Spotsylvania County, Virginia

New Issue Report

Ratings

Long-Term Issuer Default Rating	AAA
New Issue	
$38,000,000 General Obligation Public Improvement Bonds, Series 2018	AAA
Outstanding Debt	
Spotsylvania County General Obligation Public Improvement & Refunding Bonds	AAA
Spotsylvania County General Obligation Public Improvement Bonds	AAA
Spotsylvania County General Obligation Public Improvement Bonds (Taxable-Build America Bonds)	AAA
Spotsylvania County General Obligation Qualified Energy Conservation Bonds (Taxable)	AAA
Spotsylvania County General Obligation Refunding Bonds	AAA
Spotsylvania County Economic Development Authority (Public Building and Equipment Project) Public Facilities Revenue Bonds	AA+
Spotsylvania County Economic Development Authority (Spotsylvania School Facilities Project) Public Facilities Revenue & Refunding Bonds	AA+
Spotsylvania County Economic Development Authority Revenue & Refunding Bonds	AA+

Rating Outlook

Stable

Analysts

Parker Montgomery
+1 212 908-0356
parker.montgomery@fitchratings.com

Grace Wong
+1 212 908-0652
grace.wong@fitchratings.com

New Issue Details

Sale Date: Aug. 14 competitively.

Series: General Obligation Public Improvement Bonds, Series 2018.

Purpose: To finance various school and county capital projects.

Security: Spotsylvania County's (the county) full faith and credit and unlimited ad valorem taxing ability.

Analytical Conclusion: The 'AAA' Issuer Default Rating (IDR) and GO ratings reflect the county's strong revenue framework, a long-term liability burden that is at the very low end of the moderate range, healthy operating performance and broad budgetary tools. The revenue bond rating is one notch lower than the IDR at 'AA+', reflecting the requirement for annual budgetary appropriation in support of lease payments.

Economic Resource Base: The county is located along Virginia's Interstate 95 corridor, midway between Washington, D.C. and Richmond, VA (about 55 miles from each). The county continues to grow and, as of 2017, the county's population was estimated at 133,033, up about 9% since the 2010 Census.

Key Rating Drivers

Revenue Framework: 'aaa'

The county's strong tax base growth during the economic recovery, coupled with the increase of tax rates in down years, has generated consistently solid general fund revenue growth throughout the previous decade. Over time, Fitch Ratings expects the pace of revenue growth (net of policy action) above the rate of inflation though likely below the level of U.S. GDP growth. The county has the independent legal ability to raise property tax revenues in an unlimited amount.

Expenditure Framework: 'aa'

Fitch expects the natural pace of spending growth to remain in line with to marginally above revenue growth. Moderate carrying costs and broad flexibility to manage labor-related costs allow the county solid leeway to adjust spending.

Long-Term Liability Burden: 'aa'

The combined burden of debt and unfunded pension liabilities is at the very low end of the moderate range at 11% of personal income. Fitch expects the metric to remain well within the 'aa' assessment over time despite the possibility of increases in the net pension liability and future debt issuance plans that generally match the amortization rate of existing debt.

Operating Performance: 'aaa'

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

Rating Sensitivities

Revenue Growth Prospects: Expectations for a material slowing of the prospects for natural revenue growth could pressure the rating.

Long-Term Liabilities: A larger than expected increase of the county's long-term liability metric for debt and pensions could pressure the rating.

Rating History (IDR)

Rating	Action	Outlook/ Watch	Date
AAA	Affirmed	Stable	8/6/18
AAA	Upgraded	Stable	8/9/16
AA+	Upgraded	Stable	6/13/12
AA	Revised	Stable	4/30/10
AA–	Assigned	Stable	10/14/04

Credit Profile

Spotsylvania County functions as a bedroom community for the D.C. metro area. Over one-half of the county's labor force commutes outside of the county for work according to the Virginia Employment Commission. Employment trends inside the county are positive. Over the past six years, the county has continued to add jobs on par with that of the rest of the growing state economy. The unemployment rate tracks the state and remains below the U.S. The county's wealth and education indicators are mixed with estimated per-capita personal income and education levels averaging nearly the national level, but trailing the Commonwealth as a whole. Poverty levels are well below those of the U.S.

The county has a pipeline of economic development projects due to economic incentives, the availability of land and transportation investments, which are attracting private investment and continued economic growth. The county's target industries include healthcare, manufacturing, high tech, defense and tourism. Lidl, a German grocery store chain, recently constructed a $125 million distribution center and opened a grocery store in 2018. The company is expected to be a new top 10 taxpayer and plans to open an additional store in the near future.

Revenue Framework

The revenue base is dominated by property taxes at about 65% of fiscal 2017 general fund revenues, intergovernmental revenues (primarily state moneys for education) at 15% and sales taxes at 7%.

Revenues over the previous decade, bolstered by policy action to adjust tax rates as necessary, have steadily increased in line with U.S. GDP growth despite significant swings in the tax base during the recession. Going forward, Fitch expects solid revenue growth (net of policy action) at a pace roughly ahead of inflation given ongoing economic development in the region as well as positive housing trends in the county and a strong trend in building permit and values.

Lack of a legal cap on the property tax rate or levy provides the county with high independent legal revenue-raising flexibility. The county's property tax rate remains competitive relative to neighboring similarly sized jurisdictions.

Expenditure Framework

The county's expenditures are primarily composed of public safety (18% in fiscal 2017) and education (46%). These costs routinely comprise approximately 65% of total general fund expenditures. 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 board and must, at a minimum, meet the state-determined performance standards for the school system.

Given the county's solid revenue growth prospects, Fitch expects spending growth to be in line with to marginally above revenues over time.

The county has solid flexibility to adjust major expenditure items. Fixed carrying costs associated with debt service, actuarially calculated required pension costs and other post-employment benefit (OPEB) actual spending consume approximately 15% of governmental spending. The state's education funding standards require a minimum funding level, but the required local effort is very low compared to the level at which the county currently funds education. Additionally, the county has broad discretion over the terms of employee wages and benefits given the absence of collective bargaining.

Related Research

Fitch Rates Spotsylvania County, VA's $34MM GOs 'AAA'; Outlook Stable (August 2018)

Related Criteria

U.S. Public Finance Tax-Supported Rating Criteria (April 2018)

Long-Term Liability Burden

The county's overall debt and unfunded pension liability is at the very low end of the moderate range at about 11% of personal income. The metric is roughly split between direct debt of the county and the net pension liability (NPL), with the NPL slightly over one-half of the burden.

The 2019–2023 capital improvement plan (CIP) for general government, schools and transportation totals $235 million and is primarily funded with debt. The plan includes $125 million in new issuance after the current sale, although management may cash-fund more than the plan currently calls for and reports no current plans to issue additional debt. Fitch does not expect debt to pressure the liability burden as population and income growth is likely to be aligned with additional debt issuance and principal is rapidly amortized at a nearly 80% payout ratio within 10 years.

The larger portion of the liability burden is derived from pension plans. The county offers defined benefit pension plans administered by the Virginia Retirement System (VRS) as both agent plans (for general employees and nonteacher employees of the component unit school system) and as a cost-sharing multi-employer plan for teachers. Plan assets (combined and adjusted to Fitch's 6% investment rate of return assumption) covered about 64% of plan liabilities in fiscal 2017.

Systemwide funding of VRS declined over the past decade as the commonwealth set statutorily required contributions, partially used as budget balancing measure for the state, at less than actuarially sustainable levels. Positively, the commonwealth achieved full actuarially determined employer contribution payments as of fiscal 2018, which should slow the growth in the net pension liability. The use of a 7% investment return assumption is notably conservative compared to other major state systems. Overall the county's liability burden is on the low end of the Fitch's 'aa' assessment range.

The county also provides OPEB plans for county employees. At the close of fiscal 2017, the net liability for county employees was reported at $96 million, or about 1% of personal income. In fiscal 2019 the county plans to begin setting aside assets in trust and plans to reach full funding of the OPEB ARC by fiscal 2023. The school-related net OPEB liability is an additional $236 million, or nearly 4% of personal income.

Operating Performance

Given the limited economic sensitivity of the county's revenues, as modeled in FAST based on historical results, along with the county's superior level of inherent budget flexibility in the form of revenue-raising ability and cost controls, Fitch expects the county to manage through economic downturns while maintaining a high level of fundamental financial flexibility. For details, see Scenario Analysis, page 4.

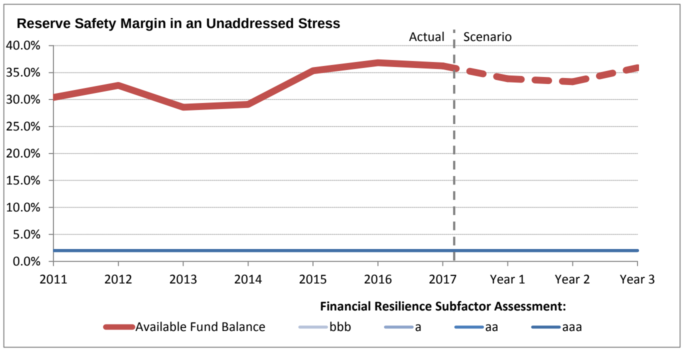
The county's conservative budget management allowed for the rapid rebuilding of financial flexibility after the previous recession. The county's current expectation for fiscal 2018 is for a slight surplus and increase of fund balance. The fiscal 2019 budget is a roughly 5% increase over 2018 and includes an adjustment of the tax rate to slightly above the equalized rate, an increase in headcount largely for public safety and an increase of the cash transfer to the capital plan to 3.75% of revenues.

The budget includes an appropriation of fund balance of nearly $10 million, or about 3.6% of revenue, of which $8.6 million is a one-time transfer to the capital fund. The county historically beats conservative budget estimates and has traditionally used a portion of fund balance in excess of its reserve policies for capital expenditure.

Spotsylvania County (VA)

Scenario Analysis

v. 2.0 2017/03/24



Analyst Interpretation of Scenario Results:

Given the limited economic sensitivity of the county's revenues, as modeled in FAST based on historical results, along with the county's superior level of inherent budget flexibility in the form of revenue-raising ability and cost controls, Fitch expects the county to manage through economic downturns while maintaining a high level of fundamental financial flexibility. Available reserves continue to meet the county's conservative policies, including reserves for emergencies and others for economic stress, economic development, and additional amounts in the self-insurance fund. In total, available reserves in fiscal 2017 increased to a very healthy $99 million, or 36% of spending when including committed reserves in the capital fund available to the general fund by direction of the county board.

The county demonstrated its financial resilience and strong budget management through the most recent recession by delaying capital spending, shifting cash back to the general fund from available reserves in the capital projects fund as necessary to address budget gaps, reducing the appropriation to the schools, and controlling cost through workforce reduction and freezing salaries.

Scenario Parameters:	Year 1	Year 2	Year 3
GDP Assumption (% Change)	(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)	2.0%	2.0%	2.0%
Revenue Output (% Change)	(1.0%)	3.8%	5.2%
Inherent Budget Flexibility	Superior		

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2011	2012	2013	2014	2015	2016	2017	Year 1	Year 2	Year 3
Total Revenues	219,056	222,751	223,415	231,150	238,739	247,537	254,463	251,919	261,592	275,242
% Change in Revenues	-	1.7%	0.3%	3.5%	3.3%	3.7%	2.8%	(1.0%)	3.8%	5.2%
Total Expenditures	208,784	212,295	225,905	233,768	231,454	246,904	261,929	267,167	272,511	277,961
% Change in Expenditures	-	1.7%	6.4%	3.5%	(1.0%)	6.7%	6.1%	2.0%	2.0%	2.0%
Transfers In and Other Sources	2,630	6,088	44,237	23,498	79,440	31,478	22,514	22,289	23,145	24,352
Transfers Out and Other Uses	6,681	9,249	48,619	19,124	76,434	25,875	11,472	11,702	11,936	12,175
Net Transfers	(4,051)	(3,161)	(4,382)	4,374	3,007	5,602	11,041	10,587	11,209	12,178
Bond Proceeds and Other One-Time Uses	-	6,017	43,496	11,584	70,419	16,414	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	6,221	7,295	(6,872)	1,756	10,292	6,235	3,576	(4,662)	290	9,459
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	2.9%	3.4%	(3.0%)	0.7%	4.3%	2.4%	1.3%	(1.7%)	0.1%	3.3%
Unrestricted/Unreserved Fund Balance (General Fund)	54,748	60,683	53,924	55,538	65,310	70,910	76,206	71,544	71,834	81,293
Other Available Funds (Analyst Input)	10,718	9,630	12,118	14,690	18,630	23,466	22,857	22,857	22,857	22,857
Combined Available Funds Balance (GF + Analyst Input)	65,466	70,313	66,042	70,228	83,940	94,376	99,063	94,401	94,691	104,150
Combined Available Fund Bal. (% of Expend. and Transfers Out)	30.4%	32.6%	28.6%	29.1%	35.3%	36.8%	36.2%	33.9%	33.3%	35.9%

Reserve Safety Margins	Inherent Budget Flexibility				
	Minimal	Limited	Midrange	High	Superior
Reserve Safety Margin (aaa)	16.0%	8.0%	5.0%	3.0%	2.0%
Reserve Safety Margin (aa)	12.0%	6.0%	4.0%	2.5%	2.0%
Reserve Safety Margin (a)	8.0%	4.0%	2.5%	2.0%	2.0%
Reserve Safety Margin (bbb)	3.0%	2.0%	2.0%	2.0%	2.0%

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's downturn scenario assumes a -1.0% GDP decline in the first year, followed by 0.5% and 2.0% GDP growth in Years 2 and 3, respectively. Expenditures are assumed to grow at a 2.0% rate of inflation. Inherent budget flexibility is the analyst's assessment of the issuer's ability to deal with fiscal stress through tax and spending policy choices, and determines the multiples used to calculate the reserve safety margin. For further details, please see Fitch's US Tax-Supported Rating Criteria.

The ratings above were solicited and assigned or maintained at the request of the rated entity/Issuer or a related third party. Any exceptions follow below.