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Ratings

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Summary:

Richmond, Virginia; General Obligation

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Summary:

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Credit Profile		
US$134.95 mil GO pub imp & rfdg bnds ser 2019A due 07/15/2039		
Long Term Rating	AA+/Stable	New
Richmond GO		
Long Term Rating	AA+/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to Richmond, Va.'s series 2019A general obligation (GO) public improvement and refunding bonds. At the same time, we affirmed our 'AA+' rating on the city's existing GO debt. The outlook is stable.

A pledge of the city's full faith credit and resources and an agreement to levy ad valorem property taxes without limitation as to rate or amount secure these bonds.

We understand proceeds from the series 2019A bonds will be used to finance capital needs in the approximate amounts of $45 million for the city and in city capital needs while $90 million will be used to provide funding related to Phase I of the New School Investment project. In addition, proceeds from the 2019A bonds will be used to refinance approximately $14 million with respect to the city's 2009B GO bonds.

The city anchors the growing regional economy, providing stability from its federal and commonwealth employment presence coupled with the broad and diversifying economy that is experiencing growth in several areas of the city. As a result, the city is seeing healthy increases in its tax base and population and decreases in unemployment. However, poverty levels remain a concern, affecting city income indicators. The city's financial operations and reserve levels continue to see positive trends and are guided by formal and well-adhered to fiscal policies. Although not expected in the near term, additional debt brought on for school purposes and the intention of improving pension funding, could place pressure on the rating over the moderate term.

The rating reflects our assessment of the following factors for the city, including its:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment methodology;
- Strong budgetary performance, with balanced operating results in the general fund and an operating surplus at the total governmental fund level in fiscal 2018;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 20% of operating expenditures;
- Very strong liquidity, with total government available cash at 45.7% of total governmental fund expenditures and 5.5x governmental debt service, and access to external liquidity we consider exceptional;

- Weak debt and contingent liability position, with debt service carrying charges at 8.4% of expenditures and net direct debt that is 104.8% of total governmental fund revenue; and
- Very strong institutional framework score.

Strong economy

We consider Richmond's economy strong. The city, with an estimated population of 226,999, is located in the Richmond, Va. MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 84.2% of the national level and per capita market value of $112,621. Overall, the city's market value grew by 4.0% over the past year to $25.6 billion in 2019. The city's unemployment rate was 3.5% in 2018.

Richmond maintains a deep, diverse economy, which continues to grow. The city is the economic hub for the greater Richmond MSA that encompasses nine counties. As the commonwealth's capital, Richmond has, and will retain, a significant federal presence: The Fifth Federal Reserve Bank and the U.S. and 4th District Federal Court of Appeals call it home. Federal employment in the city totals more than 15,000. In addition, commonwealth agencies provide more than 25,000 jobs. Local, commonwealth, and federal government positions account for nearly one-third of the employment base. Richmond is also home to several higher education institutions, including Virginia Commonwealth University (VCU)--the commonwealth's largest university with more than 31,000 students—along with University of Richmond (7,000-plus), and Virginia Union University (1,600). Government and educational institutions have historically provided employment base stability, especially during recessionary periods.

The city's renaissance continues following the national economic slowdown, in part due to the city's active recruitment and retention program. Between 2014 and 2018, the city has experienced over $4.2 billion in investments, with most of the investments and largest footprints in the residential and mixed-use areas. Since January of 2019 the city has seen an additional $735 million of investments, which includes 1,600 new multi-family units, 150 new hotel rooms and 800,000 square feet of new or renovated office space. Furthermore, as a result of the Federal Tax Cuts and Jobs Act of 2017, it now has 11 parcels of land designated as Opportunity Zones, which should spur additional economic development.

Recently completed, as well as recently approved projects are located throughout the city and not concentrated solely in the downtown area. Recent projects are primarily multi-family units, hotels, industrial sites, and the construction of the second building of the Dominion Energy headquarters and continued expansion by VCU. In addition, the Port of Richmond will receive several upgrades to its facility, as well as ongoing public housing transformations. The most recent, and significant, economic development announcement is the Navy Hill Project , which proposes a $1.4 billion multi-block, mixed-use development and includes the replacement of the obsolete Richmond Coliseum, the development of high-density mixed-income and affordable housing, an additional hotel, and the replacement of the city's bus transfer station--all while creating roughly 9,200 new jobs. In August 2019, a negotiated proposal for the Navy Hill Project was presented to the city council to review and be voted on in the coming months. Lastly, the Greater Richmond Transit Corp. (GRTC) Pulse, a rapid transit system that will serve an almost eight-mile route, and just began operations connecting residents and businesses, is seeing a positive impact in the city.

As a result of the ongoing redevelopment efforts, the population has increased, unemployment has decreased, and the tax base has experienced healthy and consistent growth over the past five years. Nonetheless, over 20% of the city's population is below the federal poverty line. The city continues to work toward gradually reducing this number through various projects and programs. Given the ongoing growth, which economic development projects across sectors, we believe the tax base should continue to experience growth in the coming years.

Very strong management

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

The city's financial assumptions are both realistic and well grounded. Formal historical trend analysis is performed and updated annually for both revenue and spending. Ongoing oversight helps the city's management team stay on track with respect to revenues and expenditures. Budget amendments are not typically made, unless for major items such as grants. The city also uses multiyear forecasting for both revenues and expenditures. Assumptions are conservative, and structural balance is a clear goal. The city also maintains an extensive five-year capital improvement plan (CIP), which has all funding sources identified. For the first time in the city's history, the fiscal 2020 budget includes a 20-year CIP which will look to address critical infrastructure needs for a projected growing population. In addition to the CIP, it maintains extensive debt issuance policies, which are quite conservative. It also maintains and adheres to its formal and conservative reserve policy. Both the debt and reserve policies were strengthened in calendar 2012 and again in 2017. The city has established an investment management policy, which closely follows that of the commonwealth. Administrators report to the city council at least monthly. The fund balance policy, first adopted in 1988, was revised in 1992 and 2001 to raise the undesignated and unassigned fund balance to 7% from 3% of budgeted expenditures. In April 2012, the city further increased the policy level to 10% of budgeted general fund and school expenditures. In 2017, the updated reserve policy requires the unassigned fund balance and the revenue stabilization reserve to total, at least, 16.67% of budgeted general fund expenditures, with the unassigned general fund balance portion to be equal to, at least, 13.67% of budget.

At the same time, it modified its debt policy with the following requirements:

- Total GO, moral obligation, and appropriation-backed debt is not to exceed 3.75% of total assessed value (AV);
- Total debt service not to exceed 10% of total general fund, school budgeted revenues, and state highway funding;
- The 10-year payout of all debt will not be less than 60%;
- Tax-supported debt will not mature over more than 30 years; and
- The city will provide cash funding for its five-year CIP.

Strong budgetary performance

Richmond's budgetary performance is strong in our opinion. The city had balanced operating results in the general fund of 0.1% of expenditures, and surplus results across all governmental funds of 1.8% in fiscal 2018.

The city closed fiscal 2018 with a modest $798,000 surplus, net of adjustments. Although general fund revenues came in 0.9% under budget (primarily property and sales taxes) and expenditures were 0.9% over budget, the city was able to close on a positive note. Leading revenue sources are diverse, with property taxes accounting for 37% of total general fund revenues, while total city taxes (which include sales, communications, machinery and tools, prepared foods, and lodging taxes) accounted for 46%. State aid accounted for 12%, while utility payments were 4.5%. The city charter requires public utilities to make payments-in-lieu-of-taxes (PILOTs) as if the properties were fully taxable. In addition, due to biannual billing, which began in fiscal 2011, Richmond eliminated the need for revenue anticipation notes that had ranged from $45 million to $75 million during the previous 20 years, thereby saving on interest costs. In addition, in fiscal 2018, it allocated $2.0 million of the surplus to the committed portion of fund balance as a contribution to the Richmond Retirement System, over and above the required annual contribution. We understand the city will make the decision annually if it will continue to make further allocations for pensions in subsequent-year budgets.

The city's fiscal year 2014, 2015, and 2016 comprehensive annual financial reports (CAFRs) were significantly delayed as a result of the implementation of a new accounting system without proper testing, among various other issues. The issue has since been rectified and the fiscal years 2017 and 2018 CAFRs was delivered earlier than expected.

Having just ended the fiscal 2019 year, the city is projecting (unaudited) to close with a healthy $24.3 million (after factoring in the encumbrance roll) surplus. From this surplus, city administration has proposed $8.9 million (meals tax) will be reserved for school capital needs, $7.2 million will be reserved for the Richmond Retirement System and to a lesser extent, finance various city capital needs and cover slight deficits in City Attorney's office. This is the first year to include the increased prepared meals tax revenues, which were increased from 6.0% to 7.5%. Revenues from the 1.5% increase in the prepared meals tax has been dedicated to the New School Investment Program and earmarked to fund three new schools, totaling roughly $150 million over the next few years. The first of the three schools is expected to be completed by the fall of 2020.

The fiscal 2020 adopted budget totals $746.2 million and has an increase in revenues of $26.3 million, or 3.65% over the prior year. The increase is due, in part, to the strong growth in several revenue categories, including property taxes (increasing $31.3 million) and other local taxes, which includes the newly implemented cigarette tax (increasing $5.0 million). The increase in property tax growth is largely due to strong tax base growth. Offsetting these increased revenues are an increase of $18.5 million for schools, a $4.9 million of general government and a 3% salary increase for employees.

Nonetheless, the fiscal 2020 budget remains in line with all reserve policies and factors in healthy tax revenue growth (primarily property and local). Given the healthy economy and more conservative budgeting practices, we do not expect the city's budgetary performance to change over the next few years.

Very strong budgetary flexibility

Richmond's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 20% of operating expenditures, or $134.1 million.

The city continues to work toward increasing its available reserves and despite a planned drawdown in fiscal 2015 for capital needs, has maintained reserves at very strong levels since 2014. Fiscal 2018 total available reserves, which include the $12 million revenue stabilization fund in the committed portion of the general fund balance, totaled $134.1 million or 19.9% of expenditures. Given the projection for another operating surplus for fiscal 2019 and management's commitment to continue to build on existing reserves, we do not believe the city's budgetary flexibility score will weaken over the near term. In addition, available revenues are in compliance with the city's own current formal policy.

Very strong liquidity

In our opinion, Richmond's liquidity is very strong, with total government available cash at 45.7% of total governmental fund expenditures and 5.5x governmental debt service in 2018. In our view, the city has exceptional access to external liquidity if necessary.

We believe the city has exceptional access to external liquidity as it has issued GO bonds and notes and utility revenues bonds frequently over the past 20 years.

Richmond has historically maintained revolving Lines of Credit with nationally recognized banking institutions. It has historically used its own cash or has drawn on its revolving credit line to fund capital projects and then periodically reimbursed itself with bond proceeds. In fiscal 2019, the city established two Lines of Credit to move forward with both its schools and city related capital needs. The series 2018A Line of Credit Bond Anticipation note was issued in the amount of $150.0 million to provide interim financing for the construction of new public schools being built in the City. The Line of Credit matures Nov. 1, 2022, at which time or before, the outstanding balance will be rolled into a long term General Obligation bond issue. The city also established the series 2018B, a $60.0 million Line of Credit Bond Anticipation Note to provide interim financing for the construction of general City Capital Improvement Projects. The Line of Credit has a final maturity date of Nov. 1, 2020, at which time or before, the outstanding balance will be rolled into a long-term GO bond issue. Given the city's very strong liquidity profile, we do not believe this to pose a liquidity risk.

Furthermore, the city does not have any investments we consider aggressive. Therefore, we do not expect the liquidity position to weaken in the near term.

Weak debt and contingent liability profile

In our view, Richmond's debt and contingent liability profile is weak. Total governmental fund debt service is 8.4% of total governmental fund expenditures, and net direct debt is 104.8% of total governmental fund revenue.

The city's five-year CIP (2020-2024) totals $462.8 million. While it includes all general fund city projects and Phase II New School Investment component of $200.0 million, it does not include utility enterprise fund projects or the previously adopted $150.0 million Phase I New School Investment component. The city's enterprise fund debt for gas, wastewater, water, and electric is all self-supporting. This issue will finance $90 million of the $150.0 million Phase I schools project with the remaining balance ($42.0 million) funded with the Line of Credit by fiscal 2022 and dedicated meals tax revenues of $18.0 million. Nonetheless, despite the additional school-related debt, the city is projected to remain in compliance with its debt policy. Although the tax base continues to grow, after layering in this issue, the overall net debt as a percentage of market values increases to 3.1%, and therefore no longer receives the positive adjustment, as per our criteria. As such, the debt and liability score shifts to weak. However, we believe the factor score could likely swing between adequate and weak in the near term depending upon continued growth in the tax base and how much additional debt the city plans to issue.

Given the growth in the tax base in recent years as a result of ongoing development, overall net debt has fallen below 3.0% of market value; and is considered a strength, in our opinion.

Richmond's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 6.7% of total governmental fund expenditures in 2018. The city made its full annual required pension contribution in 2018.

The city contributes to the Virginia Retirement System (VRS), a cost-sharing and agent multiple-employer defined-benefit pension plan administered by the VRS. City constitutional offices of the sheriff, courts, registrar, treasurer and a majority of the school board are eligible for participation in the VRS pension plan.

Richmond also maintains a defined-benefit retirement plan and a defined-contribution retirement plan for all city employees. It makes the required 100% pension contribution annually. All other city employees are participants in the Richmond Retirement System (RRS). As of June 30, 2018, the RRS pension obligation was 65.1% funded. Richmond, however, has taken significant steps to enhance the funded status by directing all general employee new hires into a defined-contribution plan and eliminating or reducing cost-of-living adjustments since 2006. Under GASB 67, the city net pension liability was $305.7 million as of June 30, 2018. The board has made several changes to the city's pension system which are expected to impact the system's funded status for the coming year. Effective for July 1, 2019, the board lowered the assumed rate of return from 7.5% to 7.0%, approved a newly released mortality table and dedicated an additional $2.0 million in revenues, over and above its required pension contribution in fiscal 2019. However, as a result of these changes, the funded status is expected to decrease by 4.4%, and the unfunded liability increases by $62 million with employer contributions expected to exceed $50 million in fiscal 2021.

OPEB payments have historically been made on a pay-as-you-go basis. However, recently city administration received council approval to participate in a pooled OPEB Trust to improve net position. The city utilized $250,000 of the fiscal 2018 surplus for an initial OPEB contribution to a pooled trust in fiscal 2019. This same amount has been built into the fiscal 2020 budget and is expected to be carried through in subsequent years' budgets as well.

The city's OPEB plan was amended in 2007 to only include participants who were currently retired or were active full-time employees hired prior to Jan. 1, 1997. General employees hired after this date are assumed to pay the full cost of the program with no implicit rate subsidy, and therefore, have no related liability. The city's unfunded OPEB liability was $80.4 million as of June 30, 2018. While we believe pension costs are manageable, given the below-average funding levels, rising costs could place pressure on future budgetary performance.

Very strong institutional framework

The institutional framework score is very strong.

Outlook

The stable outlook reflects the strong and growing MSA economy, which anchors the regional economy and employment base. The outlook further reflects the city's strong budgetary performance and very strong fiscal flexibility, and liquidity. Richmond is guided by very strong management that has implemented strong fiscal policies and practices and continues to do so, so we do not believe the rating will change within our two-year outlook horizon.

Upside scenario

If the city were to maintain sound fiscal operations and further strengthen reserves, while continuing to experience improvements in key economic indicators and future development, and while maintaining consistent debt and pension and OPEB levels, an upgrade may be warranted.

Downside scenario

Although unlikely, in our opinion, if the city were to encounter severe fiscal pressures and used reserves to bridge the imbalances, thereby reducing budgetary flexibility and liquidity levels, the rating could be lowered.

Related 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

Ratings Detail (As Of September 6, 2019)		
Richmond GO imp bnds (Federally Taxable)		
Long Term Rating	AA+/Stable	Affirmed
Richmond GO pub imp and rfdg bnds (Federally Taxable)		
Long Term Rating	AA+/Stable	Affirmed
Richmond GO		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.