FitchRatings

FITCH RATES RICHMOND, VA'S $227.15MM GOS 'AA+'; OUTLOOK STABLE

Fitch Ratings-New York-16 June 2017: Fitch Ratings has assigned a 'AA+' rating to the following Richmond, VA general obligation (GO) bonds:

--$183.49 million GO public improvement and refunding bonds, series 2017B;
--$43.665 million GO public improvement refunding bonds, series 2017C (federally taxable).

Bond proceeds will be used to refund various series of bonds and several capital improvement projects. The bonds are expected to sell through competitive sale during the week of June 26th.

In addition, Fitch has affirmed the following Richmond, VA ratings:

--Issuer Default Rating (IDR) at 'AA+';
--$699.7 million GO bonds at 'AA+'.

The Rating Outlook is Stable.

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

KEY RATING DRIVERS

The 'AA+' IDR reflects the city's strong operating performance, a solid revenue framework, and a moderate liability burden, all supported by a growing economic base.

Economic Resource Base
The city of Richmond, which is the Virginia state capital, is situated on the Interstate 95 corridor at the midpoint of the eastern seaboard, 107 miles south of Washington, D.C., and 93 miles northwest of Norfolk. With a 2016 population of 223,170, the city's population has increased by an average annual rate of 1.3% since 2010.

Revenue Framework: 'aa' factor assessment
General fund revenues are primarily funded from property taxes which have been generally in line with inflation over the last decade. Fitch expects this trend to continue. The city retains an unlimited legal ability to adjust the property tax rate, resulting in notable capacity to respond to a revenue decline in an economic downturn scenario.

Expenditure Framework: 'aa' factor assessment
Expenditures have grown at about the pace of revenues, and Fitch expects that trend to continue. 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' factor assessment
Overall debt combined with the Fitch-adjusted unfunded pension liability is moderate at about 14% of the city's personal income.

Operating Performance: 'aaa' factor assessment

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 during cyclical economic downturns.

RATING SENSITIVITIES

STABLE CREDIT PROFILE: The rating assumes continued slow revenue growth. A material improvement in Fitch's expectations for revenue growth prospects and a reduction in the long-term liability profile could put positive 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, has gained 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 city's employment base continues to expand with growth notably outpacing the state and national rates in most years. As such, the unemployment rate is below the national average. The city's poverty rate is high at 26% and wealth indicators are weak with median household income at just 63% and 76% of the state and national average respectively.

Revenue Framework

The city relies on a combination of property, and sales and other taxes, which equate to 42% and 20% of general fund revenues, respectively, in fiscal 2016, as well as intergovernmental revenues (16%).

General fund revenues have grown ahead of inflation over the 10 years through 2016, but have slowed to be generally in line with inflation in recent years. This period includes several property tax rate reductions 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 second consecutive year and the estimated 2017 valuation reflects a 3% increase. According to the most recent Zillow report, home values are 115% of prerecession levels and the one-year forecast shows a 4% increase. Given the combination of valuation growth and the pipeline of investment underway in the city, revenue growth prospects continue to be positive but slow over the near term, generally consistent with historical results.

The city is not subject to any limitation on its property tax rate or levy.

Expenditure Framework

The city's largest expenditure category is public safety at roughly 29% of general fund expenditures, followed by education at 27%.

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

Virginia public schools are largely funded by a mix of state and local aid contributions. The amount of local contributions is determined by city management, and based on the state-determined performance standards for the school system. The city's 2017 budget includes $57.5 million (approximately 8% of the fiscal 2017 general fund budget) in additional funding over the required local effort (RLE). The city has the legal ability to reduce spending to the RLE level, affording the city notable flexibility.

The city's fixed-cost burden is moderate, with carrying costs for debt, pensions, and other post-employment benefits (OPEB) equaling about 16.7% of fiscal 2016 governmental expenditures, with debt service accounting for just over 10%. The 10-year principal amortization rate is over 65%.

Long-Term Liability Burden
Overall net debt plus the city's and school's adjusted unfunded pension liability is moderate at about 14% of personal income. The city's five-year capital improvement plan (CIP) for 2018-2022 totals $175.5 million and includes total borrowing of over $112 million, compared to approximately $846.8 million of outstanding debt, following this issuance. The plan mostly funds public safety and transportation projects. Fitch does not expect much of an impact on the debt burden from the additional borrowing.

City employees participate in one of two pension plans and may also participate in a deferred compensation plan. Adjusted for a 6% return, the aggregate adjusted unfunded net pension liability totals about $454 million or approximately 4% of personal income.

The school board is a component unit of the city and reports a net pension liability for teachers at $387 million, or an additional 4% of personal income, based on a 6% return on net assets.

The city funds OPEB on a pay-go basis. As of the 2015 valuation the unfunded liability was approximately $70 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 periods yielding an adjusted 1% decline via FAST in Fitch's standard -1% U.S. GDP scenario. Revenue losses could be offset in part through the use of a portion of the city's unrestricted fund balance, which stood at over $114 million or 16.6% of spending in 2016.

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.

The fiscal 2017 adopted budget for the general fund is $717 million, an increase of $28 million, or 4% over the fiscal 2016 budget. The budget includes no change to the tax rate and no appropriation of fund balance; however, several fee increases were implemented during the budget implementation. The budget increase will mostly fund a $5.5 million increase in local funding of Richmond Public Schools' operating budget and a $10.7 million increase for public safety. As of the third quarter of fiscal 2017, revenues and expenditures are generally trending within 1% of budget.

The fiscal 2018 adopted budget is a 3.7% reduction over fiscal 2017. The reduction is reflective of categorical changes in the general fund. The budget keeps the tax rate stable and does not use fund balance.

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

Applicable Criteria
U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017)
https://www.fitchratings.com/site/re/898466