

RatingsDirect®

Summary:

Petersburg, Virginia; General Obligation

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Summary:

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Credit Profile

Stafford Cnty & Staunton Indl Dev Auth GO (recovery act) pool II

<i>Long Term Rating</i>	BB/Watch Neg	Downgraded
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Petersburg GO rfdg bnds

<i>Unenhanced Rating</i>	BB(SPUR)/Watch Neg	Downgraded
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Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings has lowered its general obligation (GO) rating on the city of Petersburg, Va. three notches to 'BB' from 'BBB'.

At the same time, due to the city's participation in governmental agreements to provide for debt service payments, we have also lowered our underlying rating on the Stafford County & Staunton Industrial Development Authority's Municipal League-Virginia Association of Counties Finance Recovery Act Bond Pool II (of which Petersburg is a participant) three notches to 'BB' from 'BBB'. We have placed our long-term ratings on CreditWatch with negative implications.

The downgrade reflects our view that the city has very weak liquidity, based on what we believe is now limited market access to external liquidity. The city's failure to secure financing for its annual tax anticipation note (TAN) during the beginning of the fiscal year underscores its diminished market access. The 'BB' rating indicates that the city faces major ongoing uncertainties regarding financial conditions, which could lead to inadequate capacity to meet its financial commitments.

The current long-term rating is constrained by our view of the city's very weak liquidity based on diminished market access, weak management conditions that resulted from an ongoing structural imbalance with no credible long-term plan in place to restore fiscal solvency, and very weak flexibility with available reserves less than negative 5% of general fund expenditures.

The CreditWatch Negative reflects uncertainty as to whether the city can resolve its near-term liquidity concerns, as well as its near-term budget challenges to mitigate its fiscal 2017 budget gap.

The city has debt service payments coming due of \$775,637 for the month of September, \$670,000 of which is a principal payment on its series 2009 qualified school construction bonds (QSCB) due Sept. 1. There is an additional \$1.7 million due for the month of October, the majority of which is GO principal and interest payments due Oct. 1. City management has indicated that it has sufficient funds to meet its obligations through Sept. 15 and that property tax collections are due by Sept. 30. The receipt of tax collections, estimated at about \$4 million, should allow the city to meet those October obligations. Additional debt service payments of \$136,488 are due for November, \$969,435 for

December (at which point additional quarterly tax payments are due), and \$215,910 for January 2018.

In our opinion, the city is actively managing its cash flows to have the ability to meet these obligations based on timing of property tax collections, timing of payments, and other cash flow management practices. However, the lack of available cash flow statements and limited market access are a near-term credit concern.

On Aug. 23, the city council was presented with several recommendations to correct the current fiscal year budgetary imbalance and agreed to cut the budget by about \$12 million. Legally, the city must provide public notice and public hearings prior to final adoption of the recommended budget changes which is expected to occur Sept. 6. The continued delay in adopting corrective action and securing short-term financing calls into question the city's ability fund operations and meet its financial obligations, including bonded indebtedness. For Petersburg, we only rate the city's series 2004 GO refunding bonds with an interest payment due Jan. 15, 2017.

The city's full faith and credit pledge secures its GO bonds to levy, without limitation as to rate or an amount, an ad valorem tax on all taxable property within its jurisdiction to pay principal and interest on its GO bonds.

Payments on the Stafford County & Staunton Industrial Development Authority's Municipal League-Virginia Association of Counties Finance Recovery Act Bond Pool II bonds are secured by an intergovernmental agreement among various participants. The bonds are a limited obligation of the issuer and payable from loan repayments or lease repayments made by pool participants. The loan agreements structure loan or lease repayments to match debt service coming due on the series 2010A-F bonds, which is due 10 days before debt service on the authority's bonds. Pursuant to the loan agreements, the trustee will give the borrowers notice in writing of the total amount of the next basic payment due on the 15th day of the month immediately preceding an interest payment date. Unless an amount equal to the expected federal subsidy is on deposit with the trustee, participants are obligated to pay the gross amount of debt service. Each participant that has received RZEDB allocations has assigned its RZEDB allocation to the Stafford County & Staunton Industrial Development Authority, as the issuer. The issuer will also receive the Build American Bonds (BABs) subsidy, and each borrower will receive its BABs credit. Each participant's obligation to pay loans is several and not joint. In the absence of a step-up provision, the rating reflects the credit quality of the pool's weakest participant, which we believe is Petersburg.

Our view of the city's credit quality reflects the following characteristics, specifically its:

- Weak economy, with projected per capita effective buying income (EBI) at 66.5% and market value per capita of \$63,736, that benefits from access to a broad and diverse metropolitan statistical area (MSA);
- Weak management, with "vulnerable" financial policies and practices under our financial management assessment (FMA) methodology;
- Very weak budgetary performance, with operating deficits in the general fund and at the total governmental fund level in fiscal 2015;
- Very weak budgetary flexibility, with an available fund balance in fiscal 2015 at negative 6.1% of operating expenditures that is also low on a nominal basis at negative \$5.0 million, as well as limited capacity to raise revenues due to consistent and ongoing political resistance;
- Very weak liquidity, with total government available cash at 0.5% of total governmental fund expenditures and 9.6% of governmental debt service;
- Very strong debt and contingent liability position, with debt service carrying charges at 4.7% of expenditures, net

direct debt at 56.4% of total governmental fund revenue, and low overall net debt at less than 3% of market value; and

- Very strong institutional framework score.

Weak economy

We consider Petersburg's economy weak. The city, with an estimated population of 32,899, is 25 miles south of Richmond on Interstate 95, encompassing about 23 square miles in Petersburg City (Dinwiddie County/Colonial Heights/Petersburg combined area). It is in the Richmond MSA, which we consider to be broad and diverse. It has a projected per capita EBI of 66.5% of the national level and per capita market value of \$63,736. Overall, market value fell by 2.4% over the past year to \$2.1 billion in 2015. The unemployment rate was 6.6% in 2015.

Despite access to a broad and diverse MSA, the city exhibits below-average wealth and income levels and has undergone a population decline over the past decade. Property values have also remained stagnant at around \$2.1 billion on average for the past five years.

According to the U.S. Census Bureau, the city's poverty rate of 27.5% is more than double the percentage of people living in poverty in the state overall (11.5%) and in the Richmond MSA (12.3%) and a slightly higher rate of poverty than Richmond (25.5%).

Weak management

We view the city's management as weak, with "vulnerable" financial policies and practices under our FMA methodology, indicating the government lacks policies in many of the areas we believe are most critical to supporting credit quality.

The city council negotiated an exit of its former city manager of five years in March 2016 and has had an interim manager in place since April. The city's finance director of five years also departed in April 2016 and the assistant finance director is serving as director in an interim capacity. In May 2016, the state received an informal request for technical assistance from the acting city manager. Since then, the city council passed an ordinance authorizing a request for additional technical assistance past June 30, 2016, that had been approved by the governor through July 29, 2016.

Our view of the city's weak management is constrained by our view of an ongoing structural imbalance with no plan to correct. While measures have been identified for the current fiscal year, it is unclear if such measures can be sustained over the long term.

Based on a report by the state, the accumulated overspending across all accounts from fiscal years 2012-2016 is nearly \$16 million with nonrecurring revenues and restricted revenues used. There is the potential that this amount could increase, based on further analysis. The state is working with the city on improving internal controls and monitoring after concluding that the city's general ledger financial information is difficult to tie to the annual adopted and amended budgets. The city currently tracks both daily and weekly cash-flow projections for managerial purposes, but month-to-month cash flow statements are currently unavailable.

Our current FMA assessment reflects our view of the city's recent over-optimistic revenue and expenditure assumptions and lack of meaningful budgetary amendments to addresses annual shortfalls. The lack of these controls

has resulted in a structural imbalance as expenditures have significantly exceeded revenues in recent years. The city has a negative reserve position, coupled with inadequate cash management practices that have contributed to historically thin liquidity. While it does not currently have a credible long-range planning in place, we recognize that through outside consultants, a plan is being developed to restore fiscal stability. However, in our opinion, implementation risk is a concern as the city attempts to improve its fiscal position. The city does not maintain formal debt management policies.

Very weak budgetary performance

Petersburg's budgetary performance is very weak, in our opinion. The city had operating deficits at negative 6.7% of expenditures in the general fund and negative 6.5% across all governmental funds in fiscal 2015. Weakening our view of Petersburg's budgetary performance is the city's deferral of significant expenditures, which we think inflates the budgetary result ratios.

In fiscal 2015, the general fund expended \$82.9 million while revenues totaled \$77 million, a deficiency of \$5.9 million. The negative variance largely reflects revenues, mainly general property taxes of \$3.5 million and other local taxes of \$1.8 million coming in under budget and expenditures for public safety and health and welfare exceeding budget by \$2.5 million.

Based on the state's technical assistance team report, the general fund ledger across all funds shows expenditures exceeded revenue by at least \$5.3 million in fiscal 2016, indicating continued weak performance in the fiscal year. Based on the current fiscal imbalance, in our opinion, the city is deferring payment on a cash basis as it has insufficient liquidity and must prioritize payments.

The state's team has also identified a structural imbalance with the city's fiscal 2017 budget. The estimated budgetary shortfall of \$12 million is based on unaudited fiscal 2016 revenues and estimated fiscal 2017 expenditures for all funds.

The city has already enacted a 10% pay reduction for employees that will generate an estimated \$2.5 million in savings for fiscal 2017. Additional proposed changes include reducing the city's school contribution by \$4.1 million to the minimum level required by state law. These two changes make up more than 50% of the city's estimated fiscal 2017 budget gap. However, we believe these budget practices may not be sustainable for future budgets and that future fiscal reforms beyond the current year are at risk. Given these risks, in our opinion, the plan will likely alleviate short-term pressures, but is not credible to restore balance over the long term. The city has had negative revenue and expenditure variances for all funds (excluding schools) of \$16 million from 2012-2016 despite a positive year in fiscal 2014 due primarily to expenditure reductions. The city underperformed its budget on revenues by nearly \$3 million in 2014.

Very weak budgetary flexibility

Petersburg's budgetary flexibility is very weak, in our view, with an available fund balance in fiscal 2015 at negative 6.1% of operating expenditures. We expect the available fund balance to remain below negative 5% of expenditures for the current and next fiscal years, which we view as a negative credit factor. In addition, the city's reserves are low on a nominal basis at negative \$5.0 million, which we view as vulnerably low and a negative credit factor. Weakening budgetary flexibility, in our view, is limited capacity to raise revenues due to consistent and ongoing political resistance.

The city currently has \$9.148 million due from other governmental units on its general fund balance sheet, representing primarily \$6.4 million from its mass transit enterprise fund and \$2 million from its golf course enterprise fund. The balance of this receivable is recorded as a non-spensible in the general fund balance sheet for McKenney scholarships.

Given the extreme fiscal imbalance for the year and significant decline in available general fund reserves, the uncollected receivables represent a significant challenge for the city. Budgetary flexibility will likely remain very weak for the medium term.

Property taxes represent the city's largest revenue source at 42% for the general fund. Petersburg has one of the highest property tax rates in the state at \$1.35 per \$100 of value. The rate was reduced to \$1.35 in 2007 and has stayed there since. In our opinion, the city has demonstrated a limited capacity to raise revenues during a period of ongoing fiscal pressure.

Very weak liquidity

In our opinion, Petersburg's liquidity is very weak, with total government available cash at 0.5% of total governmental fund expenditures and 9.6% of governmental debt service in 2015. In our view, the city has limited access to external liquidity if necessary.

The city's liquidity position is extremely thin, with no unrestricted cash assets in its governmental funds and only \$392,090 in its enterprise funds. The state's team estimates that following the TAN repayment at the end of fiscal 2016, there were \$18.8 million in unpaid obligations (\$14.7 million to external entities and \$4.1 million of internal loans from other funds).

According to the state's presentation, the city will have extreme difficulty paying essential bills (including payroll) in the latter part of 2016. Historically, it has operated with little to no cash reserves, relying on TANs to meet liquidity needs. The city was nearly unable to repay its last TAN by July 1, 2016, and has not secured short-term financing in fiscal 2017, presenting a severe liquidity concern in the coming months.

In our opinion, the city has market obstacles to the use of debt instruments for liquidity management and the availability of bank loans is limited given its direct placement of its annual TAN and current inability to secure short-term financing.

The city has entered into privately placed GO- and appropriation-backed bonds. Some appropriation-backed obligations are subject to partial acceleration for all payments due within the year. However, in our opinion, these do not pose a liquidity concern at this time. The city does not report any covenant violations and is not aware of any ratings triggers on its obligations.

Very strong debt and contingent liability profile

In our view, Petersburg's debt and contingent liability profile is very strong. Total governmental fund debt service is 4.7% of total governmental fund expenditures, and net direct debt is 56.4% of total governmental fund revenue. Overall net debt is low at 2.2% of market value, which is, in our view, a positive credit factor.

The city has no additional debt plans, but may seek to restructure its debt for budgetary relief. While it has a significant

back-log of unpaid bills, it is unclear at this point how it will choose to address these outstanding obligations.

Petersburg's combined required pension and actual other postemployment benefit (OPEB) contributions totaled 4.9% of total governmental fund expenditures in 2015. The city made its full annual required pension contribution in 2015.

All full-time, salaried permanent employees of the city are automatically covered by the Virginia Retirement System (VRS). The city's contractually required contribution rate for the year ended June 30, 2015 was 15.25% of covered employee compensation. The plan's fiduciary net position as a percentage of the total pension liability measured at the fiscal year-end 2015 was 86.88% for the city. Eligible retirees may elect to purchase retiree health care up until age 65 through the city's health plan. For participating retirees, the city contributed zero per month toward the monthly premium and the retiree contributes all remaining funds toward the premium. Retirees pay 100% of spousal premiums. The plan is funded on a pay-as-you-go basis.

In a letter dated July 11, based on publicly available reports, the VRS informed state legislators that the city was more than 60 days late on payments totaling \$1.9 million, and the total had since risen to \$2.3 million.

Very strong institutional framework

The institutional framework score for Virginia cities is very strong.

CreditWatch

The CreditWatch Negative reflects uncertainty as to whether the city can resolve its near-term liquidity concerns. Obtaining market access could be a key to improved liquidity. In our opinion, the city is actively managing its cash flows to have the ability to meet its obligations based on timing of property tax collections, timing of payments, and other cash flow management practices. However, it faces major ongoing uncertainties regarding financial conditions, which could lead to inadequate capacity to meet its financial commitments.

Within the next 90 days, the city should be able to provide updated information on its ability to obtain short-term financing and close its fiscal 2017 budget gap of \$12 million. The city has upcoming payments on bonded indebtedness which should be made, based on current cash on hand and upcoming receipt of quarterly property tax collections due before Sept. 30 and Dec.31.

If the city can obtain short-term liquidity, resolving current cash concerns, and mitigating its \$12 million budget gap, we may affirm the rating and resolve the CreditWatch. If interim financing is achieved but proposed budgetary reforms appear to be insufficient for the current year, we may lower our rating. However, if current-year budgetary action is insufficient or interim financing is not achieved with cash flow suggesting continued liquidity strain that could impair payment on its obligations, we would likely lower the rating by several notches.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, July 27, 2016
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local

Government GO Criteria, Sept. 2, 2015

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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