Conference

Credit Rating Panel

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FitchRatings

Topics of Interest

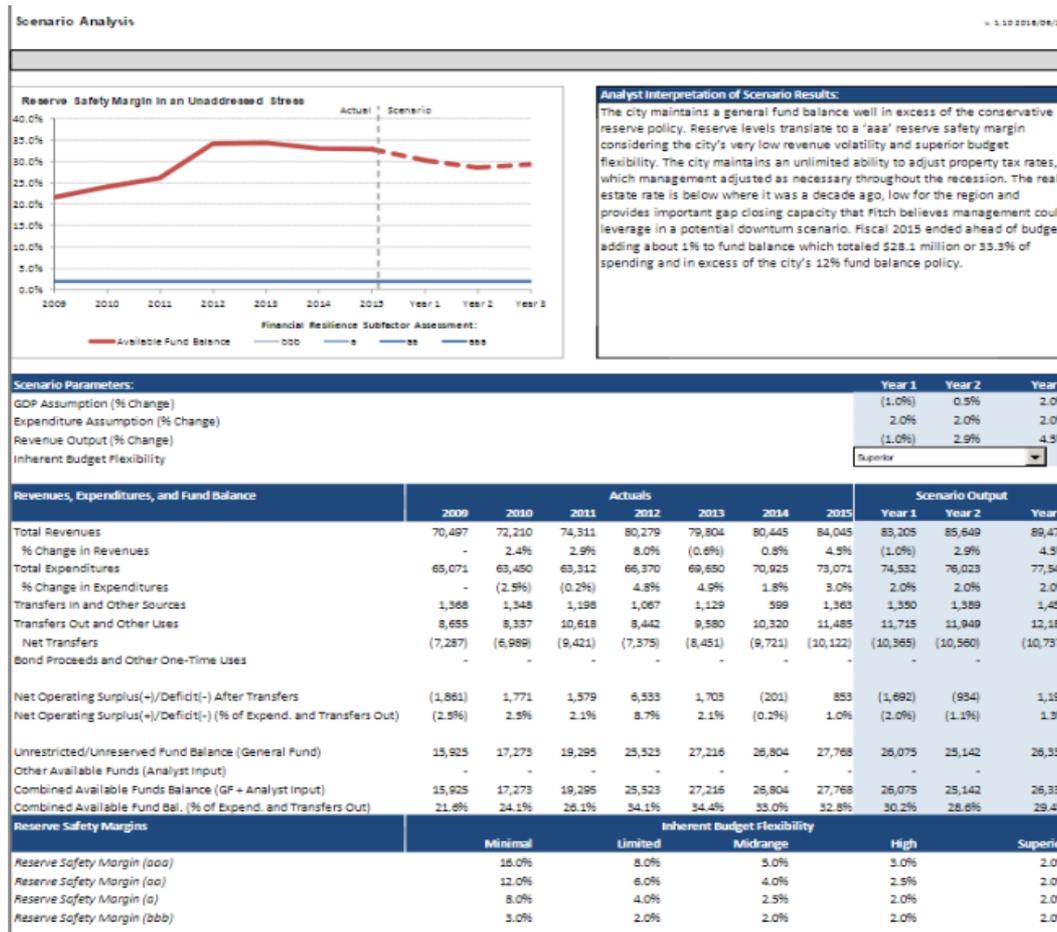
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New Criteria Brings Changes

- Fitch released its new U.S. Tax-Supported Rating Criteria in April 2016
- Introduction of the Issuer Default Rating (IDR)
- Key Rating Factors (KRFs)
 - Cover both the institutional framework in which an issuer operates and performance within that framework
 - Fitch will publish key rating factor assessments ('aaa' through 'bb')
- Rating outcome does not reflect standard weighting of KRFs
 - Consideration of issuer-specific qualitative and quantitative factors

Rating Through-the-Cycle

- Scenarios address rating tolerance

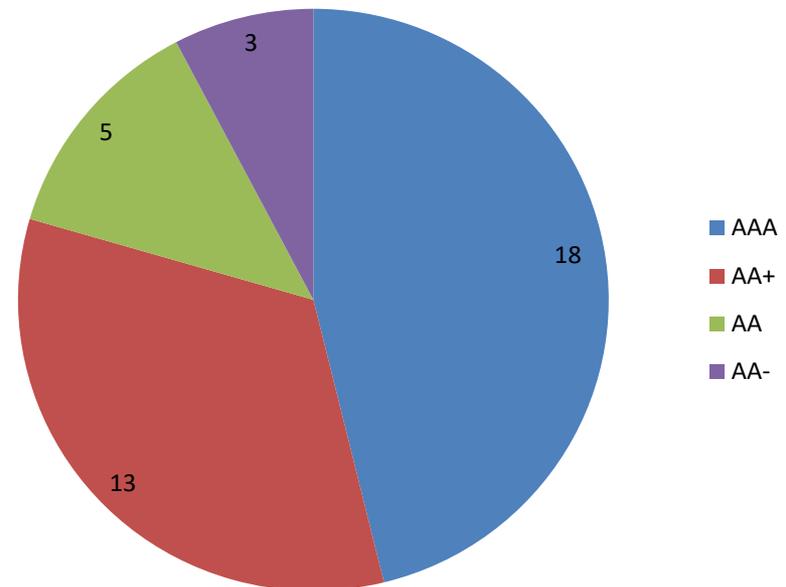


- Considers how a government's revenues may be affected in a cyclical downturn and the options available to address the resulting budget gap
- Conveys the range of performance where a rating would be expected to remain stable
- Recognizes that an issuer's financial position will fluctuate through an economic cycle

Criteria Implementation: VA Local Government Ratings

- 39 city and county issuers reviewed (GO and IDRs)
 - 30 rating affirmations and 9 upgrades
- Rating upgrades largely reflect criteria change
 - More focused consideration of economic factors
 - Sufficiency of economic resources relative to the issuer's risk profile

Fitch VA Local Government IDR Distribution



Virginia Local Governments – Revenue Framework

- KRF assessments – roughly even split of 'aaa' and 'aa'
- Generally strong growth prospects in-line with Fitch's view of the Commonwealth
 - Risk factors present, including slowed personal income growth
 - State revenues will be affected by Federal policy decisions, having a knock-on effect on locals if federal revenue-sharing with states is curtailed
- Economic profile remains strong
 - Industry diversity – leader in technology
 - High wealth and skilled labor
- Unlimited ad valorem taxing power – focus on legal authority a key criteria change
- Stable tax base - Zillow Home Prices (April 2017) are up 4.5% y-o-y across the Commonwealth; 1.5% 1-year forecast

Virginia Local Governments – Expenditure Framework

- KRF assessment of 'aa' for all VA local governments
- Solid flexibility, manageable spending pressures
 - Strong legal control over personnel costs – labor terms not collectively bargained
 - Most entities have regained capacity to reduce spending in a downturn without threatening basic service levels
- Debt and retiree benefits consume a reasonable portion of governmental spending
- Education funding
 - Flexibility within statutory requirements
 - Exposure to shifts in state funding
- Proposed changes to federal trade policy may raise costs of equipment & materials
- Higher Medicaid costs may consume resources for other programs

Virginia Local Governments – Long-term Liabilities

- KRF assessment of 'aaa' for strong majority of VA local governments
- Many comfortably within 'aaa' metric guidance (10% of personal income)
- Key criteria changes
 - Focus on combined debt and pension metric
 - Liabilities expressed as a percentage of personal income not market value
- Conservative debt management practices
- Infrastructure funding concerns
 - For the third year in a row, the National League of Cities' 2016 survey of fiscal conditions cited a lack of infrastructure funding as the leading budgetary concern, above employee salary, pension and healthcare benefits as a source of pressure

Moderate Pension Cost Growth, Few Reporting Surprises

- Pension liabilities pressured by discount rate assumptions and weak recent investment performance
- Updated mortality tables add to projected liabilities
- However, the rate of annual contribution increases has become more manageable,
- Reporting under new GASB standards has begun
 - Enhanced reporting has not yielded any notable surprises so far
 - Increased comparability and information on cost-sharing plans support analytical tools
 - Reported long-term liability burdens will be more volatile going forward due to elimination of “asset smoothing”; liability measures more closely linked to recent investment returns
 - Liability burdens for most locals will be moderately affected by the reporting changes

Virginia Local Governments – Operating Framework

- KRF assessment of 'aaa' for 38 of 39 VA local governments rated by Fitch
- The adequacy of an issuer's financial flexibility and reserves is considered in the context of its inherent budget flexibility and the decline in revenue an issuer might experience in an economic downturn
- Superior inherent budget flexibility reflects broad legal control over leading sources of revenue and personnel-related costs, and low fixed-cost burden
- Revenue sensitivity analysis produced via Fitch Analytical Sensitivity Tool (FAST)
- Analytical interpretation – expectations of what an issuer would do in response to a cyclical revenue decline is key to the analysis
- Budget management practices examined for deferral of required spending, risk to outside parties, and timeliness and quality of financial information, among other factors

U.S. Local Government Outlook Stable for 2017

- Core fundamentals remain strong
- The average IDR across U.S. local government portfolio lies between 'AA' and 'AA+' and reflects the following strengths shared by most municipalities
 - The authority to levy property taxes, nonpayment of which can result in property foreclosures
 - Additional taxing power that can include sales, utility, and income taxes
 - The ability to control spending to at least a moderate degree
 - The essentiality of and lack of competition for services provided by local governments
 - Moderate carrying costs relative to spending and long-term liabilities relative to income
- Ratings account for normal cyclical variations
- No expectation for economic cycle of unusual depth or duration or fundamental change in intergovernmental relationships

Related Research

- [U.S. Tax-Supported Criteria Implementation Update: More Focused Analysis and More Robust Communication \(January 2017\)](#)
- [Tax-Supported Criteria Revision \(April 2016\)](#)
- [2017 Outlook: US Local Governments \(December 2016\)](#)
- [Work Force Evaluation Key to Local Government Analysis \(October 2015\)](#)
- [Pension Obligation Bonds – Weighing Benefits and Costs \(March 2015\)](#)
- [New Pension Perspectives – Long-Awaited GASB Pension Changes Begin \(February 2015\)](#)

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