Debt Policy Review

prepared for

Fairfax County, Virginia

Joint Board of Supervisors & School Board CIP Committee

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Discussion Topics

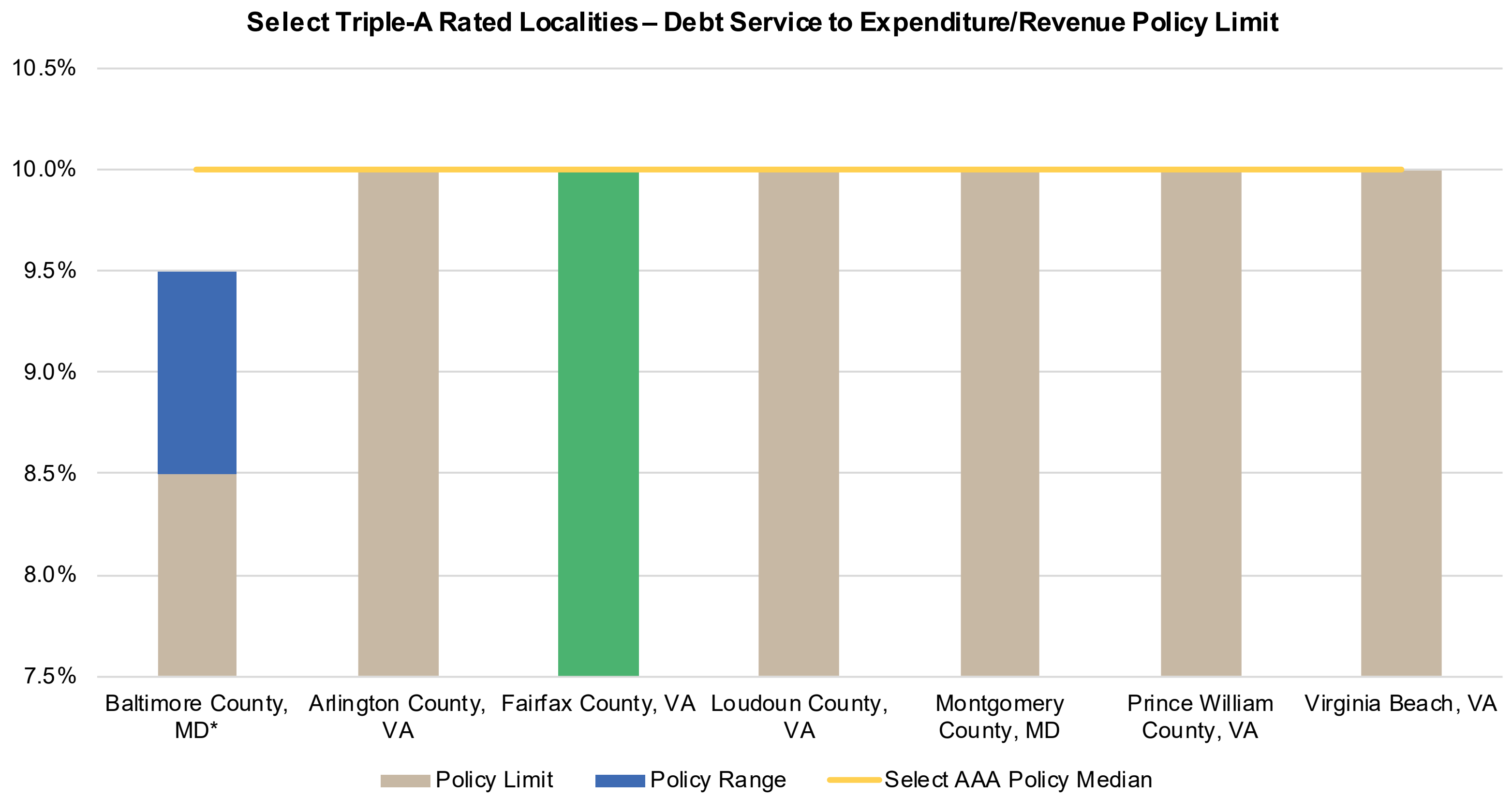
- Review the County's debt management policies and procedures compared to credit rating criteria & to triple-A rated peers
- Explore possible ways to increase funding of capital program
  - Maintain affordability of annual debt service in the operating budget
  - Consider debt policies & need to remain in compliance
  - Assume protection of triple-A ratings
  - Continue positive credit agency views of the County's debt burden
- Review two scenarios to create context for future decision-making
- Outline considerations for future decision-making

Fairfax's Key Debt Policy Ratios

- The County's Ten Principles of Sound Financial Management includes two primary debt management policy ratios
  - Debt service as a % of General Fund disbursements shall not exceed 10%
  - Net debt as a % of assessed value (AV) to be less than 3%
- Additionally, the County applies a dollar cap to its annual issuance plans
  - General Obligation Bonds shall not exceed $300 million per year, or $1.5 billion over 5 years, with a technical limit of $325 million in any given year
- Both ratios are consistent with rating agency metrics & with debt policies of triple-A rated peers
- Maintaining compliance with current policy protects Fairfax's triple-A ratings
- Of the two metrics, debt service as a % of General Fund disbursements ratio is the primary limiting ratio
- The County's ability to accommodate additional debt service in its operating budget, balanced against other expense items is essential

Debt Service as a % of General Fund Disbursements: Peer Comparison

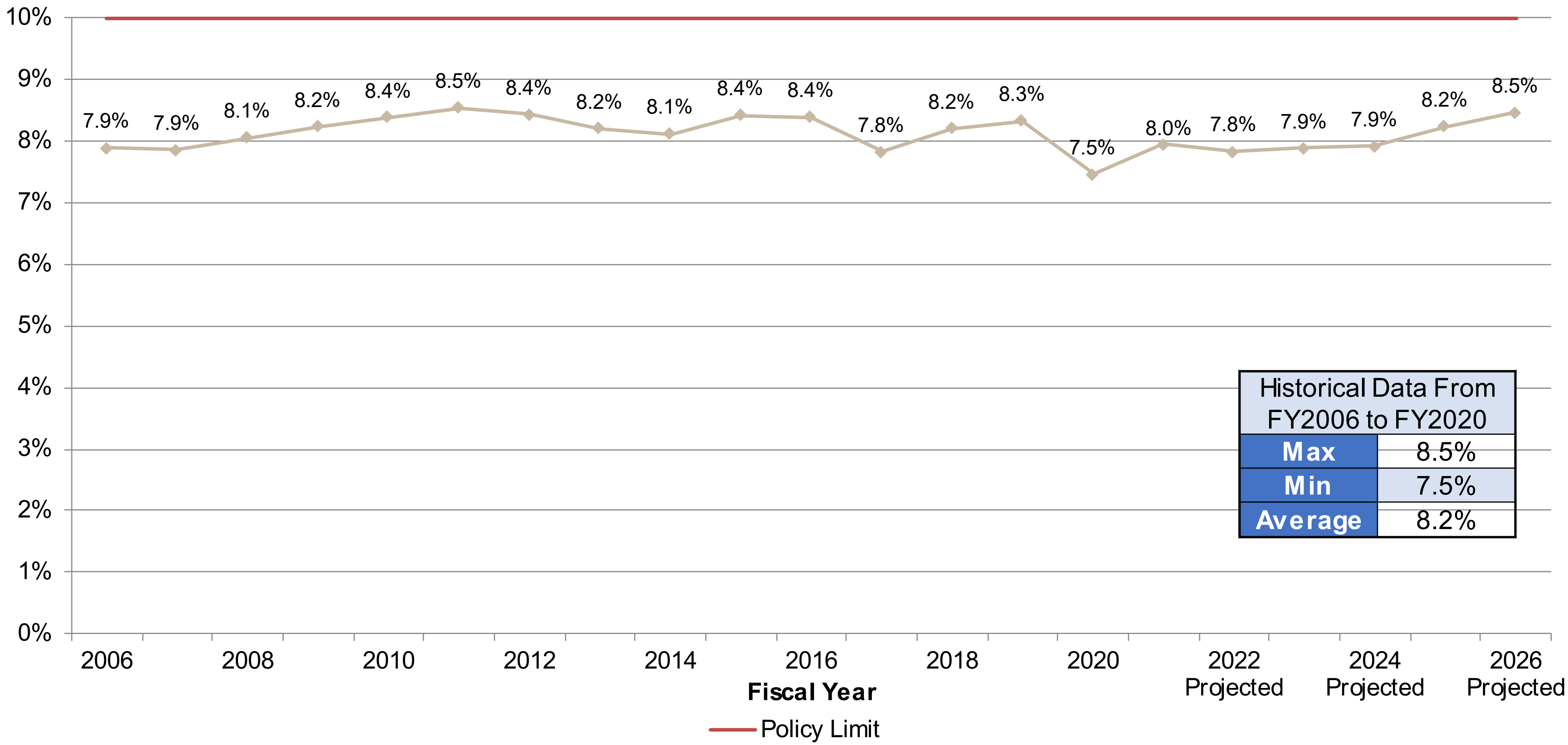
Fairfax's 10% debt service to disbursements ratio limit is consistent with policies of other Triple-A peers.



Source: Various financial policies. Reflects peers with this financial policy. Localities specifically define numerator and denominator inputs in their policies which are important to understanding the metric. Baltimore County, MD's policy sets a target range, rather than one limit.

Debt Service as a % of General Fund Disbursements: Fairfax History

- As of 6/30/2020, Fairfax is well below the 10% limit at 7.46%

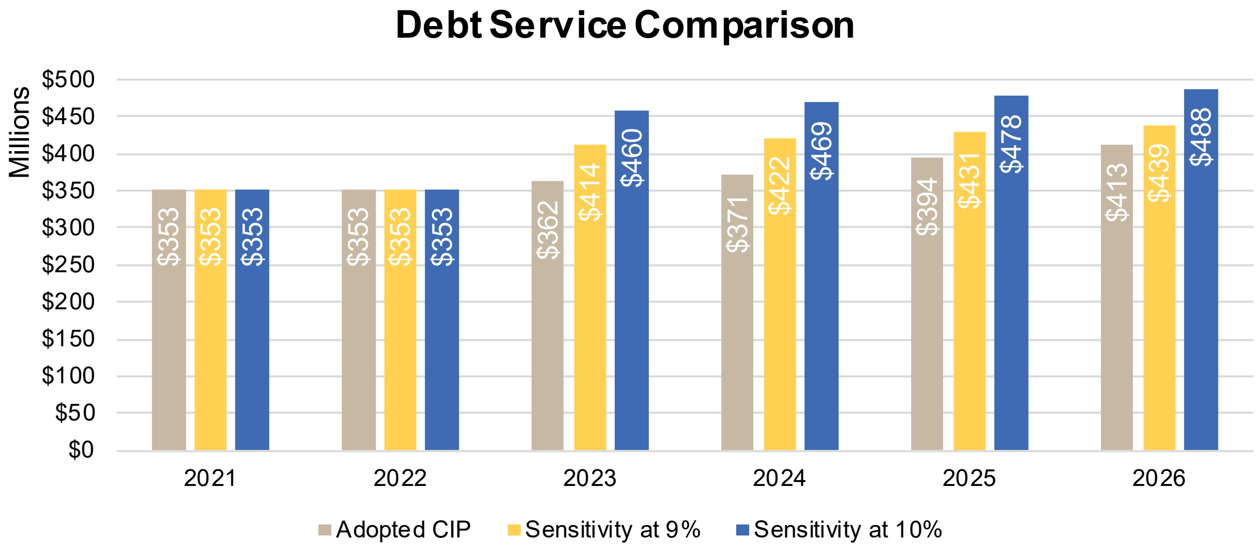


Historical Data From FY2006 to FY2020	
Max	8.5%
Min	7.5%
Average	8.2%

Source: County audit reports from FY 2006 to FY 2020; FY 2022 – FY 2026 per Adopted Capital Improvement Program; *Assumes 2% annual revenue growth.

Sensitivity Case 1: Higher Annual Debt Service

- What if the County issued up to the 10% limit?
  - Annual debt service increase of approximately $98 million
  - Equals approximately $1.3 billion of additional debt
  - If 1 penny on the tax rate equals $27 million, $98 million is the equivalent of 3.6 cents
  - By 2026, debt to AV ratio reaches 1.78%
  - Assumes revenue growth of 2% per year



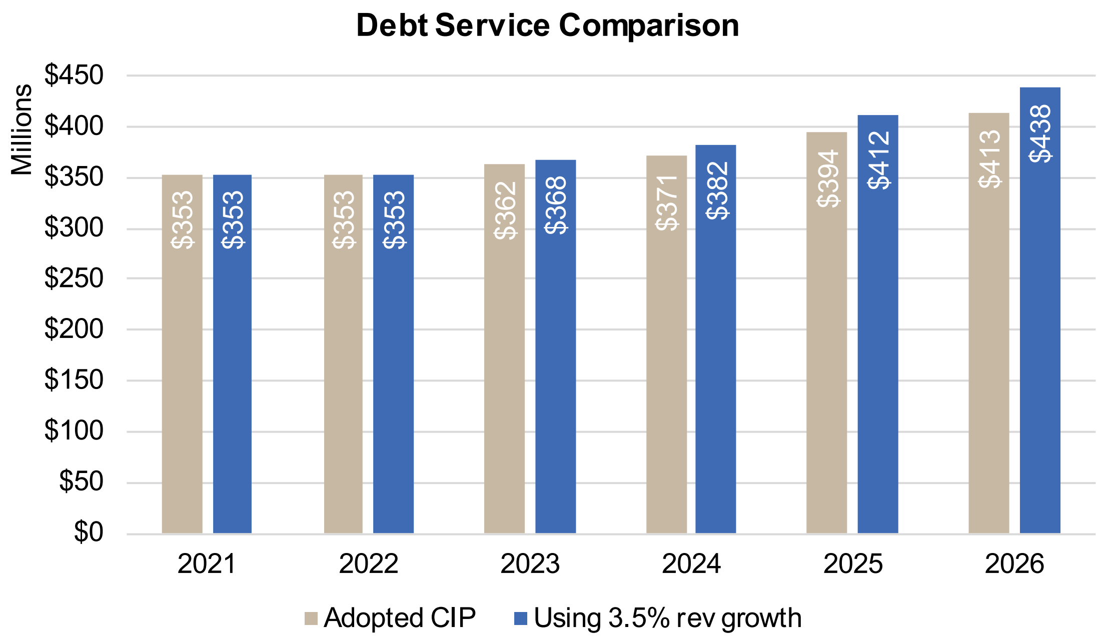
What about Credit Rating Agencies?

- If the County decides to increase issuance above historical ratios, advance communication to rating agencies would be critical
  - Strong focus on maintaining structural balance in its operating budget, in light of other expenditure pressures
  - Willingness to reduce other spending or increase revenue in recessionary periods
- Credit agencies use similar measures to the County's policies, but different methodologies
- In these scenarios, debt metrics used by all three rating agencies would increase as well

Agency	Metric	Current	Projected (if 9%)	Projected (if 10%)	Assessment
Moody's	Debt to Operating Revenue	0.65x	0.77x	0.89x	Weakens
S&P	Debt Service to Expenditures	9.2%	10.0%	10.7%	No change
Fitch	Carrying Cost	13.9%	14.5%	15.2%	No change

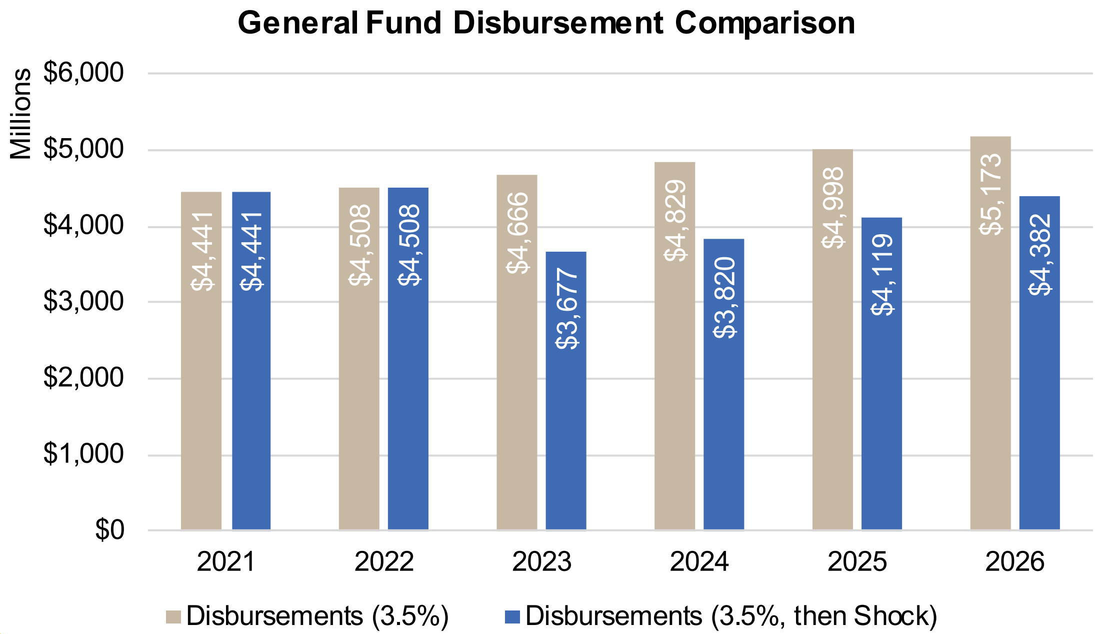
Sensitivity Case 2: Higher Assumed Revenue Growth

- County assumes future revenue growth of 2% based on historical revenue trends
  - Based on historical trend of General Fund expenditures since FY 2013 (ranged from 2.7% to 4.4%)
- What if County assumed future growth of 3.5% while maintaining the debt service ratios at levels in the Adopted CIP?
  - Results in annual debt service increase ranging from $5 million to $25 million in FY2023 to FY 2026
  - Equals approximately $800 million of additional debt over period from FY2023 to FY 2026



Sensitivity Case 2b: What if revenue comes in below 3.5%?

- A conservative revenue assumption provides a cushion for instances when revenue contracts
- If 3.5% growth is assumed, a revenue contraction of 15% to 21% would drive the debt service ratio up to the limit of 10%
  - Assumes approximately $800 million of additional debt is issued over period from FY2023 to FY 2026
  - Assumes total annual debt service of $367 million to $438 million over period from FY2023 to FY 2026, higher than adopted CIP levels ($362 million to $413 million)
- Beyond the impact to the ratio, the County would need to address other budget impacts of contracting revenue, including curtailment of other spending

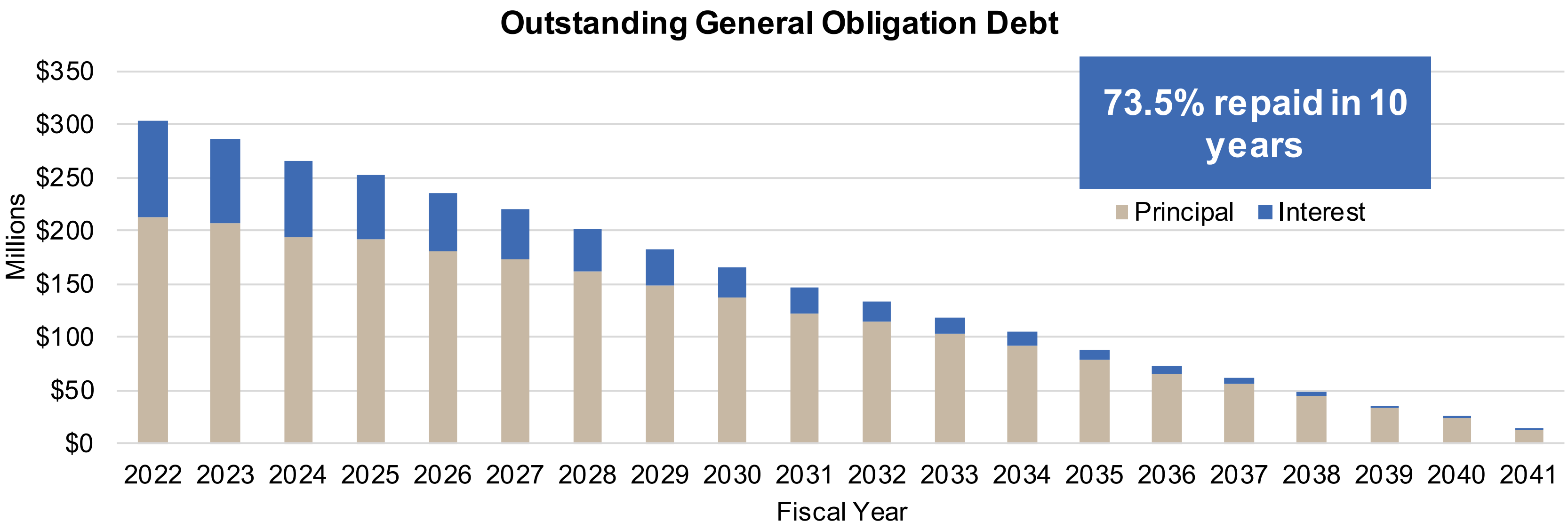


Considerations for Increasing CIP Funding

- Consider a soft, planning cap, below the 10% limit to protect the County's ratings
  - Based on strong financial management history, rating agencies view 10% is a maximum limit, not a target to be achieved
  - Highest prior point of ratio was 8.54% over last 15 fiscal years, through FY2020
  - Adopted CIP reaches 8.47% in FY2026
- Maintain conservatism in the budget growth assumption
  - Annual debt service can be managed by amount of issuance
  - Recessions & other uncertainties can drive the debt service ratio higher, even without an increase in debt
  - When revenue contracts, the existing debt service due and payable to investors is not a discretionary spending line item compared other categories
- Match increase in debt service with other flexibility
  - Continued use of & potential increase in pay-as-you-go
  - Maintenance of reserves

Fairfax's Debt Management Practices

- Fairfax employs many best practices in debt management above & beyond the Ten Principles
  - Repays General Obligation (GO) debt on a rapid schedule with equal principal payments over 20 years
  - Commitment to balancing debt with pay-as-you-go sources
  - Sets targets for savings when refinancing debt
- Continuation of these practices will be positive factors, supporting an affordable debt burden



Tax-Supported Debt Techniques Used by Fairfax*

*Counts against 10% debt ratio.

G.O. Bonds	EDA or FCRHA Debt (Subject to Appropriation)
• Schools • Transportation (Metro) • Public Safety • Human Services • Parks • Library	• School Administration Building • Public Safety Building • Merrifield Center • Community Centers • Laurel Hill public school & golf course

- Tried & True Techniques
  - Long term, fixed rate debt
  - Public sales, competitive & negotiated
  - Short term, direct placement with banks
  - Equipment lease financing
- Opportunistic, driven by market conditions or other special circumstances
  - Interim financing using bond anticipation notes
  - Line of credit draw down facility
  - Short term notes
  - Build America Bonds
  - Tax Credit Financings
  - Forward refunding bonds

Practices for Annual Borrowing

- Fairfax observes a dollar cap on its annual issuance plans under the Ten Principles
  - General Obligation Bonds shall not exceed $300 million per year, or $1.5 billion over 5 years, with a technical limit of $325 million in any given year
  - Fairfax's practice has been to issue fixed, set amounts of debt each year of $180 million for schools and $120 million for County
- Practices among other peer counties vary for annual issuance sizing
- Arlington County issues new money G.O. Bonds on an annual basis
  - Amounts sold for County & School projects vary each year, depending on project cash flow needs, not fixed
  - Since 2016, the mix of G.O. debt issued for county or school purposes has ranged from 75%/25% to 40%/60% each year
  - Pre-pandemic, referenda only in even years
- Prince William County use the Virginia Public School Authority (VPSA) to issue G.O. debt for school projects on an annual basis
  - GO new money bonds for non-school purposes was last issued in 2015
  - County's general capital needs are funded from pay-as-you-go, occasional IDA debt and other budget sources including a capital reserve
  - Referenda held periodically, most recently in 2019 & prior to that in 2006

Conclusion

- Existing debt policies & practices are sound
- Fairfax has additional borrowing capacity it can tap into without jeopardizing its bond ratings
- Debt service is a non-discretionary item in the operating budget
  - More debt service requires flexibility in the operating to manage through downturns & the unexpected
  - Expanded use of pay-go sources adds flexibility
- Additional sensitivity analysis can be used to test results of higher borrowing levels

Questions?

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