Davenport & Company

Financial Status Report Bond Rating/Fund Balance Update/Next Steps

City of Petersburg, Virginia

April 6, 2021

Topics to be Addressed

- Background.
- Credit Rating History.
- Why Unassigned Fund Balance (or “Reserves”) Matters.
- History of the City of Petersburg’s Unassigned Fund Balance (Reserve) levels.
- Fund Balance Comparatives.
- Credit Rating Agency/GFOA Commentary.
- Next Steps.

Background

- The City of Petersburg (The “City”) established a series of Financial Policy Guidelines which included Unassigned Fund Balance (or “Reserve”) levels in 2014.

- In addition, the City’s Financial Policy Guidelines also called for a structurally balanced budget wherein recurring revenues are sufficient to meet all recurring expenditures.

- Because the City had been using its Unassigned Fund Balance and had a history of unbalanced budgets, its Credit Rating was down graded in 2014 to “BBB” from “A+”

- By 2016, the City’s finances had reached a critically low point, which resulted in a further Credit Rating downgrade to “BB” from “BBB”

- Over the past 4 years (Since 2017):
  - The City’s fiscal health has rebounded and as such Unassigned Fund Balance (Reserve) levels have dramatically improved.
  - Over the same time period, the City has received 3 Credit Rating Upgrades – *The most recent upgrade is to “BBB+” from “BBB-” with a Positive Outlook.*

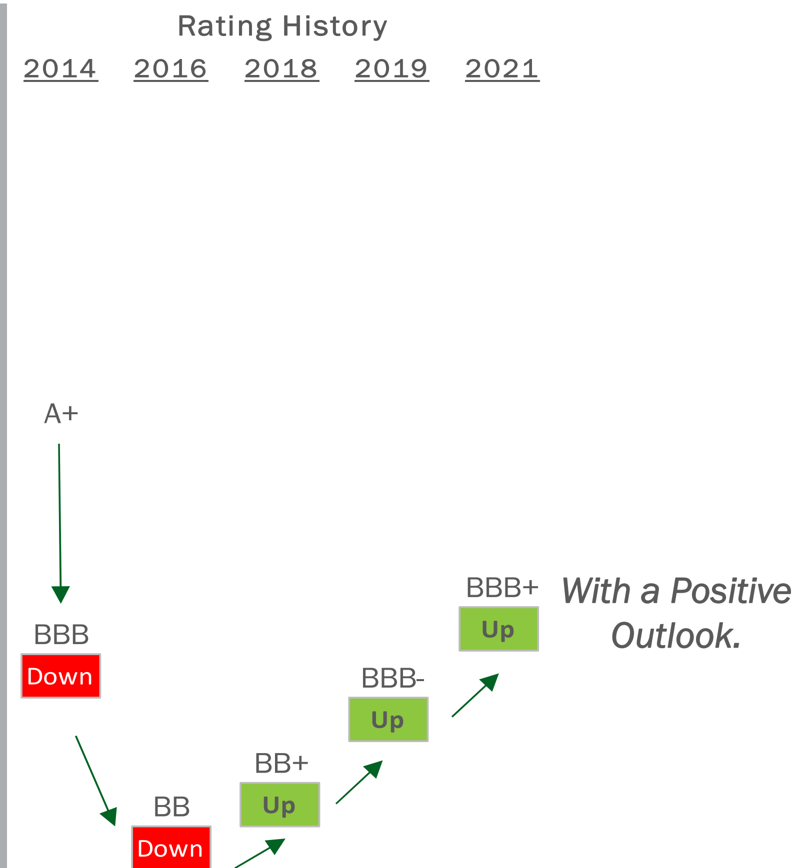
Petersburg's Credit Rating History

- The table below shows the rating categories from the three National Credit Rating Agencies and the City's rating history since 2014 from S&P.

		Fitch	Moody's	S&P
Top tier "Highest Possible Rating"		AAA	Aaa	AAA
2nd Tier "Very Strong"	(Highest)	AA+	Aa1	AA+
	(Middle)	AA	Aa2	AA
	(Lowest)	AA-	Aa3	AA-
3rd Tier "Strong"	(Highest)	A+	A1	A+
	(Middle)	A	A2	A
	(Lowest)	A-	A3	A-
4th Tier "Adequate Capacity to Repay"	(Highest)	BBB+	Baa1	BBB+
	(Middle)	BBB	Baa2	BBB
	(Lowest)	BBB-	Baa3	BBB-
5th - 10th Tiers "Below Investment Grade"		BB, B, CCC, CC, C, D		

= Current Rating

= Prior Rating



S&P Credit Rating Commentary

- The City's most recent Credit Rating ***upgrade to "BBB+" from "BBB-"*** represents a "double or two-notch upgrade" and ***along with the Positive Outlook shows that the City is on the right financial trajectory.*** S&P has indicated that:

"The upgrade reflects our view of Petersburg's continued achievement in rebuilding a sound financial position, including increased reserves and liquidity, such that short-term cash flow borrowing is no longer necessary."

- During the rating process, S&P evaluates four primary criteria (Economy. Management, Finances, Debt/Pensions).
  - As cited above, "increased reserves and liquidity" - which is reflected by the City's Unassigned Fund Balance - is arguably the single most important financial metric to the rating agencies.

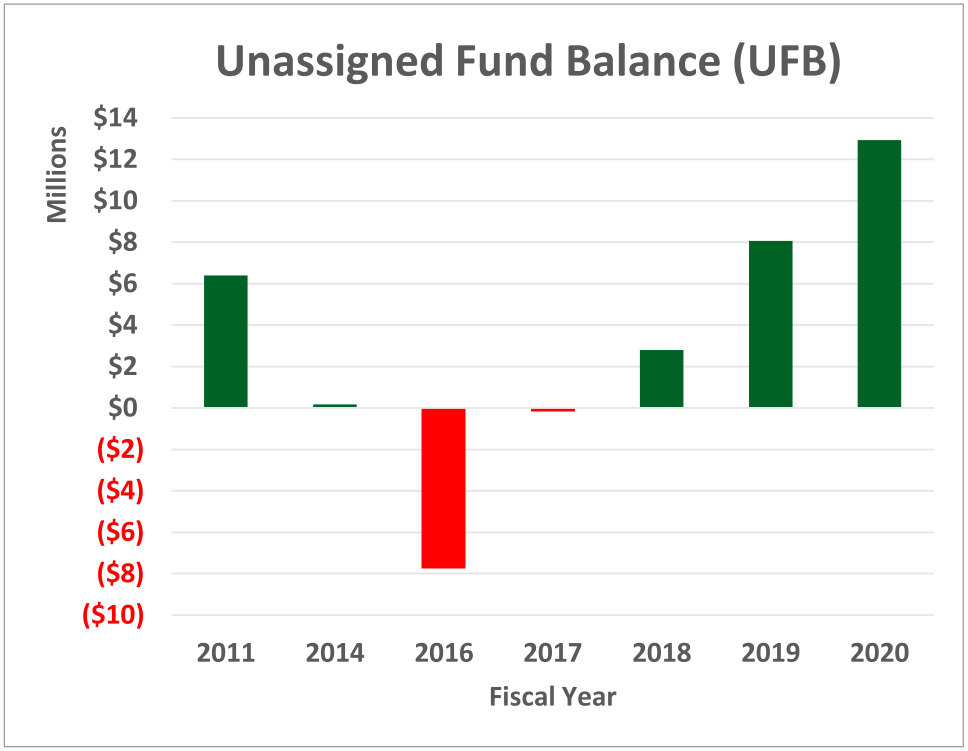
S&P's positive outlook indicates that the City has a 1 in 3 chance of an additional Bond Rating Upgrade in the next 12 to 24 months, but that future upgrades are based on their expectation that the city's management team will maintain fiscal balance and potentially bolster liquidity and reserve levels, while continuing to adopt structurally balanced budgets and making full and timely payment on all its obligations.

Why Unassigned Fund Balance Matters

- Allows the City to fully cash flow its month-to-month operations and avoid costly Tax Anticipation Notes ("TANs") /Revenue Anticipation Notes ("RANs").
- Enables the City to earn interest income, which helps the General Fund and alleviates pressure on tax rate(s).
- Serves as the single most important factor for credit ratings.
- Enables the City to borrow at lower interest rates, which in turn, provides for lower debt service and potential refunding opportunities for debt service savings.
- Excess Unassigned Fund Balance can be used for one-time capital investment and economic development purposes.

History of Petersburg's Unassigned Fund Balance

- Over the past 4 years, the City fiscal health has rebounded and as such Unassigned Fund Balance (Reserve) levels have dramatically improved.



FY	UFB Amount ($mil)	UFB % of Expenditures	S&P Credit Rating
2011	$6.4	7.9%	A+
2014	$0.2	0.2%	BBB
2016	($7.7)	(10.8%)	BB
2017	($0.1)	(0.2%)	BB
2018	$2.8	3.8%	BB+
2019	$8.1	10.6%	BBB-
2020	$12.9	17.5%	BBB+

Source: City of Petersburg audited financial statements.

Existing Unassigned Fund Balance Policy

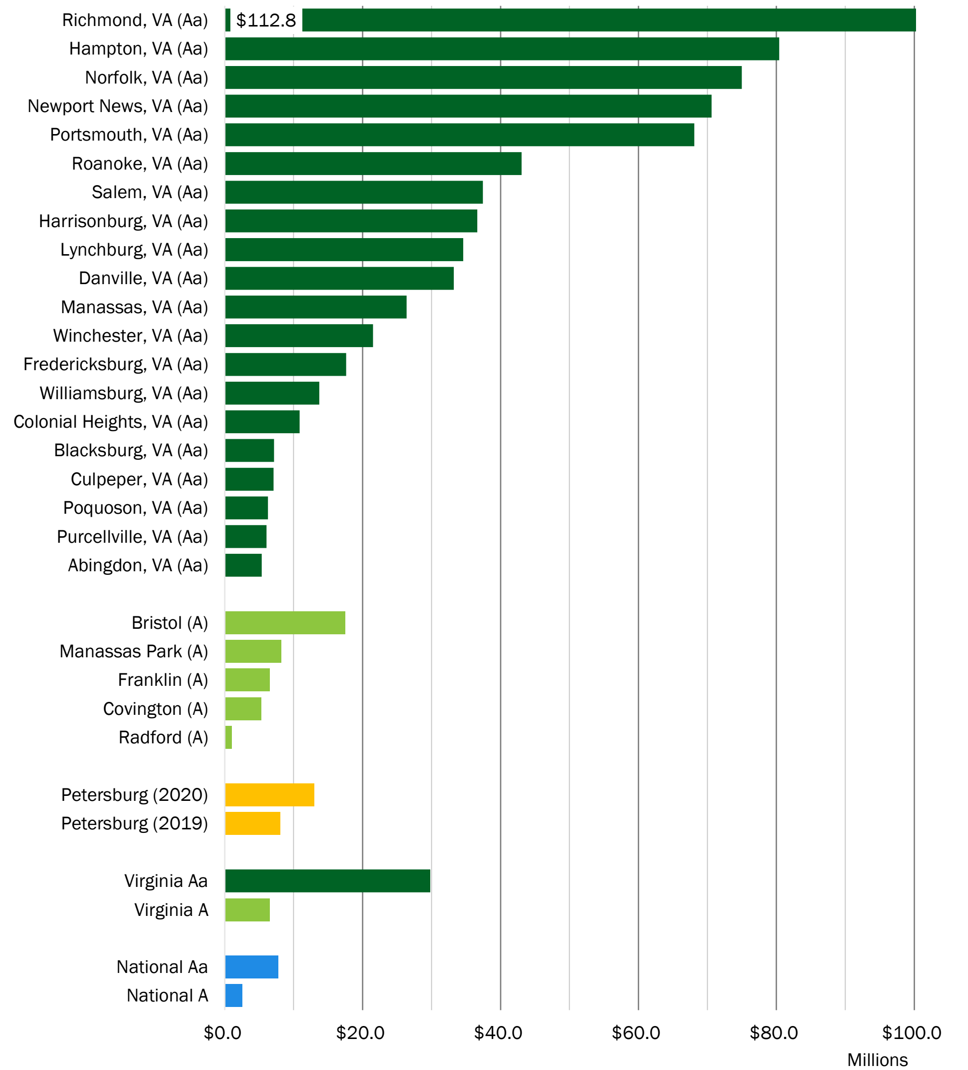
- Key Tenets - Unassigned Fund Balance shall:
  - Be comprised of liquid cash and investments.
  - Consist of a sufficient amount to meet the City's cash flow needs and allow the City to avoid the use of TANs/RANs (i.e. cash flow borrowing).
  - Allow for a margin of safety against unforeseen expenditures.
  - Not be used for annual recurring expenditures, except in the event of unforeseen emergency circumstances.

- Existing Unassigned Fund Balance Policy Target (Adopted July 2020):
  - The City shall have a Minimum Initial Target Unassigned Fund Balance that represents 30 days of its General Fund Operating Expenditures.
    - The budget will include $1 Million annually toward the Unassigned Fund Balance; Upon reaching the Minimum Initial Target the City shall budget $500,000 toward Fund Balance Replenishment and $500,000 toward Pay-Go Capital Projects.
  - Within 3 years following the City meeting the Minimum Initial Target, the City shall increase the Unassigned Fund Balance to a level that represents 60 days of its General Fund Operating Expenditures.

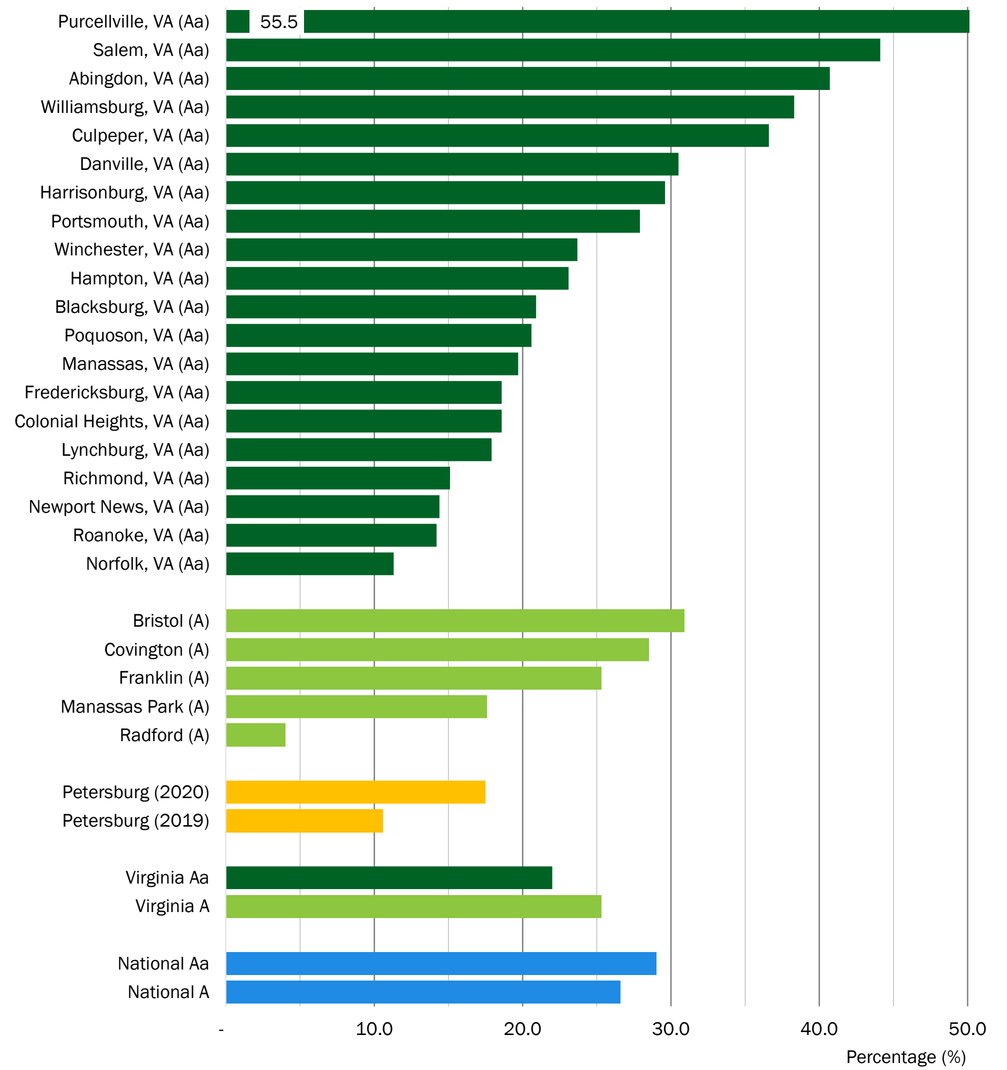
Peer Comparison | Unassigned Fund Balance

- The City's FY 2020 and Unassigned Fund Balance levels are compared with selected "Aa" and "A" rated cities below.

Unassigned Fund Balance ($)



Unassigned Fund Balance as a % of General Fund Revenues



Source: Moody's MFRA, FY 2020 audited financial statements.

Rating Agency Methodology | Moody’s

Moody’s Rating Methodology

Category	Rating Percentage	Short-Term Control	Long Term Control
1. Economy / Tax Base	30%		✓
2. Finances	30%	✓	✓
3. Management	20%	✓	✓
4. Debt / Pensions	20%	✓	✓

- Finances (i.e. Fund/Cash Balances and trends) is the single most important criteria from the Credit Rating Agency’s perspective and comprise 30% of the credit rating evaluation.

Source: Moody’s Investors Service

Rating Agency Methodology Updates | S&P

S&P Rating Methodology

Category	Rating Percentage	Short-Term Control	Long Term Control
1. Institutional Framework	10%		✓
2. Economy	30%		✓
3. Management	20%	✓	✓
4. Budgetary Flexibility	10%	✓	✓
5. Budgetary Performance	10%	✓	✓
6. Liquidity	10%	✓	✓
7. Debt and Contingent Liabilities	10%	✓	✓

- Budgetary Flexibility/Liquidity (i.e. Fund/Cash Balances) are collectively 20% of the credit rating evaluation and are critical factors from the Credit Rating Agency's perspective.

Source: Standard & Poor's

GFOA Commentary on Fund Balance (Reserves)

- GFOA recommends that governments establish a formal policy on the level of unrestricted fund balance that should be maintained in the general fund.

- The adequacy of unrestricted fund balance in the general fund should be assessed based upon a government's own specific circumstances.

- GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of <u>no less than two months</u> of regular general fund operating revenues or regular general fund operating expenditures.

- <u>Furthermore, a government's particular situation often may require a level of unrestricted fund balance in the general fund significantly in excess of this recommended minimum level</u>.
  - Such measures should be applied within the context of long-term forecasting.

Source: (i) Government Finance Officers Association “Fund Balance Guidelines for the General Fund”.

Next Steps

- Fund Balance/Budgeting:
  - Continue the momentum with structurally balanced budgets and continue to revisit Financial Polices as the City's finances and needs evolve
  - Revisit the City's Unassigned Fund Balance policy levels to include potentially higher targets and the concept of Budget Stabilization Fund.
  - Davenport to assist the City in analyzing and developing potential amendments to its Unassigned Fund Balance policy levels in order to further solidify the City's positive financial trajectory.

- General Fund Capital Investment:
  - Position the City to undertake essential capital investment for both general and utility enterprise needs.
  - Davenport to work the City to undertake capital planning debt capacity and debt affordability analysis for the General Fund in anticipation of potential capital investment which may include financial system upgrades as early as FY 2022.

- Utility Rate Study:
  - Davenport/Jacobs continue work on finalizing the 2021 Utility Rate Study (approximate completion in 6 weeks) and present results to City Council.
  - Davenport to work with City staff in the analyzing and implementing funding through various programs (i.e. DEQ/VDH, City Bonds or other financing programs that may be available) for Utility Capital Needs.

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