FitchRatings

RATING ACTION COMMENTARY

# Fitch Rates Prince William County, VA's $84.8 Million GOs 'AAA'; Outlook Stable

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Fitch Ratings - New York - 21 May 2020: Fitch Ratings has assigned a 'AAA' rating to the following general obligation (GO) bonds to be issued by Prince William County (VA):

--$26 million GO public improvement refunding bonds, series 2020A;

--$58.8 million GO public improvement refunding bonds (taxable), series 2020B.

The competitive tax exempt series A bonds and the negotiated taxable series B bonds are expected to sell the week of May 25. Proceeds of the public improvement refunding bonds will be used to refinance a portion of outstanding GO and Virginia Public School Authority (VPSA) bonds for savings.

In addition, Fitch has affirmed the following county ratings:

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

--$599.6 million outstanding GO bonds issued by the VPSA at 'AAA';

--$34.9 million outstanding county GO bonds at 'AAA';

--$20.6 million outstanding county refunding COPs, series 2013 at 'AA+';

--$19.3 million outstanding county lease obligations issued by the Industrial Development Authority (IDA) at 'AA+';

--$3.3 million outstanding county refunding lease participation certificates, series 2010 at 'AA+'.

The Rating Outlook is Stable.

## SECURITY

VPSA bonds are payable from county debt service payments on underlying GO bonds on behalf of the school board, which are held by the VPSA and pledged to the payment of the bonds.

County GO bonds are general obligations of the county, payable from its full faith and credit pledge and unlimited taxing power.

Lease obligation bonds are backed by lease payments equal to debt service and subject to annual appropriation by the county board.

## ANALYTICAL CONCLUSION

The 'AAA' IDR reflects the county's superior gap-closing capacity and budget flexibility, and its unlimited ability to raise revenues. Fitch expects the county to maintain a high level of financial flexibility given its solid operating performance, healthy available fund balance, and moderate liability burden. The one-notch distinction between the IDR and the lease obligation bond ratings reflects the slightly higher degree of optionality associated with appropriation payments.

## ECONOMIC RESOURCE BASE

The county is located in northern Virginia, less than 25 miles southwest of Washington, D.C. The county's population reached an estimated census population of 470,335 in 2019, up 17% since 2010.

## KEY RATING DRIVERS

**Revenue Framework: 'aa'**

Fitch expects the natural pace of growth over time to be in line with the level of inflation given expected tax base growth. The county enjoys strong control over revenues given the independent legal ability to increase property taxes without limitation.

**Expenditure Framework: 'aa'**

Fitch expects the natural pace of spending growth to generally track or marginally exceed natural revenue growth. Moderate carrying costs and broad flexibility to manage labor-related costs afford the county solid flexibility to adjust spending.

**Long-Term Liability Burden: 'aa'**

The combined burden of debt and Fitch-adjusted net pension liabilities has decreased to about 9.4% of personal income. About 56% of the burden stems from the county's and county school's participation in the Virginia Retirement System (VRS). Fitch expects debt to slowly increase as the county plans to annually issue debt to meet school and other county capital needs. Somewhat offsetting the debt pressure is the rapid pace of debt amortization and the population and income gains leading to an increasingly large personal income resource base. Fitch expects the liability burden to be moderate over the long term even with the issuance of this debt.

**Operating Performance: 'aaa'**

The county's superior budget flexibility and ample general fund balance allow it to comfortably manage through economic downturns without diminishing its overall financial flexibility.

## RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

--Not applicable for an 'AAA' rating.

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

--A material long-term reduction in the county's tax base, resulting in an extended decline in the county's revenue growth prospects;

--Economic contraction extending well into the second half of the year or beyond, consistent with Fitch's coronavirus downside scenario, which triggers declines in the county's ability to maintain reserves in line with its current gap-closing capacity;

--A material shift in the county's traditionally conservative budgeting practices.

## 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 coronavirus outbreak and related government containment measures worldwide create an uncertain global environment for U.S. state and local governments and related entities in the near term. While Prince William County's most recently available fiscal and economic data may not fully reflect impairment, material changes in revenues and expenditures are occurring across the country and is 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.

The county has been approved to receive $41 million in CARES Act funding to reimburse coronavirus-related expenses in addition to an allotment of $9.3 million dedicated to public school funding within the county. As of May 2020, the county spent $3.6 million on PPE and other related expenses and is currently projecting coronavirus-related expenses to total about $8 million for fiscal 2020. The county's conservative assumptions project general fund revenues could come in $4.8 million below the adopted forecast for fiscal 2020. The county expects to offset a potential shortfall in total general fund revenues of up to $7 million through anticipated expenditure savings of roughly $13.5 million-$16 million at year-end. To mitigate the financial impacts of the coronavirus, the county also implemented a hiring freeze, halted discretionary spending and deferred capital projects not under contract. The adopted fiscal 2021 budget generates $31.5 million in additional general fund revenues over fiscal 2020, primarily due to increased property values and overall property tax base growth.

## CREDIT PROFILE

The county benefits from being part of the Washington, D.C. metropolitan area, its relative affordability compared to neighboring counties and a well-educated workforce. Its stable economic base, rooted in government and military employment, has expanded to encompass the targeted industries of life sciences, information technology and federal government agencies and contractors. The number of data centers in the county continues to increase in and outside of

Innovation Park and now stands at 41 data centers, a $9 billion investment providing 1,170 new jobs. Currently, 18 new data center projects are in the pipeline with a total investment of roughly $6.7 billion and are expected to generate 570 new jobs. The county's employment base has outpaced growth in the greater D.C. metro area in recent years. Unemployment rates typically trend below state and national averages.

The presence of the Marine Corp Base Quantico along with the addition of the FBI Northern VA satellite office help to attract contractors and federal agencies. Since nearly 20% of available land within the county is owned by the federal government, the county remains exposed to changes in federal defense spending, which has been volatile over the past decade, particularly during the Great Recession. However, Prince William County's installations fared well through previous BRAC realignments. The U.S. Department of Defense is the county's third-largest employer but the federal government currently represents just 5% of the resident employment base.

**REVENUE FRAMEWORK**

The county primarily relies on property tax revenues, totaling 70% of general fund revenues in fiscal 2019. The next largest category was intergovernmental revenues at 14% from state and federal sources for schools and other social services.

The county's 10-year general fund revenue CAGR, adjusted for real property tax rate changes, has experienced inflationary growth at about 1.6% through fiscal 2019. The county's taxable assessed base was hit very hard during the recession with a peak to trough decline of 33%. As of fiscal 2018, the tax base has largely returned to pre-recession levels after several years of strong growth due to ongoing economic development as depicted in solid construction permit data and continued home value appreciation. The fiscal 2019 taxable assessed value (TAV) of $67.6 billion is a 6% increase over 2018. The budgeted fiscal 2020 TAV for real property only is up 4% yoy. Fitch expects a long-term trend of at least inflationary natural revenue growth.

The Commonwealth of Virginia does not limit the property tax rate or levy, affording the county significant independent revenue-raising authority. The county's fiscal 2021 tax rate of $1.125 per $100 of assessed value has been relatively stable since a decrease in 2016 to $1.122 from the $1.148 rate for 2015.

## EXPENDITURE FRAMEWORK

The county's largest expenditure category is education, at roughly half of fiscal 2019 general fund expenditures, followed by public safety at 23%. Virginia public schools are largely funded by a mix of state and local aid contributions. The amount of local contribution is determined by the county's board, and based on the state-determined performance standards for the school system, known as the required local effort (RLE). A revenue sharing agreement between the county and the component unit school district diverts 57% of general fund revenue to fund the district's budget. The agreement has had a few minor adjustments in its 20-year life, including a fairly minor change in fiscal 2014 to increase revenue for schools.

Fitch expects the natural pace of spending growth to be in line with to marginally above natural revenue growth, given the county's full control over employee wages and benefits, as well as its manageable debt service and retiree benefit costs.

The county's fixed carrying cost burden is moderate, with costs for debt, pensions, and other post-employment benefits (OPEB) equaling 14% of fiscal 2019 total governmental expenditures. Debt service accounts for the majority of costs at roughly 11%. The amortization rate of debt is above average at approximately 75% of debt retired in 10 years. The county contributes to five other post-employment benefit plans. During fiscal 2019, the county funded contributions for pensions and OPEB at the aggregate actuarially determined contribution (ADC) level. Expenditure flexibility also benefits from the state's workforce environment that provides broad legal ability to manage labor-related costs.

## LONG-TERM LIABILITY BURDEN

The county's long-term liability burden associated with total net debt and the county's and component unit schools' Fitch-adjusted net pension liability is roughly 9.4% of residents' personal income. The county's six-year capital improvement plan from 2021-2026 of $541.6 million (excluding school capital plans) is approximately $63 million debt funded (less than 1% of personal income).

The voter-approved November 2019 bond referendum includes $355 million for road and mobility projects and $41 million for parks. The county plans to issue this debt over an eight-year period. Fitch expects the liability burden to moderate over the long term even with the issuance of this debt.

The county participates in the state-administered VRS for regular full-time employees as does the component unit school district for teachers and non-professional employees. The county also maintains a small supplemental defined benefit retirement plan for police officers, uniformed fire and rescue personnel, uniformed adult detention center staff and sheriff employees and a volunteer fire and rescue personnel length of service award program (LOSAP). On a combined basis, the net pension liability totals roughly 6% of personal income, largely due to the net pension liability for the teachers' plan. The combined ratio of net assets to liabilities is currently about 70% using Fitch's standard 6% investment return assumption.

Positively, the county makes full actuarial payments to fund OPEBs producing a very small net liability of 0.2% of personal income. Assets are held in the OPEB Master Trust Fund to fully fund the OPEB liability for the county and schools. Assets held in trust totaled $87.2 million at the end of fiscal 2019.

## OPERATING PERFORMANCE

The county has a superior level of inherent budget flexibility, with unlimited independent revenue raising capacity and solid spending flexibility to manage through economic cycles. Fitch expects the county to maintain a high level of financial flexibility through the current economic downturn, with reserves remaining above the county's unassigned fund balance goal of 7.5% of revenues. The county also maintains a 2% capital reserve, a 2% revenue stabilization reserve and $3 million in its economic development opportunity fund reserve as part of the committed general fund balance. The fiscal 2019 unrestricted general fund balance of $185.3 million was a healthy 15% of spending. The county has additional reserves held outside of the general fund that are accessible with board approval, providing additional flexibility.

The county demonstrated its financial resilience and strong budget management through the most recent recession by raising tax rates, deferring most non-school capex, reducing the overall operating budget, implementing a temporary freeze on compensation increases and making a limited number of reductions-in-force, among other measures. Fitch expects the county to make similar operational changes as needed during the current economic downturn and continue to update its very thorough long-term comprehensive plans and detailed forecasting reports.

According to management's preliminary fiscal 2020 YE operating results, general fund revenues for 2Q20 compared to the adopted forecast could yield a range of outcomes, from a deficit of $4.8 million to a surplus of $2.7 million. Both scenarios assume growth in real and personal property tax revenues and declines in various revenue sources, including sales tax, communications tax, BPOL tax and investment income. Though current projections show a shortfall in total general fund revenues of about $5 million-$7 million for fiscal 2020, the county plans to reconcile this gap through expenditure savings of approximately $13.5 million-$16 million at fiscal year-end. The county expects coronavirus-related expenses to be reimbursed from the Commonwealth through CARES Act monies.

The adopted fiscal 2021 general fund budget of $1.1 billion is $40 million less than the originally proposed budget due to the coronavirus outbreak, and approximately 9% less than the adopted fiscal 2020 budget. The budget keeps the real property tax rate stable and includes an $18.1 million (roughly 3.2%) increase in school transfers in accordance with the revenue sharing agreement. According to the county, general fund revenue projections now show a $31.5 million increase in additional revenues over fiscal 2020, mainly due to real estate tax base growth and increased personal property tax revenues. Fitch expects the county will continue to budget conservatively while exercising strong budget management practices through economic cycles and maintain reserves sufficient to retain the highest gap-closing capacity.

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.

## RATING ACTIONS

| ENTITY/DEBT | RATING | | |
|---|---|---|---|
| Prince William County (VA) [General Government] | LT IDR | AAA | Affirmed |
| • Prince William County (VA) /Appropriation Supported/1 LT | LT | AA+ | Affirmed |
| • Prince William County (VA) /General Obligation - Unlimited Tax/1 LT | LT | AAA | Affirmed |

VIEW ADDITIONAL RATING DETAILS

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## APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (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

| | |
|---|---|
| Prince William County (VA) | EU Endorsed |
| Prince William County Industrial Development Authority | EU Endorsed |
| Virginia Public School Authority | EU Endorsed |

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