

RatingsDirect®

Summary:

Petersburg, Virginia; General Obligation

Primary Credit Analyst:

Timothy W Little, New York (212) 438-7999; timothy.little@spglobal.com

Secondary Contact:

Timothy W Barrett, Washington D.C. (1) 202-942-8711; timothy.barrett@spglobal.com

Table Of Contents

Rationale

Outlook

Related Research

Summary:

Petersburg, Virginia; General Obligation

Credit Profile		
Stafford Cnty & Staunton Indl Dev Auth GO (recovery act) pool II		
<i>Long Term Rating</i>	BB/Negative	Affirmed
Petersburg GO rfdg bnds		
<i>Unenhanced Rating</i>	BB(SPUR)/Negative	Affirmed

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings has removed its 'BB' rating on Petersburg, Va.'s existing general obligation (GO) debt from CreditWatch, where it had been placed with negative implications on Aug. 26, 2016. We affirmed the rating. The outlook is negative.

At the same time, due to the city's participation in governmental agreements to provide for debt service payments, we affirmed our 'BB' 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). 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.

We removed the rating from CreditWatch due to the city securing \$6.5 million in cash-flow notes. Petersburg annually issues cash-flow notes, but was unable to do so earlier this year and faced a substantial liquidity shortfall. By placing the notes, it will be able to meet debt service and primary operating expenses as it works to address its structural imbalance. The notes issued December 2016 mature in 10 months.

The negative outlook reflects uncertainty regarding the city's ability to create, implement, and sustain structural budgetary reforms. To aid Petersburg's efforts to obtain short-term financing, ensure implementation of a balanced 2017 budget, generate a budget calendar for 2018, and develop a long-range plan to restore fiscal stability, the city council has hired The Robert Bobb Group to serve as interim city management for a five-month period (ending March 2017). City council previously adopted measures toward establishing a balanced fiscal 2017 budget, but it is unknown if such measures are sufficient to achieve structural balance and management could not provide an update on expected results for fiscal 2016 (fiscal year-end June 30). The audit results for 2016 are likely to be significantly delayed. Further heightening implementation risks are an uncertain management environment following the conclusion of the interim financing team's contract and substantial staff turnover within the past year.

The current long-term rating is constrained by our view of the city's very weak liquidity based on diminished market access, very 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 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 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 recovery zone economic development bond (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 market value per capita of \$63,736 and projected per capita effective buying income (EBI) at 66.7%, but that benefits from access to a broad and diverse metropolitan statistical area (MSA);
- Very 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 of 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, and access to external liquidity we consider limited;
- Very strong debt and contingent liability position, with debt service carrying charges at 4.7% of expenditures and net direct debt that is 56.4% of total governmental fund revenue, as well as 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 in Petersburg City (in the Dinwiddie County/Colonial Heights/Petersburg combined area) in the Richmond MSA, which we consider to be broad and diverse. It has a projected per capita EBI of 66.7% 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 county 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 the city of Richmond (25.5%).

Very weak management

We view the city's management as very 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.

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

The city council negotiated an exit of its former city manager of five years in March 2016 and the finance director of five years also departed in April 2016. Interim managers replaced them. 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.

The city council has hired The Robert Bobb Group to serve as interim city management for a five-month period (ending March 2017). The major goals of the group are to obtain short-term financing, ensure implementation of a balanced 2017 budget, generate a budget calendar for 2018, and develop a long-range plan to restore fiscal stability. As part of the deficit mitigation this summer, the city cut 10% of pay across the board. This has resulted in 146 resignations and to date this fiscal year, almost \$200,000 in leave payouts. Over the past summer, most senior department heads have left. While it is a goal of the interim management to recruit and hire key staff to facilitate the city's turnaround once its contract ends, the instability and turnover, coupled with what have been inadequate financial controls, have contributed to negative financial results.

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

We recognize the city has hired interim management to aid in its recovery and new financial policies and controls are likely to be implemented over the next four months.

Very weak budgetary performance

Petersburg's budgetary performance is very weak, in our opinion. The city had operating deficits of 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. The city has insufficient resources to meet current-year expenditures evidenced by a back-log of unpaid bills and paying prior-year invoices from current-year resources. These deferred payments on a cash basis further inflate audited results.

The state's technical assistance team has also identified a structural imbalance with the city's fiscal 2017 budget. The city council acted on measures to eliminate the \$12.5 million deficit. Even with the reduction, there is significant risk; it is unclear if sufficient controls and monitoring are in place to ensure Petersburg can meet its fiscal 2017 targets. Significant mitigation measures included a 10% pay reduction for employees that will generate an estimated \$2.5 million in savings for fiscal 2017 and \$4.1 million reduction 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 about \$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 of 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.

Audited 2015 results reported the city had \$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-spendable 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. Petersburg has historically used special revenue and enterprise funds to pay general fund obligations. 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 based on audited 2015 results. The state's technical assistance team estimates that following the tax anticipation note (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).

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 difficulty securing short-term financing. The city was able to secure a \$6.5 million privately placed TAN maturing cross fiscal years in 10 months (October 2017) with Wells Fargo at an interest rate of 4.5%. In our opinion, the interest rate is high compared to other non-distressed entities that annually place TANs, further underscoring the fiscal distress of the city. The loan should bridge the timing needed for implementing structural reforms and improving budgetary practices while the 2016 audit is completed, fiscal 2017 is monitored, and a budget for fiscal 2018 is developed. However, it is likely the city will continue to rely on short-term financing for annual operating expenditures.

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. Late payments are likely to continue, further stressing the city's liquidity pressures.

Very strong institutional framework

The institutional framework score is very strong.

Outlook

The negative outlook reflects the extreme uncertainty regarding Petersburg's ability to return to structural balance and what will likely be persistently very weak liquidity in a difficult budgetary environment. If the city cannot continue implementing and sustaining structural reforms following the departure of interim management in March 2017, resulting in further fiscal deterioration or potential inability to make timely payments on its obligations, we could lower the rating further. Over the next year, if the city can produce a credible plan to restore solvency, meet its fiscal targets, and improve liquidity, we may revise the outlook to stable.

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
- 2015 Update Of Institutional Framework For U.S. Local Governments

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.

Copyright © 2017 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription) and www.spcapitaliq.com (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.