Fairfax County, Virginia

Review of Debt Management Practices

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Overview

Objective: Review Fairfax’s current debt management practices

- Focus on additional flexibility
- How to maintain debt affordability over long term
- Preserve Aaa/AAA/AAA credit ratings
- Survey other jurisdictions for innovation
- Review relative risk elements

Scope of Review

- “Tax Supported” Debt
- Includes General Obligation Bonds & certain EDA or FCRHA debt paid from General Fund resources

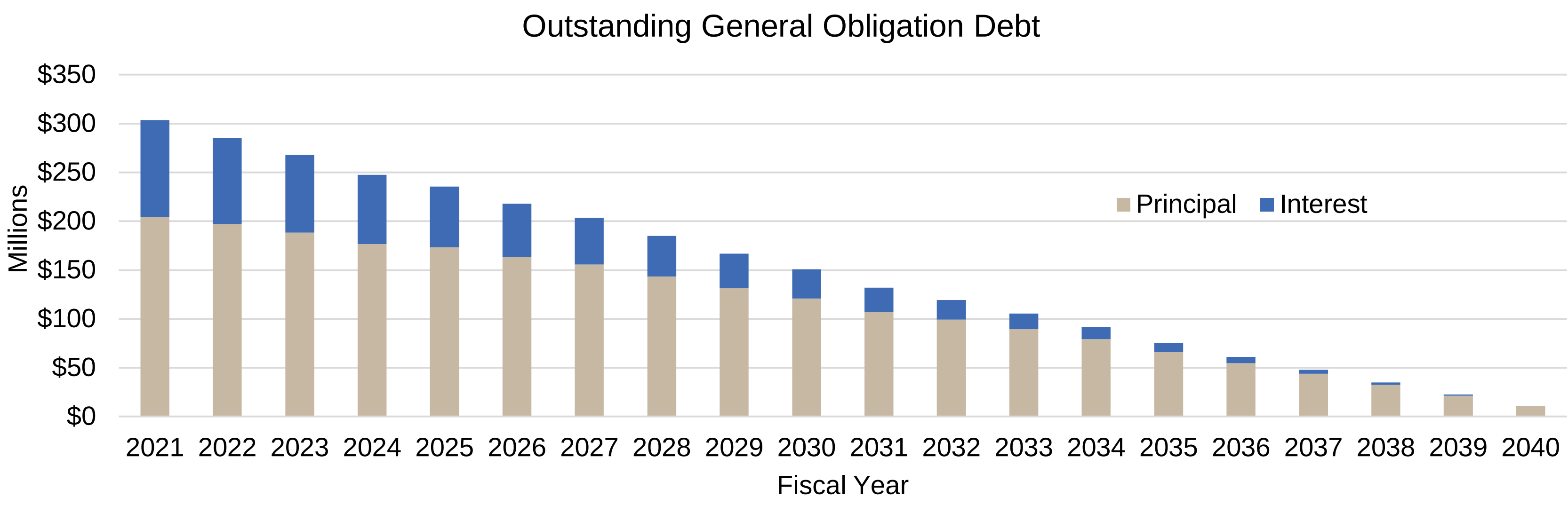
Results

- Current debt policies & practices support an affordable debt burden that is aligned with Fairfax's Aaa/AAA/AAA ratings
- Fairfax's debt management practices are consistent with the practices of other triple-A rated entities
- Fairfax has used multiple & diverse borrowing strategies, when prudent
- Pro/con of new approaches should be examined in light of market conditions & Aaa/AAA/AAA ratings

Fairfax’s Debt & Debt Practices

Fairfax's G.O. Debt at a Glance

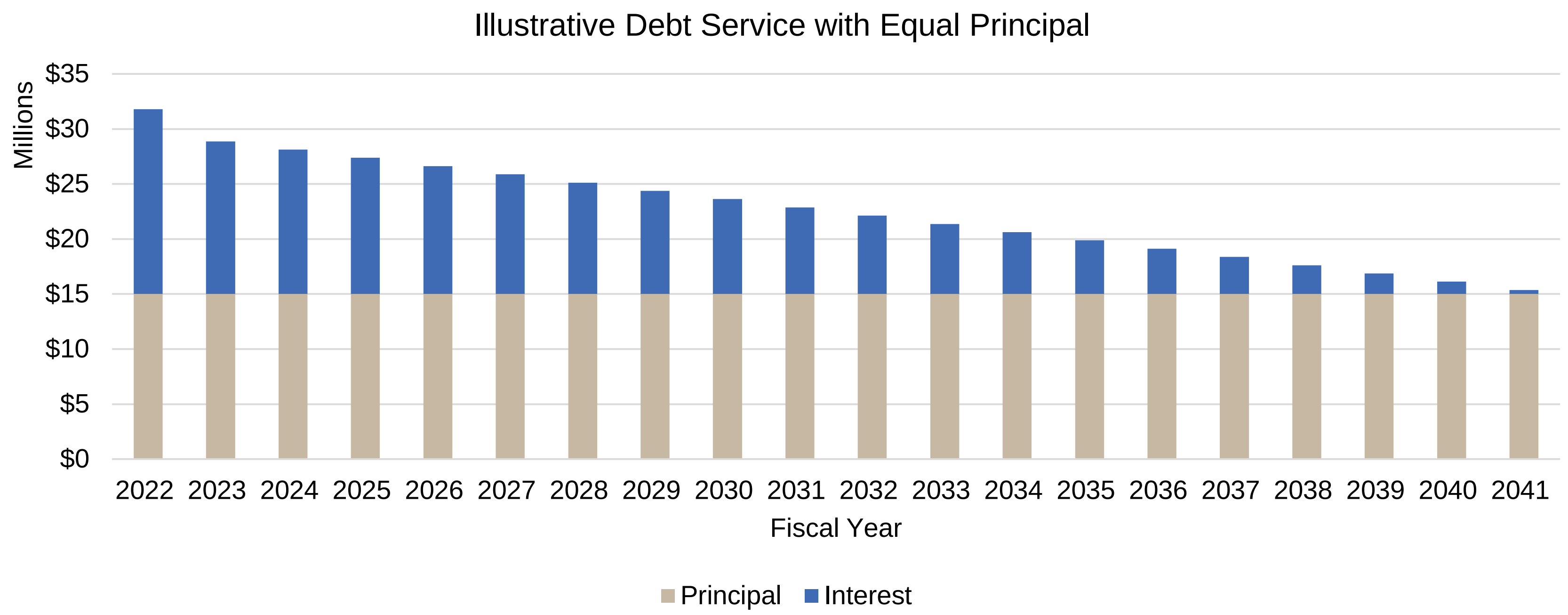
- Currently, Fairfax has $2.303 billion of G.O. debt outstanding
  - Other types of debt are paid with dedicated revenue such as sewer revenue bonds
  - Also, several issues of debt issued through EDA or FCRHA and paid from identified sources (Phase 1 & Phase 2 Silver Line Tax Districts, Mosaic Community Development Authority, Route 28 Transportation District, Wedgewood & Crescent Affordable Housing Projects)
- Currently, no variable rate debt, swaps or derivatives allowing County to avoid risk of unpredictable debt service in current & future budgets
- FY2021 principal payable of $204 million, the equivalent of 7.7 cents on the real estate tax rate



Note: As of 2/28/2020. Does not include future GO bond sales.

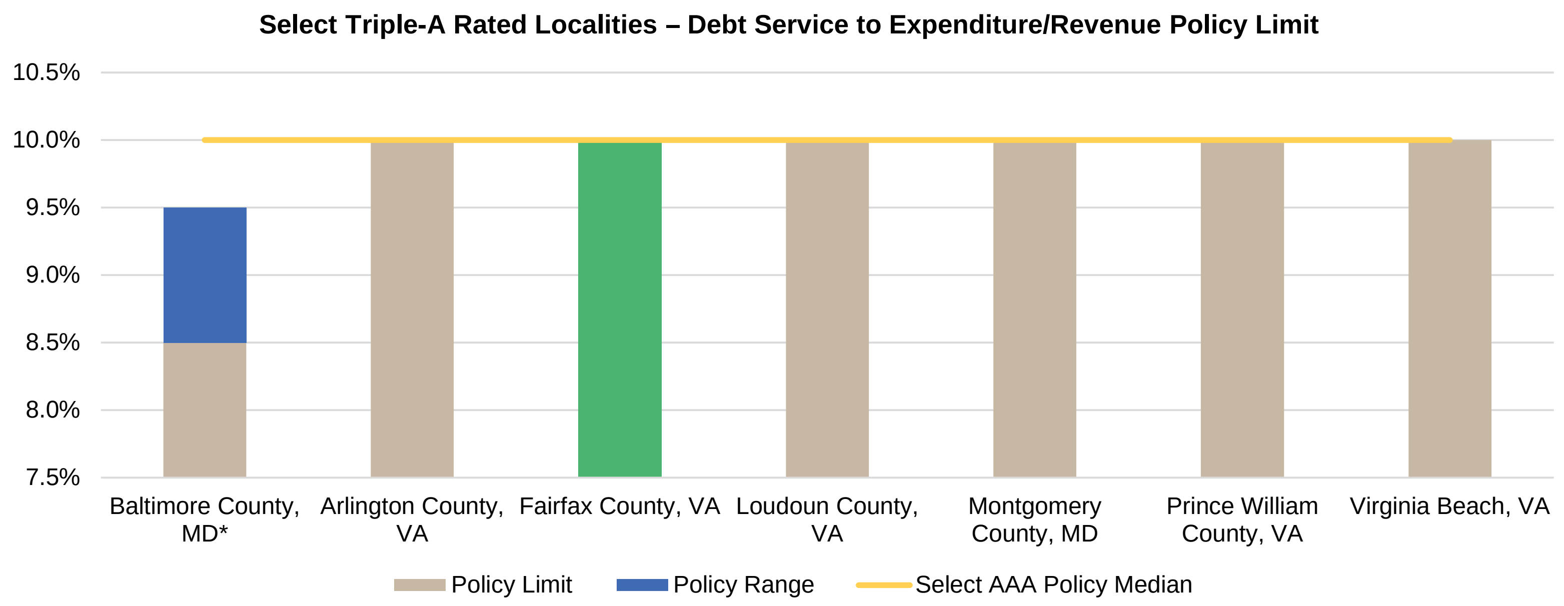
Rapid Repayment Recycles G.O. Debt Capacity

- GO debt is structured with equal annual principal payments over 20 years
- Results in a very rapid repayment with 69% of debt repaid in 10 years
- Recycles debt capacity for future projects quickly



Ten Principles of Sound Financial Management - Debt Ratios

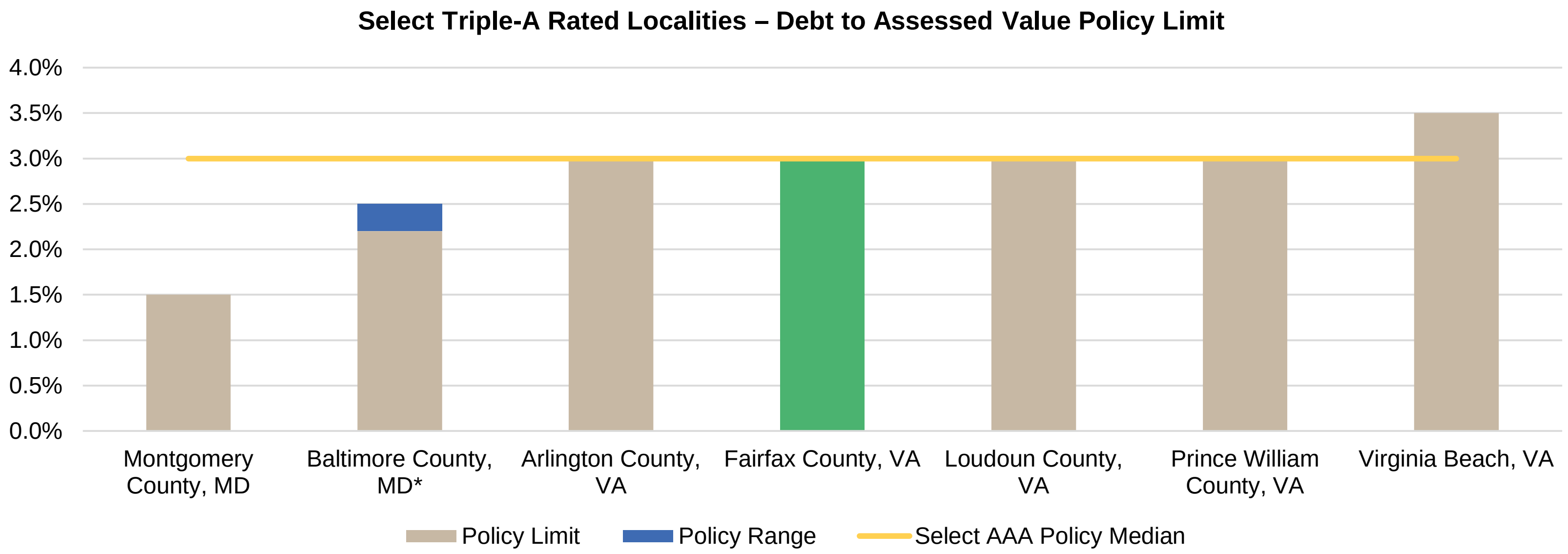
- Debt ratios serve as a proxy for affordability so that debt, a non-discretionary budget item, does not constrain current or future budgets
  - Debt service expenditures as percentage of General Fund disbursements shall not exceed 10%
  - Net debt to estimated market value less than 3%



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 as a whole. Baltimore County, MD's policy sets a target range, rather than one limit.

Ten Principles – Additional Parameters

- Fairfax's primary debt policy ratios are consistent with Triple-A peers and with rating agency benchmarks
- Annual limit of $300 million or $1.5 billion over % years, with technical limit of $325 million in any given year
- Considers G.O. & subject to appropriation debt, excludes revenue bonds, equipment leases
- Lease purchase financings treated as operating expenses & limited to 3% of annual General Fund disbursements



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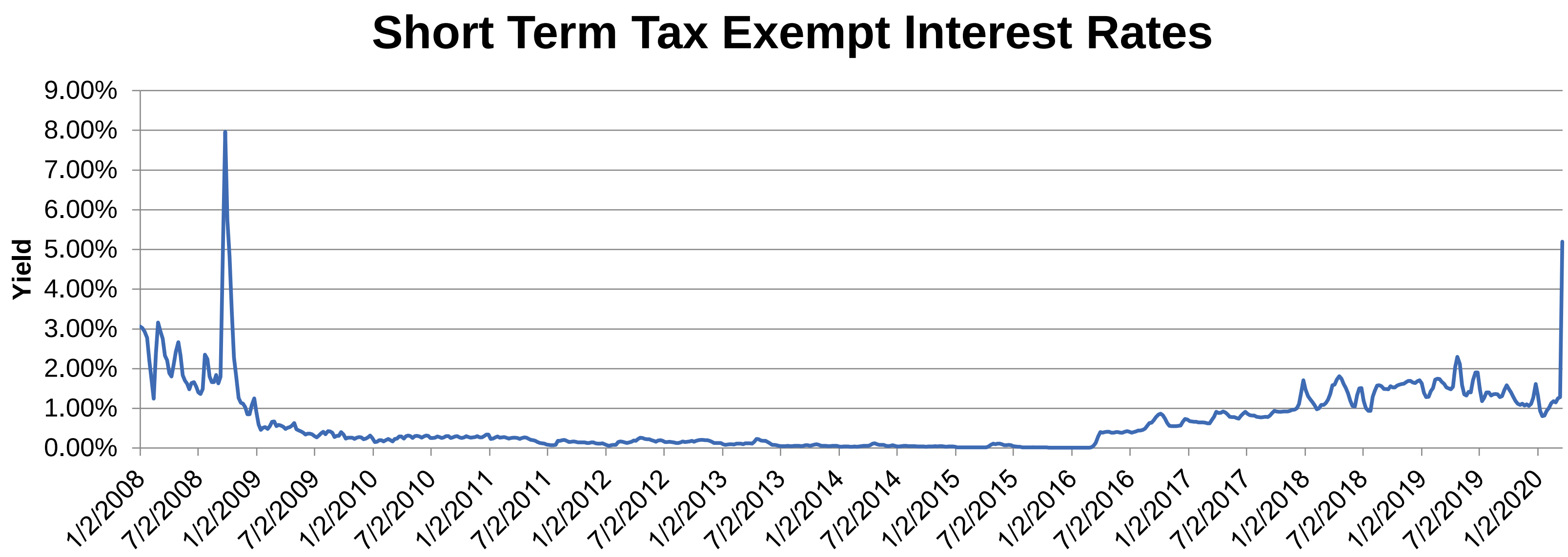
Ten Principles – Variable Rate Debt

- Variable rate debt permitted subject to oversight by Variable Rate Debt Committee and detailed, written Variable Rate Debt Procedures adopted in November, 2007
- County has no variable rate debt in its portfolio at this time, thankfully
- Current variable & short term municipal market conditions are extremely volatile due to economic effects of COVID-19, adding risk to local government budgets when both revenue & expenditure concerns are acute



SIFMA, as of March 18, 2020.

Potential Debt Policy Enhancements

- Fairfax employs many best practices in debt management above & beyond the Ten Principles
  - Sets targets for savings when refinancing debt
  - Repays GO debt on a rapid schedule
  - Commitment to balancing debt with pay-as-you-go or paydown
  - Periodic review & update of Ten Principles
  - Consideration & use of market opportunities/new borrowing techniques
  - Does not use interest rate swaps or other derivatives as part of debt portfolio
  - No use of Revenue or Tax Anticipation Notes
- Consider adding “Debt Management Guidelines” document (similar to Variable Rate Debt Procedures)
  - Further communicate strong fiscal discipline & management to external stakeholders, including those already aware, like rating agencies
  - Add specific targets or metrics to increase transparency

Considerations for Issuing More Debt

- Not ideal in near term given current financial uncertainty due to COVID-19
  - Rating agencies are focused on understanding potential financial impacts of the pandemic on local budgets
  - Financial management strategies, liquidity & available reserves are viewed as important in immediate term
- Even after COVID-19 effects abate, higher policy thresholds for debt ratios are not recommended without countervailing measures to provide an increase in financial flexibility
  - Enhancements to existing policies to manage increase in non-discretionary debt service budget expense
  - Availability of additional &/or more diversified revenue sources
  - Additional reserves may be needed to offset credit impact of higher debt burden
  - Increase in pay as you go
- In long term, need to assess potential credit rating impact of a higher debt burden, once current COVID-19 situation abates

Tax-Supported Debt Techniques Used by Fairfax*

*Counts against 10% debt ratio.

G.O. Bonds	EDA or FCRHA Debt (Subject to Appropriation)
• Schools • Transportation • Parks • Library • Human Services	• Public Safety Building • School Administration 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

Diverse Techniques to Conserve G.O. Debt Capacity

One hallmark of Fairfax's approach to debt management has been to identify opportunities & use techniques to maximize use of non-GO financing where specific revenue streams can be leveraged.

Special Districts/Tax Increment Financings
- Silver Line Phase 1 and Phase 2
- Route 28
- Mosaic at Merrifield

FCRHA/ Penny Fund
- Wedgewood Apartments
- Crescent Apartments

Moral Obligation
- Route 28
- Innovation Station & Herndon-Monroe parking garages
- Vienna parking garages

Revenue Bonds
- Sewer
- Waste to Energy Facility
- Parking System
- Stormwater/sewer Administration Building

Fairfax County Parks Authority
- Conservation easement for Salona historic site

Public Private Partnerships
- Wiehle Garage

Federal, State & Other Borrowing Programs
- Virginia Resources Authority
- UOSA
- TIFIA
- C-PACE

G.O. Debt: Opportunities for Exploration

- Different repayment structure
- Use Interim and/or draw down financing
- Retail focused sales
- Use of variable rate debt

Advantages & Disadvantages

Approach	Pro	Con
Level Debt Service vs. Equal Principal	Lowers annual debt service payments in short term	Slows down repayment & capacity recycling
		Higher total interest paid over life of bonds ($177.9 million vs. $152.2 million on $300 million borrowing)
Interim Financing	Lower annual debt service payments in short term	Interest rate risk
	Funds borrowed as needed to match construction schedule & pace	Budgetary uncertainty
	Provides flexibility to manage timing of bond sales	Market volatility requires “plan B”
	Frees liquid cash for non-capital purposes	
Retail Investor Focused Sales	Diversifies investor base beyond institutional investors	Incremental costs of issuance may not be outweighed by lower interest rates
	Create avenue for local resident access to Fairfax bonds	

What makes (& maintains) a Triple-A credit?

Fairfax's General Obligation Bond Ratings

- G.O. Bonds are rated Aaa/AAA/AAA by Moody's, Standard & Poor's & Fitch
- Each rating agency has its own distinct criteria, methodology & metrics
- Four primary areas of focus
  - Economic & demographic factors
  - Financial performance
  - Debt burden & pension obligations
  - Financial management practices, policies & track record
- Annually, PFM performs an independent credit assessment
  - Review expected rating outcomes, credit strengths & weaknesses
  - Benchmark to other Triple-A peer localities
  - Cautionary Tales of Triple-A credits facing potential downgrades
  - Changes to credit criteria & "hot topics"

Moody's		Standard & Poor's/Fitch	
Aaa		AAA	
Aa	Aa1	AA	AA+
	Aa2		AA
	Aa3		AA-
A	A1	A	A+
	A2		A
	A3		A-
Baa	Baa1	BBB	BBB+
	Baa2		BBB
	Baa3		BBB-

Moody's View of Fairfax's Credit

"Fairfax's credit profile reflects a satisfactory financial position that is projected to remain stable given continued tax base expansion which is driving revenue growth, conservative budget management, and adherence to formal fiscal policies."

- Credit Strengths
  - Sizeable tax base and regionally important local economy
  - County practice of single annual appropriation for all debt service
  - Above-average resident income levels
  - Strong comprehensive fiscal policies
- Credit Challenges
  - Below-average reserve levels compared to the Aaa median
  - Elevated pension liability
  - Exposure to federal budget cuts & prolonged government shutdowns
- Factors that could lead to a downgrade
  - Downgrade of the US Government rating
  - Reduction in operating flexibility and reserve levels
  - Substantial increase in debt burden
  - Material contraction in tax base and weakened income levels

An Important, Recent Chapter with Moody's

- On January 8, 2014, Moody's assigned a **negative outlook** to Fairfax's Aaa GO rating
- Fairfax took immediate action to protect its Aaa rating & avoid a downgrade
  - Adopted enhanced reserve policies raising amounts from a total of 5% of General Fund disbursements to 10%
  - Develop multi-year plan to increase pension funding
  - Eliminate use of one-time funds for on-going expenditures in operating budget
- Absent swift action, Fairfax's rating could have been **downgraded to Aa1**
- On January 12, 2016, Moody's returned the outlook to **stable**

Moody's Commentary January 2014:

What could make the rating go down:

- Further declines in reserve levels
- Inability to increase pension funding to meet actuarially required contributions (ARC)
- Inability to eliminate structural imbalance in operating budget
- Downgrade of the U.S. government's rating

What could remove the negative outlook:

- Increase reserve levels that are more consistent with other Aaa-rated entities
- Fully funding pension ARC
- Elimination of structural imbalance in operating budget

Standard & Poor's View of Fairfax's Credit

- Very Strong Economy
- Very Strong Management
- Strong Budgetary Performance
- Very Strong Budgetary Flexibility
- Very Strong Liquidity
- Strong Debt & Contingent Liability Profile

"In our opinion, net direct debt is likely to rise modestly given the county's current debt plans…we understand the county expects slight upticks in its debt to general revenues ratio as well as its debt to assessed value ratio, but that these measure will remain well within policy limits."

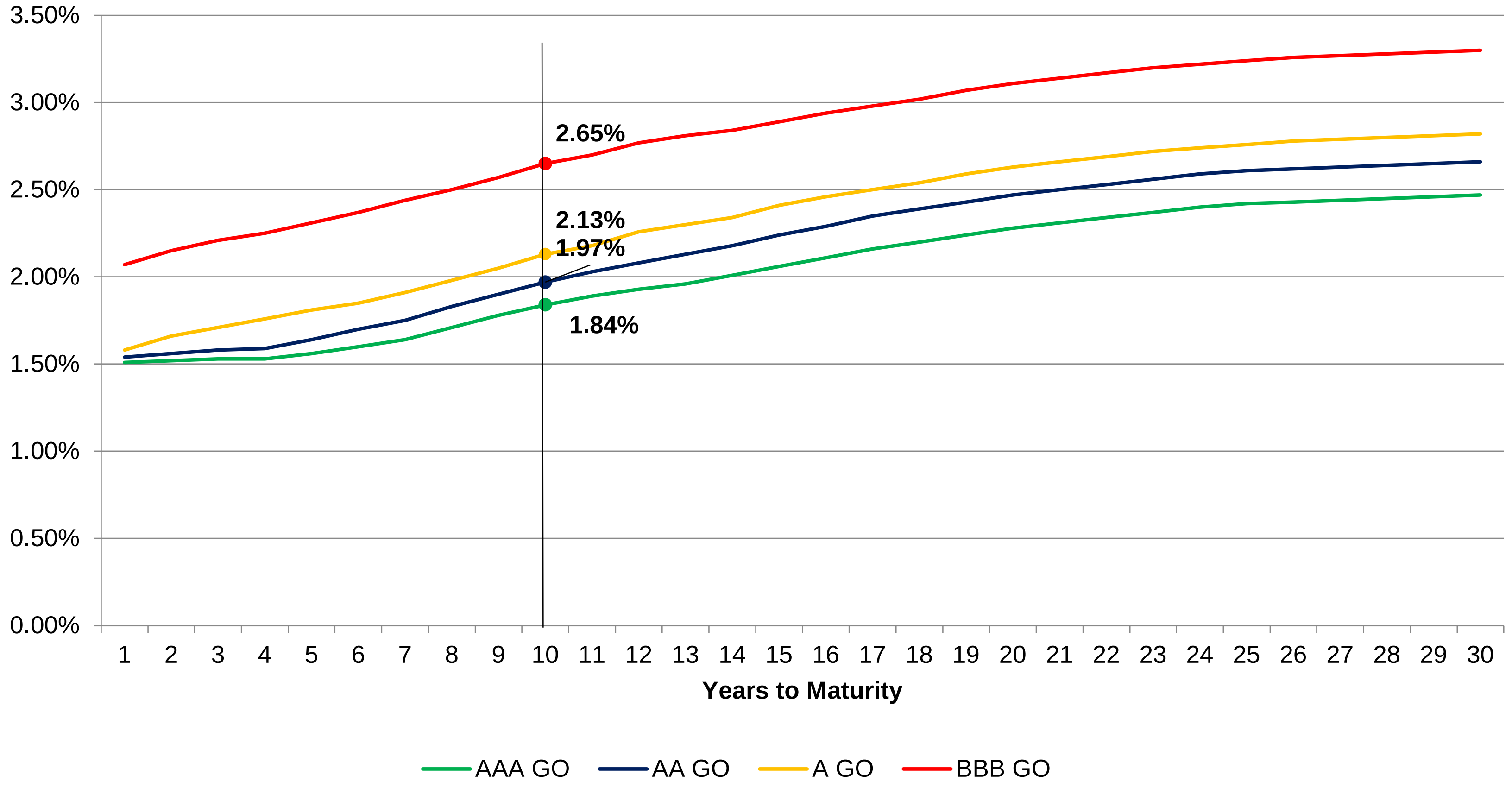
Fitch's View of Fairfax's Credit

- Strong revenue trends, largely reflective of property tax rate increases in four of the past eight fiscal years
- Healthy expenditure flexibility, with fixed carry costs (debt service, pension contributions & OPEB) consuming approximately 15% of FY2019 spending
- Expects liabilities to remain a moderate burden on resources
- Budget management in times of recovery noted as strong, crediting county for preparation for next downturn through enhancing reserves
- County has eliminated the practice of using reserves to balance the budget

"The County's AAA GO rating..reflect[s] exceptionally strong operating performance, supported by expenditure flexibility and a moderate long-term debt burden…The rating assumes near-term economic growth that leads to improved natural revenue growth as evidenced by consistent growth. Lack of near-term improvement could put negative pressure on the rating."

Value of High Credit Ratings

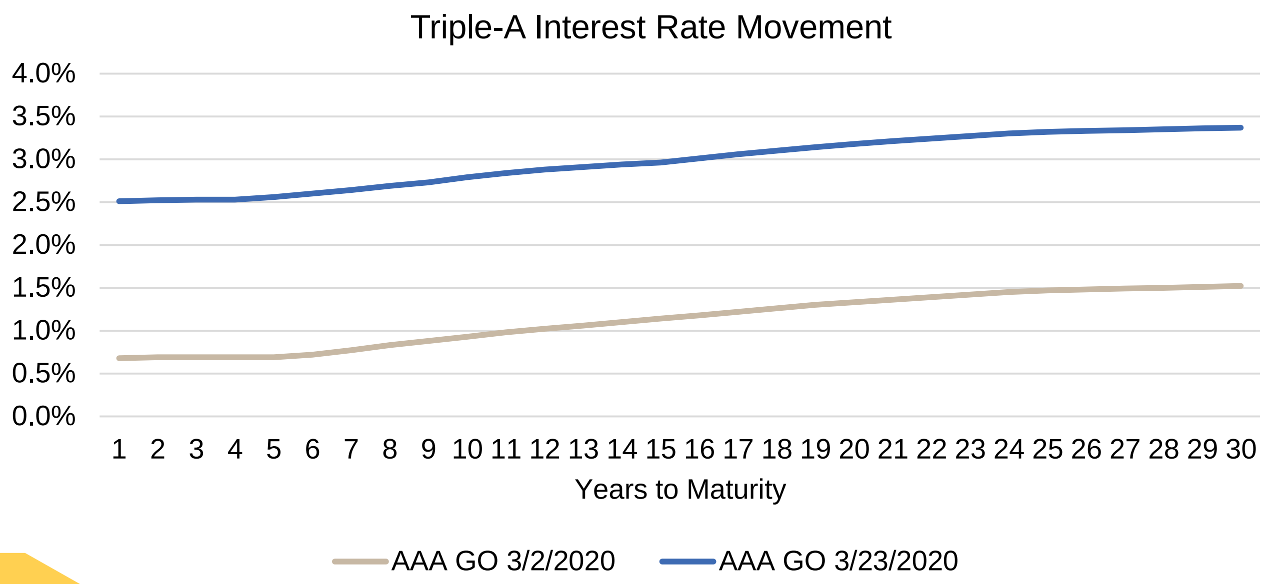
For the $3.5 billion of G.O. debt planned in the FY2021 to FY2030 CIP, the difference in total debt service on triple-A rated bonds vs. double-A rated bonds is estimated at $43 million.



Market conditions as of March 18, 2020

Triple-A Ratings in the Time of Coronavirus

- All local government credits are expected to be under ratings pressure given the pandemic & its implications
- Fairfax's AAA ratings are of their highest value when markets are melting down, like now
- High quality credit supports access to capital & liquidity in times of financial stress
- Triple-A ratings also allow the County to take advantage of bonds issued through EDA/FCHRA at double-A ratings & access favorable interest rates for non-G.O. projects
- Having financial flexibility is important & Fairfax exhibited this post-Lehman bankruptcy in 2008 when municipal markets shut down for several weeks



Concluding Remarks

- Current debt policies & practices support an affordable debt burden that is aligned with Fairfax's Aaa/AAA/AAA ratings
- Fairfax's debt management practices are consistent with the practices of other triple-A rated entities
- Fairfax has used multiple & diverse borrowing strategies, when prudent
- Opportunities to expand debt issuance should be examined in light of access to increased financial flexibility (i.e., diversified revenue, reserves, etc.) and ability to maintain Aaa/AAA/AAA ratings
- Impacts of COVID-19 on Fairfax County & its financial outlook & the County's financial management response will be primary focus of credit agencies in the near term

Thank You

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