FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Henrico County, VA's $115MM GOs 'AAA'; Outlook Stable

Mon 08 Jun, 2020 - 4:36 PM ET

Related Content:
Henrico County, Virginia

Fitch Ratings - New York - 08 Jun 2020: Fitch Ratings has assigned the following ratings to Henrico County, VA:

--Approximately $100 million Series 2020A GO bonds 'AAA';

--Approximately $15 million GO refunding bonds, Series 2020B 'AAA'.

These bonds are the fourth of five expected installments of the election of 2016 authorization. The proceeds of the Series 2020A bonds will be used to finance school capital improvement projects, road improvements, fire station and facilities projects, and recreation and parks facilities in the County pursuant to the 2016 voter authorization. The proceeds of the Series 2020B GO refunding bonds will be used to partially refund the Series 2011 bonds for debt service savings.

These bonds are scheduled for competitive sale on Tuesday, June 16, 2020.

Also, Fitch has affirmed the following outstanding ratings of the county:

--Issuer Default Rating (IDR) at 'AAA';

--Outstanding GO bonds at 'AAA';

--Outstanding lease revenue bonds at 'AA+'.

The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Henrico County (VA) [General Government]	LT IDR	AAA Rating Outlook Stable	Affirmed	AAA Rating Outlook Stable
Henrico County (VA) /General Obligation - Unlimited Tax/1 LT	LT	AAA Rating Outlook Stable	Affirmed	AAA Rating Outlook Stable
Henrico County (VA) /Lease Obligations - Standard - Henrico County Governmental Projects/1 LT	LT	AA+ Rating Outlook Stable	Affirmed	AA+ Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

SECURITY

The GO bonds are general obligations of the county, and the full faith and credit of the county is irrevocably pledged.

ANALYTICAL CONCLUSION

Analytical Conclusion: The 'AAA' IDR and GO ratings reflect the county's high fundamental financial flexibility and resilience to cyclical economic stress, its low liability burden and growing economic base supporting expectations for solid revenue growth absent policy action. The ratings on the lease revenue bonds are one notch below the IDR, reflecting the slightly higher degree of optionality associated with lease payments subject to appropriation. Fitch expects the county to manage through near-term fiscal pressures from the economic slowdown caused by the coronavirus pandemic.

Economic Resource Base

Henrico County surrounds the Commonwealth of Virginia's capital, the city of Richmond (GO bonds AA+/Stable), on the northern side of the James River. With an estimated 2019 population of 330,818 the county's population has increased 7.8% since 2010.

KEY RATING DRIVERS

Revenue Framework: 'aa'

Fitch expects long-term revenue growth to be above the rate of inflation on the basis of the county's sound economic and demographic fundamentals. The county enjoys high revenue flexibility given the independent legal ability to increase property taxes without limitation.

Expenditure Framework: 'aa'

Fitch expects the natural pace of spending to generally track revenue growth or marginally exceed it. Moderate carrying costs and broad flexibility to manage labor-related spending support the county's superior inherent budget flexibility.

Long-Term Liability Burden: 'aaa'

The county's overall debt and pension liability burden is low. Direct debt levels account for roughly one-third of the burden and should remain stable based on limited future debt needs and the rapid pace of debt amortization. Pension liabilities are the key driver of the liability burden and have been fairly stable.

Operating Performance: 'aaa'

The county's revenue and expenditure flexibility, strong reserves and modest revenue volatility support a high level of resilience to cyclical economic pressures. The county's budget management is strong as evidenced by its recent track record of surplus results and manageable deficits during the last recession.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Not applicable.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A deeper or longer sustained decline in the economy than currently anticipated could challenge the county's operating performance;

--A material and sustained increase in long-term liabilities above 10% of personal income without a commensurate rise in population or personal income.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Public Finance issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best-and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CURRENT DEVELOPMENTS

The recent outbreak of coronavirus and related government containment measures worldwide creates an uncertain global environment for U.S. state and local governments and related entities in the near term. While Henrico County's most recently available fiscal and economic data do not fully reflect impairment, material changes in revenues and expenditures are occurring across the country and likely to worsen in the coming weeks and months as economic activity suffers and public health spending increases. Fitch's ratings are forward-looking in nature, and Fitch will monitor developments in state and local governments as a result of the virus outbreak as it relates to severity and duration, and incorporate revised expectations for future performance and assessment of key risks.

In its baseline scenario, Fitch assumes sharp economic contractions to hit major economies in 1H20 at a speed and depth that is unprecedented since World War II. Sequential recovery is projected to begin from 3Q20 onward as the health crisis subsides after a short but severe global recession. GDP is projected to remain below its 4Q19 level until mid-2022. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the report entitled, "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update" (https://www.fitchratings.com/site/re/10120570), published April 29, 2020 and 'Fitch Ratings Updates Coronavirus Scenarios for U.S. State and Local Tax-Supported Issuers', published May 15, 2020 on www.fitchratings.com.

CORONAVIRUS IMPLICATIONS FOR HENRICO COUNTY

Henrico County's available fund balance at the end of fiscal 2019 was $266 million, or 33%, of total general fund spending following a larger-than-usual transfer out for capital expenditures. Accounting for planned budgetary responses to the coronavirus, the county expects to continue to meet its 15% reserve policy, based on the unassigned fund balance only, reflecting robust fiscal resilience.

County management has indicated data through April 2020 showed it was on track to finish the fiscal year well-above budget. Revenue intake is expected to slow through the remaining months of the fiscal year due largely to a reduction in sales, meals, and hotel tax collections. However, since growth was robust in the months leading up to the economic contraction, revenues are still expected to meet the original budgeted estimates for fiscal 2020 despite the slowdown. Management did indicate it has instituted a hiring and spending freeze to offset some of the revenue uncertainty in the final months of fiscal 2020. It has also received $38 million in Coronavirus Aid, Relief, and Economic Security (CARES) Act funding. The county expects to end the year with a lower than projected surplus and to utilize $20 million to $30 million of reserves for planned capital projects in fiscal 2020.

Fiscal 2021 reserve balances are expected to remain robust despite near-term fiscal and economic pressure. The Fitch Analytical Sensitivity Tool (FAST) output suggests Henrico County is moderately exposed to a downturn based on Fitch's baseline scenario of a 5.6% annual contraction in national GDP. The county's fiscal 2021 general fund revenue projections (less state aid for schools) were decreased to $756 million in May 2020, a decrease of about 8.1%, or $67 million, from the March 2020 adopted budget. Non-ad valorem taxes (primarily driven by sales, hotel and meals taxes) makes up about 20% of general fund budget and contributed the largest share of the decrease with performance expected to be 20% below initial projections.

In order to mitigate the anticipated fiscal 2021 revenue decline, the county made revisions to its budget so that revenues match expenditures. Revisions included decreasing transfers for capital and solid waste, applying 5% cuts to departmental operating budgets and extending a hiring freeze. Though not expected or planned, the county also retains significant flexibility to manage workforce costs in the absence of collective bargaining. Management also expects a minimal use of fund balance ($3 million).

Given the county's budget flexibility and level of reserves, Fitch expects Henrico County to maintain an 'aaa' level of resilience through the near-term pressure.

CREDIT PROFILE

The local employment base is substantial and diverse, representing over a quarter of the Richmond metropolitan statistical area's employment base. Two fortune 500 companies, Altria (tobacco manufacturer) and Genworth (financial services) base their headquarters in Henrico County, with the former recently expanding its corporate headquarters facility. The county is targeting investment from the data center sector due to the proximity of a new transatlantic fiber optic cable that will connect North America to Europe through Virginia. Facebook is currently constructing a 2.4 million sf data center, which is a $1.75 billion investment with 200 full-time employees. The county's employment base has expanded in recent years, keeping the unemployment rate historically below the nation's rate and in line with the Commonwealth.

Revenue Framework

The county relies mostly on property tax revenues, which were 55% of general fund revenues in fiscal 2019. Other taxes (meals and business license) and sale taxes account for almost a third of general fund revenues.

Fitch expects long-term revenue growth to trend above the level of inflation. The 10-year compound average growth rate of 2% through fiscal 2019, which is above inflation, is not adjusted for reductions in the machinery and tools, aircraft or data center personal property tax rates, or the implementation of a meals tax in fiscal 2015 that has generated over $28.6 million in new revenue on average annually (in comparison to more than $815 million in general fund revenue in fiscal 2019). Given notable tax base growth and a robust pipeline of economic activity, Fitch expects future revenue growth to trend above inflation, but below national GDP. The fiscal 2019 taxable assessed value (TAV) was $46 billion or 6.3% above the prior year, and the estimated fiscal 2020 TAV is $47.6 billion or a 4% annual increase.

Fitch's revenue framework assessment is also supported by high revenue raising ability provided by the unlimited property tax rate and levy.

Expenditure Framework

The county's largest expenditure is education at roughly 35% of general fund expenditures, followed by public safety at about 30%. Virginia public schools are largely funded by a mix of state and local aid contributions, the latter being subject to satisfaction of state determined performance standards for the school system rather than enrollment.

Fitch expects the natural pace of spending growth to remain generally in line with, to marginally above revenue growth given steady population and manageable education spending needs.

Fixed carrying costs associated with debt service, actuarially determined pension payments and other post-employment benefits (OPEB) actual payments consumed 11% of fiscal 2019 governmental spending. The county has broad discretion over the terms of employee wages and benefits given the absence of collective bargaining. Fitch believes the county's pay-go capital spending, including a $69 million transfer (approximately 8% of fiscal 2019 spending) to the capital projects fund in fiscal 2019, provides additional flexibility, which is a much higher transfer than in prior years.

Long-Term Liability Burden

Overall net debt plus the county's Fitch-adjusted net pension liability (NPL) is low at approximately 8% of resident personal income, with the adjusted NPL making up the majority of the liability. The county's capital improvement program anticipates spending about $1.3 billion between fiscal 2021 and fiscal 2025, excluding capital spending for enterprise utility funds. The plan has about $800 million in planned expenditures that do not correspond with any form of payment such as a bond issuance or general fund transfer. Given the currently low debt burden and rapid principal amortization (65% in 10 years following the current refunding), the overall debt burden is expected to remain low notwithstanding the potential for additional new money issuance for the capital improvement program or other purposes.

The county participates in the statewide Virginia Retirement System (VRS), an agent multiple-employer defined benefit pension plan. All county employees, including county school board and nonprofessional employees participate in VRS. As of the June 30, 2018 measurement date, aggregate fiduciary assets covered approximately 71% of total pension liabilities when adjusted by the Fitch standard 6% rate of return assumption (VRS's reported asset to liability ratio is 80% at its 7% return assumption). The Fitch-adjusted aggregate NPL is over approximately $956 million or about 4% of personal income.

The county provides limited OPEB and the outstanding net liability is minimal relative to personal income. The aggregate net OPEB liability is approximately $85 million or less than a half of 1% of personal income.

Operating Performance

Given the county's superior inherent budget flexibility in the form of control over revenues and spending, Fitch expects the county to manage through cyclical economic downturns while maintaining a high level of fundamental financial flexibility. The general fund recorded a modest $115 thousand operating surplus in fiscal 2019, including the $69 million transfer out to the capital projects fund. The unrestricted general fund balance of $266 million in fiscal 2019 was a high 32.6% of general fund spending. The county also reported a balance of $281 million in the capital reserve fund that will be used over time to fund the capital improvement plan but could be used for general fund purposes if needed.

The county exhibited strong budget management and resilience in the most recent recession by instituting a hiring freeze, offering a retirement incentive, refunding debt and making department budget reductions among other measures. Those operational changes are similar measures to what the county is doing during the current economic contraction.

The fiscal 2021 adopted and revised general fund budget of $756 million is a 3.4% and 8.1% decrease from the original fiscal 2021 and fiscal 2020 budget. A minimal usage of $3 million from general fund balance has been appropriated in the revised fiscal 2021 budget and a planned usage of fund balance for capital needs is expected to have been utilized during the current fiscal year. The budget still dedicates about 80% to school funding and public safety with the county contributing well above their required local effort. Just under half of the school funding is expected to come from local resources. Given the county's history of conservative budgeting, Fitch expects operating performance to remain at an 'aaa' assessment.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria -- Effective 3/27/20--5/4/21 (pub. 27 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Henrico County (VA)	EU Endorsed
Henrico County Economic Development Authority (VA)	EU Endorsed

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