Davenport & Company

Strategic and Holistic Plan of Finance Prepared for the City of Petersburg, Virginia

March 14, 2017

Table of Contents

1. Background

Background

Background

- In the 3rd and 4th quarters of FY 2016, the City of Petersburg (the "City") faced a financial crisis resulting from years of structurally unbalanced budgets and a breakdown of its utility billing/collection processes, among other issues.
- In the summer of 2016, at the request of the City the Commonwealth's Technical Assistance Team undertook a review of the City's financial operations.
- In August 2016, the Commonwealth, Davenport & Company LLC (Financial Advisor to the City) and PFM delivered a Joint Presentation to City Council:
  - Commonwealth: presented its finding that the City had upwards of $18.8 million of unpaid obligations as of June 30, 2016.
  - Davenport: presented it's review of the City's deteriorating year-to year financial condition, which had been previously provided in 2012.
  - PFM: presented its FY 2017 budget amendment action plan.

Background (Cont)

Background

- In response to the August 2016 Joint Presentation, the City took the following steps:
  - Hired an Emergency Management Team (the Robert Bobb Group) and hired an Interim Assistant City Manager;
  - Amended its FY 2017 Budget in an attempt to bring about structural balance and conducted a mid-year budget review to further adjust the budget as necessary;
  - Obtained a Revenue Anticipation Note;
  - Implemented greater financial controls to monitor and control spending;
  - Worked to repay its outstanding unpaid obligations, which approximated $18.8 million at June 30, 2016, through various payment plans; and
- In late 2016 and early 2017, Davenport & Company LLC, as Financial Advisor, worked with the City in developing a Strategic and Holistic Plan of Finance in order to “reset” the City’s finances.

2. Current State of the City

Current State of the City

Key Observations

- The City continues to be in fiscal stress and is actively managing its finances on a daily basis.
- The City has NEGATIVE Fund Balance, which means that it has effectively no savings that can be used to manage cash flow
  - *Rather, the City is still projected to owe various creditors an estimated $8.7 million (excluding the 2016 RAN) as of June 30, 2017 (the "Remaining Unpaid Obligations" – i.e. past due bills)*.
- With the development of the FY 2018 budget, the City continues to face pressure on limited resources in order to fund both current needs and repay its Remaining Unpaid Obligations.
  - *The City still faces financial challenges in FY 2018 and beyond.*
- Absent a liquidity event that provides a one-time windfall of cash, the City will need to undertake another Revenue Anticipation Note ("RAN") borrowing almost immediately after the current RAN is repaid by this October.

Current State of the City (Cont)

Key Observations

- The City's bond rating from Standard & Poor's ("S&P"), one of the three National Credit Rating Agencies, is "BB" with a Negative Outlook (See Appendix A). This rating is below investment grade and is the lowest of any local government in the Commonwealth.

- S&P cites the following in its most recent Credit Report dated December 14, 2016 (See Appendix B):
  - "The Negative Outlook reflects uncertainty regarding the City's ability to create, implement and sustain structural budgetary reforms."
  - "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 in an ongoing structural imbalance…"
  - "…No credible long-term plan in place to restore fiscal solvency…"
  - "…Very weak flexibility with available reserves less than negative 5% of general fund expenditures."

- The City adopted Financial Policy Guidelines in September 2, 2014 (See Appendix C) that govern Budgeting Practices, Debt Management and Fund Balance, but has not adhered to the adopted policies.

Current State of the City (Cont)

Unassigned Fund Balance

- Most recent audited financial statements for fiscal year ended June 30, 2015 show a ***NEGATIVE Unassigned Fund Balance of $5.0 million and a Reconciled Overdraft of approximately $7.1 million.***
  - Unassigned Fund Balance is essentially a "Rainy Day" Fund or "savings account" that the City needs to have in order to manage the timing of revenue inflows and expenditure outflows of the annual budget.
  - In addition, an Unassigned Fund Balance could also serve as a source of one-time cash in an emergency situation.

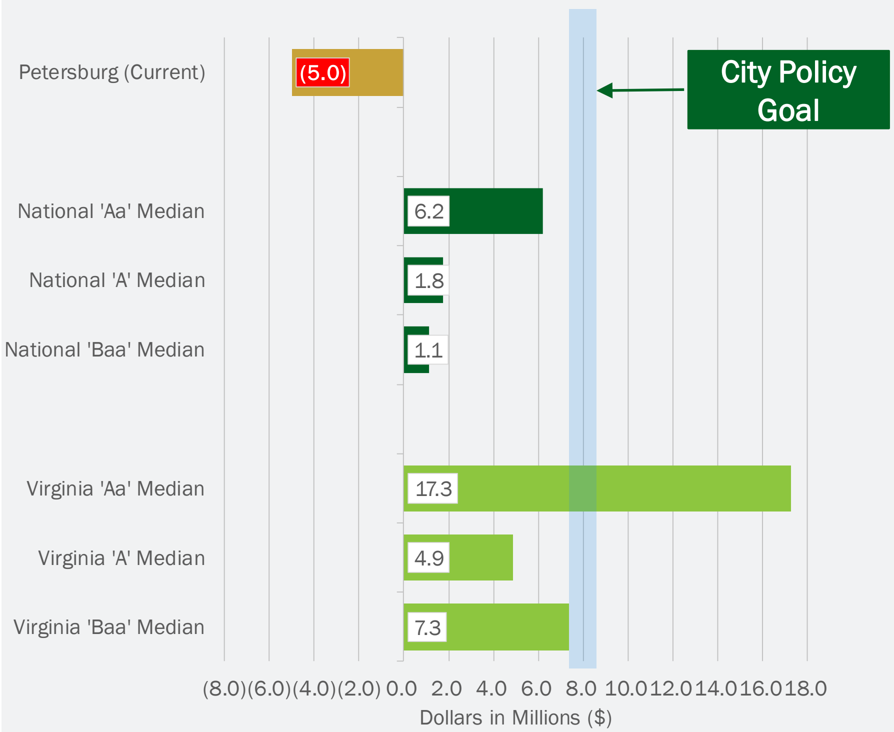
- The City's Unassigned Fund Balance should be sufficient and in keeping with "Best Practices" so that annual RAN cash flow borrowings are not necessary.
  - "Best Practices" are those considered to be appropriate and prudent for fiscally responsible and well managed local governments based on National Credit Rating Criteria, Government Finance Officers Association ("GFOA") criteria and strongly rated local governments.
  - Minimum of two months general fund operating revenues according to GFOA – This translates into an approximate amount of $13.2 million[(1)].
  - 15% to 20% of budgeted operating revenues/expenditures based on comparative data for strongly rated "A" or better local governments – This translates into a range of $11.9 to $15.8 million[(1)].
  - Based on the City's financial policies adopted in 2014, the Unassigned Fund Balance goal is 10% of Operating Revenues. Currently the City does not meet this goal.

(1) Based on a $79.2 million budget excluding water and sewer and storm water utilities.

Unassigned Fund Balance Comparative

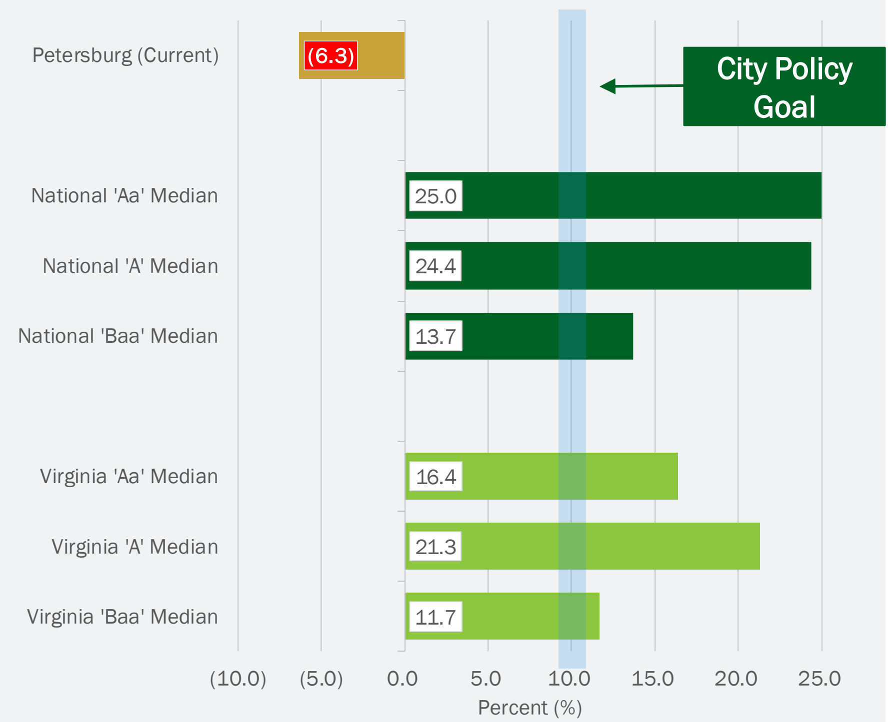
Unassigned Fund Balance $

- The City has a NEGATIVE $5.0 million Unassigned Fund Balance.



Unassigned Fund Balance - % of Revenue

- Unassigned Fund Balance as a % of Revenue is NEGATIVE 6.3%.



The Path Forward: The Road to Financial Recovery

The Road to Financial Recovery

The Road to Financial Recovery is a long-term plan to restore fiscal solvency and includes:

- Structurally balanced governmental operating budgets that are responsible and sustainable.
- Budgeting annual additions to Unassigned Fund Balance until the appropriate policy target level has been attained.
  - An Unassigned Fund Balance at a appropriate level is essential to a healthy and vibrant city.
- Follow the adopted Financial Policy Guidelines in all areas.
- <u>As soon as practical, implement the Strategic and Holistic Plan of Finance that includes a Targeted Restructuring of annual debt service payments.</u>
- Implement a plan to address the City's Utility Enterprise Fund with the understanding that rates will increase in order to pay for operations, repairs, maintenance and capital investment.
  - Note: the plan and rate study impact for the Utility Enterprise Fund is currently being analyzed by the City's Management, Engineering Consultants, Financial and Rate consultants and will be presented to City Council at a later date.

3. Strategic and Holistic Plan of Finance

Targeted Restructuring of City Debt

Strategic and Holistic Plan of Finance

The Targeted Restructuring of City Debt

- Davenport has developed the Strategic and Holistic Plan of Finance – The Targeted Restructuring of City Debt– to be implemented by the City that will assist in resetting the City's finances.

- Goals & Objectives of the Targeted Restructuring include:

  A. Provide budgetary cash flow relief from a heavily front-loaded debt service structure;

  B. Level out the City's debt service payments akin to a home mortgage style repayment.

  C. Provide budget flexibility by reducing debt service payments in the next 5-years;

  D. Allow the City to begin to rebuild fund balance as soon as possible;

  E. Provide the ability to repay any remaining Unpaid Obligations so as to avoid potential litigation.

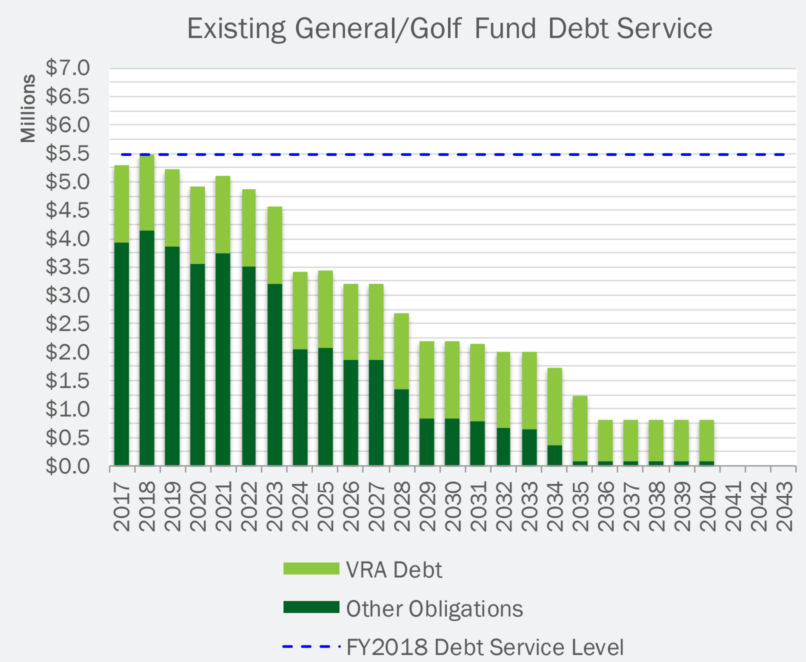
  F. Preserve the ability to borrow for future capital needs at a later date.

Existing General/Golf Fund Debt Service

Key Observations

- As of 3/14/2016, outstanding debt supported by the General/Golf Funds totals $50.5* million as follows:
  – $17.9 million G.O. Bonds issued through VRA;
  – $23.9 million non-VRA G.O. debt.
  – $8.7 million of Leases.
- FY 2017 debt service is $5.3 million.
- FY 2018 debt service is $5.5 million.
- Note: the City has $15.0 million of Utility/Stormwater Fund related debt not included in the figures above.

Existing General/Golf Fund Debt Service*



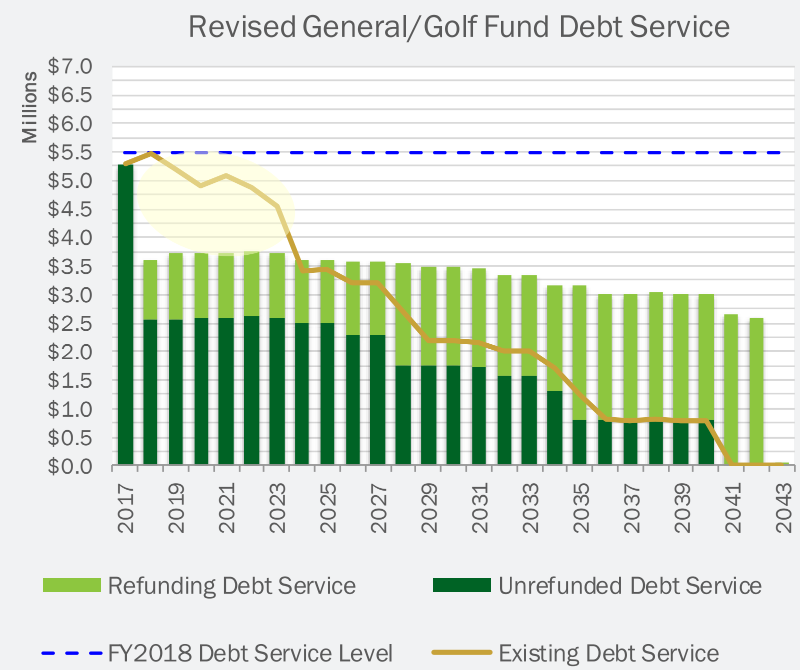
* Does not include Utility/Stormwater Fund debt.

Preliminary Results
The Targeted Restructuring of City Debt

Key Observations

- Approximately $18.6* million of Existing Debt is restructured:
  - $13.5* million of City G.O. Bonds; and
  - $5.1 million of bonds issued through VRA.
- Approximate $23.3 million financing minimizes issuance of Stand Alone “BB/A (intercept)” rated City G.O. Bonds.
- Revised annual Debt Service approximates $3.7 million for the next 10 Years and gradually declines thereafter.

Revised Debt Service Schedule vs. FY 2018 Budget



* Includes $733,000 of Utility Fund allocated debt.

Note: Based on market conditions as of February 27, 2017 obtained from Crew & Associates, Inc. Preliminary, subject to change.

Cash Flow Relief

The Targeted Restructuring of City Debt

Revised Debt Service Schedule vs. FY 2018 Debt Service Budget

- Provides $8.9 million in Cash Flow Relief in the next five years (i.e., from FY 2018 to FY 2022) related to General/Golf Fund debt service.

	FY 2018 Budgeted Debt Service	Revised Debt Service	Cash Flow Difference
Totals	**$ 32,726,834**	**$ 23,830,063**	**$ 8,896,771**
FY			
2017	5,293,118	5,288,809	4,309
2018	5,486,743	3,619,195	1,867,549
2019	5,486,743	3,719,520	1,767,223
2020	5,486,743	3,728,690	1,758,053
2021	5,486,743	3,726,268	1,760,475
2022	5,486,743	3,747,581	1,739,163

Note: FY 2023 and thereafter not shown.

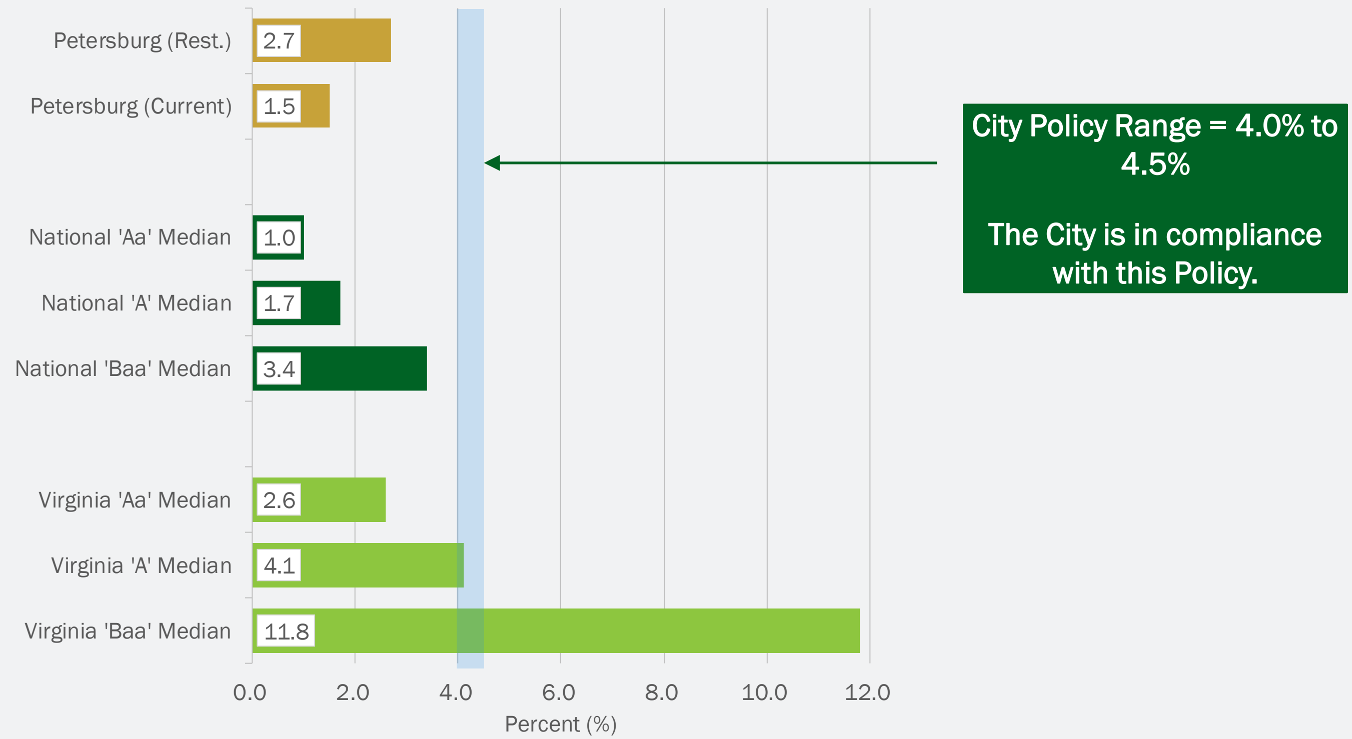
Note: Based on market conditions as of February 27, 2017 obtained from Crew & Associates, Inc. Preliminary, subject to change.

Key Debt Ratio/City Policy: Debt to Assessed Valuation

The Targeted Restructuring of City Debt

Tax Supported Debt to Assessed Valuation

- The City's Debt to Assessed Value[1] is in-line with National and Virginia medians and is below 4%, which is generally considered an industry standard benchmark for strongly rated communities.
  - City Policy: Debt shall not exceed 4.0% to 4.5% of Assessed Value.

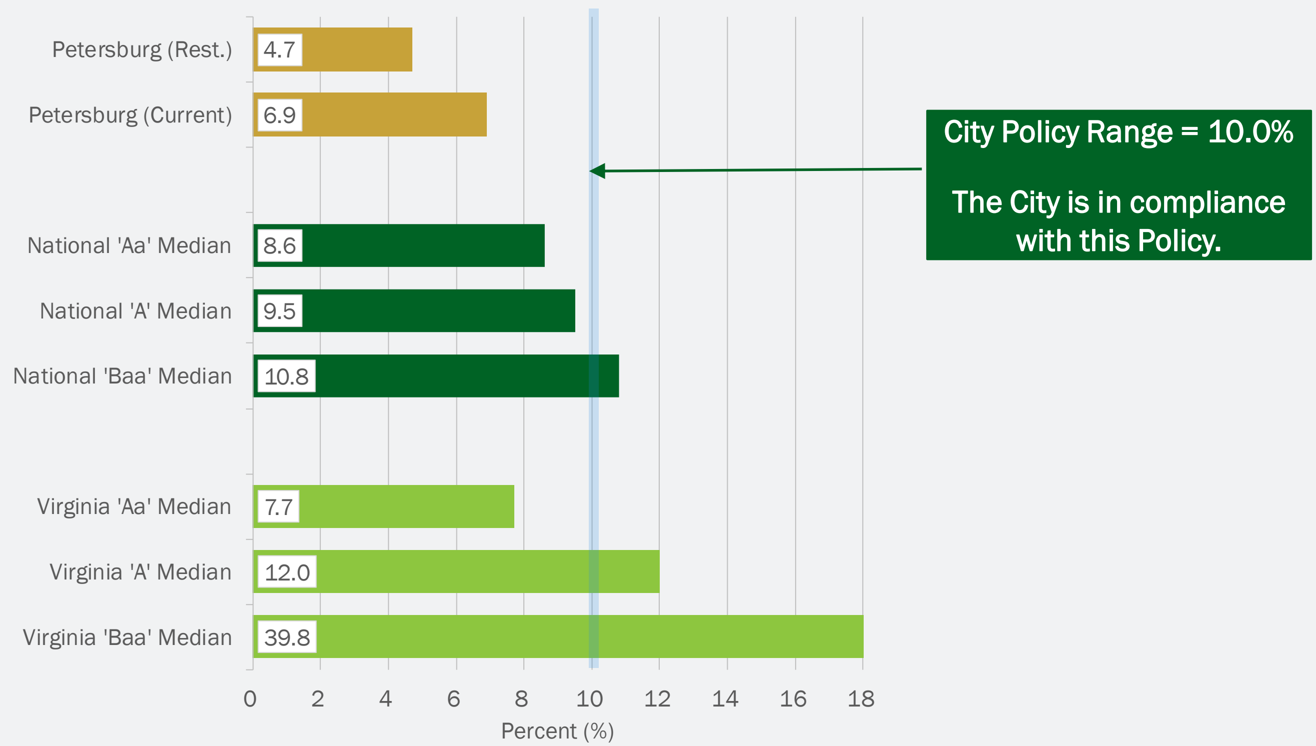


(1) Total Assessed Value is based on FY 2017 Budget for Real Estate Values and FY 2015 Personal Property Values.

Key Debt Ratio/City Policy: Debt Service vs Expenditures
The Targeted Restructuring of City Debt

Tax Supported Debt Service vs. Expenditures

- The City's Debt Service versus Expenditures[1] is below National and Virginia medians and is well below the industry standard benchmark level of 10% to 12% for strongly rated communities.
  - City Policy: Debt Service shall not exceed 10.0% of Expenditures.



(1) Based on FY 2018 Budget for debt service versus amended FY 2017 Budget (excluding Utilities and Stormwater).

Goals Achieved

The Targeted Restructuring of City Debt

Goals Achieved by the Targeted Restructuring

- Immediate reduction in debt service payments beginning in FY 2018.
- Provides enhanced budget flexibility.
- Preserves approximately $24 million of borrowing capacity in the next decade;
- Allows the City to:
  - Rebuild fund balances sooner rather than later. ***This is a key consideration for the Credit Rating Agencies;*** increasing fund balance will enable the City to reduce its reliance on costly RAN borrowings;
  - Repay Remaining Unpaid Obligations from cash flow;
  - Fund new capital projects and/or deferred maintenance needs sooner rather than later; or
  - Some combination of the above.

* Does not include Utility Fund debt.

Key Considerations
The Targeted Restructuring of City Debt

- The Targeted Restructuring results in an approximate present value cost of \$3.1 million. However, the following offsets need to be taken into consideration:
  - Ability to reduce and eventually eliminate the RAN – potential interest costs avoidance ranging from \$200,000 to \$500,000 per year.
  - Funding capital sooner rather than later avoids potential inflationary impacts. (i.e. for each \$5 million investment that is accelerated by 5 years, approximately \$800,000 in inflationary costs(1) can be avoided).

- Non-quantifiable offsets include:
  - Enhanced financial and budget flexibility; and
  - Improved credit standing as determined by the Rating Agencies (Note: Unassigned Fund Balance is viewed as the single most important factor in addition to structurally balanced budgets).

(1) Assumes compounded inflation rate of 3.5% on \$5 million project cost over 5 years.

Next Steps / Timetable for Action

The Targeted Restructuring of City Debt

Preliminary Time Schedule

- Implementing the Strategic and Holistic Plan of Finance is dependent on the completion of the FY 2016 Audited Financial Statements (Preliminary time schedule below assumes Audited Financial statements are completed by May 1).
- Note: to the extent the Audited Financial Statements are delayed beyond May 1, the timing below will be affected.

Date	Activity
March	• Begin drafting of Preliminary Official Statement (disclosure document)
April	• City to provide status report on unpaid obligations and year-to-date FY 2017 revenues versus expenditures.
Mid/Late May	• Rating agency meeting/conference call with Standard & Poor's - formal rating request for Restructuring Bonds.(timing subject to draft audit availability).
Late May	• City Council to authorize via resolution the issuance of the Restructuring Bonds.
By May 31	• Completion of FY 2016 Audited Financial Statements.
Early/Mid June	• Receive ratings; Mail Preliminary Official Statement • Sell Restructuring Bonds; results are finalized.
Mid/Late June	• Close Restructuring Bonds.

Appendix A:
Rating Table/Petersburg Credit Rating

Petersburg Credit Rating

- The City's current rating is "BB" with Negative Outlook by Standard & Poor's, one of the three nationally recognized rating agencies for municipal debt and local governments.
- "BB" is a "Below Investment Grade" rating.
- "Negative Outlook" means that in the next rating review, the Rating Agency may either:
  - Take additional rating action that could include further downgrades; or
  - Removal of the "Negative Outlook".

		Moody's	S&P	Fitch
Top tier "Highest Possible Rating"		Aaa	AAA	AAA
2nd Tier "Very Strong"	(Highest)	Aa1	AA+	AA+
	(Middle)	Aa2	AA	AA
	(Lowest)	Aa3	AA-	AA-
3rd Tier "Strong"	(Highest)	A1	A+	A+
	(Middle)	A2	A	A
	(Lowest)	A3	A-	A-
4th Tier "Adequate Capacity to Repay"	(Highest)	Baa1	BBB+	BBB+
	(Middle)	Baa2	BBB	BBB
	(Lowest)	Baa3	BBB-	BBB-
5th - 10th Tiers "Below Investment Grade"				
5th Tier		Ba	BB	BB
6th - 10th Tiers		B, CCC, CC, C, D		

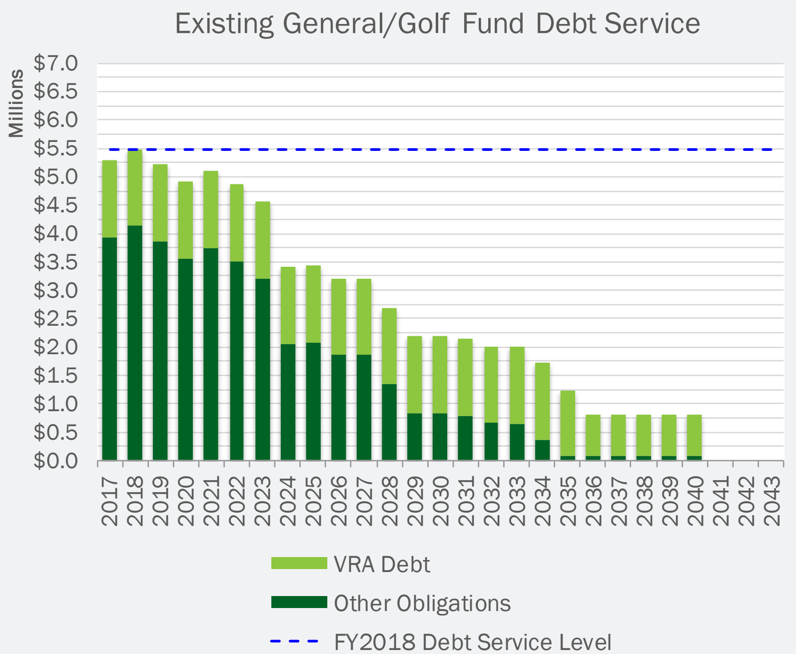
Appendix B: Standard & Poor's Credit Report Dated December 14, 2016

Appendix C: City of Petersburg Financial Policy Guidelines

Appendix D: Existing Debt

Exhibit A: Existing Debt Service*

General Fund/Golf Fund Debt Service



- As of 12/8/2016, outstanding debt supported by the General/Golf Funds totals $50.9 million.
  - VRA related debt is $17.6 million or 35% .
- FY 2017 debt service is $5.3 million.
- FY 2018 debt service is $5.5 million.

Debt Service Schedule

Existing General+Golf Fund Debt Service	VRA Debt Service	Other Debt Service	Total Debt Service
Totals	$ 29,166,698	$ 39,698,264	$ 68,864,961
FY			
2017	1,355,731	3,937,387	5,293,118
2018	1,353,881	4,132,862	5,486,743
2019	1,353,816	3,857,824	5,211,640
2020	1,356,891	3,560,857	4,917,748
2021	1,358,328	3,741,361	5,099,690
2022	1,358,103	3,512,297	4,870,400
2023	1,355,691	3,199,041	4,554,732
2024	1,357,056	2,061,112	3,418,168
2025	1,356,878	2,073,727	3,430,605
2026	1,354,697	1,856,342	3,211,039
2027	1,360,603	1,853,716	3,214,319
2028	1,360,047	1,335,760	2,695,807
2029	1,357,966	824,501	2,182,467
2030	1,356,463	826,546	2,183,008
2031	1,358,284	790,750	2,149,034
2032	1,350,863	656,977	2,007,840
2033	1,356,147	645,217	2,001,364
2034	1,353,638	363,023	1,716,661
2035	1,140,022	80,829	1,220,851
2036	724,044	82,134	806,178
2037	719,716	77,984	797,700
2038	723,906	78,834	802,740
2039	721,481	74,338	795,819
2040	722,447	74,842	797,289
2041	-	-	-
2042	-	-	-
2043	-	-	-

* Does not include Utility Fund debt.

Exhibit B: Summary of Existing Debt

Existing Debt as of March 14, 2017

		General/Golf Fund	Utility	Stormwater	Total	Amount Restructured
1	G.O. Debt Issued Through VRA					
2	VRA 2009A (Pool) G.O.	$ 9,985,000	$ -	$ -	$ 9,985,000	$ -
3	VRA 2011 G.O.	323,451	-	-	323,451	-
4	VRA2013C (Pool) G.O.	2,530,000	-	-	2,530,000	-
5	VRA2014C (Pool) G.O.	5,095,000	-	-	5,095,000	5,095,000
6	Subtotal G.O. (VRA) Bonds	$ 17,933,451	$ -	$ -	$ 17,933,451	$ 5,095,000
7						
8	Non-VRA G.O. Debt					
9	Series 2004 Bonds	$ 215,000	$ -	$ -	$ 215,000	$ -
10	Carter Bank 2010	546,138	178,540	-	724,678	466,751
11	VML/VACO Series 2010D/F	1,095,000	-	-	1,095,000	-
12	SunTrust 2011 EDA	2,277,140	-	-	2,277,140	2,277,140
13	SunTrust 2012A G.O.	3,670,250	617,750	-	4,288,000	4,288,000
14	SunTrust 2013B G.O.	4,682,150	-	-	4,682,150	4,518,598
15	Literary Loans G.O. Debt	1,800,000	-	-	1,800,000	1,125,000
16	QSCB G.O. Debt	7,019,000	-	-	7,019,000	835,000
17	QZAB G.O. Debt	2,677,041	-	-	2,677,041	-
18	Subtotal Non-VRA G.O. Debt	$ 23,981,719	$ 796,290	$ -	$ 24,778,009	$ 13,510,488
19						
20	Subtotal Leases	$ 8,667,114	$ 4,843,662	$ -	$ 13,510,776	$ 18,354,438
21						
22	Revenue Debt					
23	VRA2015A (Pool) Revenue	$ -	$ 7,220,000	$ -	$ 7,220,000	$ -
24	2015 Stormwater Bond	-	-	2,142,097	2,142,097	-
25	Subtotal Revenue Debt	$ -	$ 7,220,000	$ 2,142,097	$ 9,362,097	$ -
26	Total Debt as of March 14, 2017	$ 50,582,284	$ 12,859,952	$ 2,142,097	$ 65,584,333	$ 36,959,926

Note: Yellow highlighted obligations identify those components of the City's debt portfolio which are included in Part 1 (Targeted Restructuring).

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