Topics to be Addressed

- Background.

- Credit Rating History.

- Why Unassigned Fund Balance (or “Reserves”) Matters.

- History of the City of Petersburg’s Unassigned Fund Balance (Reserve) levels.

- Fund Balance Comparatives.

- Credit Rating Agency/GFOA Commentary.

- Next Steps.
The City of Petersburg (The “City”) established a series of Financial Policy Guidelines which included Unassigned Fund Balance (or “Reserve”) levels in 2014.

In addition, the City’s Financial Policy Guidelines also called for a structurally balanced budget wherein recurring revenues are sufficient to meet all recurring expenditures.

Because the City had been using its Unassigned Fund Balance and had a history of unbalanced budgets, its Credit Rating was downgraded in 2014 to “BBB” from “A+”

By 2016, the City’s finances had reached a critically low point, which resulted in a further Credit Rating downgrade to “BB” from “BBB”

Over the past 4 years (Since 2017):

– The City’s fiscal health has rebounded and as such Unassigned Fund Balance (Reserve) levels have dramatically improved.

– Over the same time period, the City has received 3 Credit Rating Upgrades – The most recent upgrade is to “BBB+” from “BBB-” with a Positive Outlook.
The table below shows the rating categories from the three National Credit Rating Agencies and the City’s rating history since 2014 from S&P.

<table>
<thead>
<tr>
<th>Rating History</th>
<th>Fitch</th>
<th>Moody's</th>
<th>S&amp;P</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top tier &quot;Highest Possible Rating&quot;</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Highest)</td>
<td>AAA</td>
<td>Aaa</td>
<td>AAA</td>
</tr>
<tr>
<td>(Middle)</td>
<td>AA+</td>
<td>Aa1</td>
<td>AA+</td>
</tr>
<tr>
<td>(Lowest)</td>
<td>AA</td>
<td>Aa2</td>
<td>AA</td>
</tr>
<tr>
<td>2nd Tier &quot;Very Strong&quot;</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Highest)</td>
<td>A+</td>
<td>A1</td>
<td>A+</td>
</tr>
<tr>
<td>(Middle)</td>
<td>A</td>
<td>A2</td>
<td>A</td>
</tr>
<tr>
<td>(Lowest)</td>
<td>A-</td>
<td>A3</td>
<td>A-</td>
</tr>
<tr>
<td>3rd Tier &quot;Strong&quot;</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Highest)</td>
<td>BB+</td>
<td>Baa1</td>
<td>BBB+</td>
</tr>
<tr>
<td>(Middle)</td>
<td>BB</td>
<td>Baa2</td>
<td>BBB</td>
</tr>
<tr>
<td>(Lowest)</td>
<td>BB-</td>
<td>Baa3</td>
<td>BBB-</td>
</tr>
<tr>
<td>4th Tier &quot;Adequate Capacity to Repay&quot;</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Highest)</td>
<td>BB+</td>
<td>Baa1</td>
<td>BBB+</td>
</tr>
<tr>
<td>(Middle)</td>
<td>BB</td>
<td>Baa2</td>
<td>BBB</td>
</tr>
<tr>
<td>(Lowest)</td>
<td>BB-</td>
<td>Baa3</td>
<td>BBB-</td>
</tr>
<tr>
<td>5th - 10th Tiers &quot;Below Investment Grade&quot;</td>
<td>BB, B, CCC, CC, C, D</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

= Current Rating

= Prior Rating

With a Positive Outlook.
The City’s most recent Credit Rating upgrade to “BBB+” from “BBB-” represents a “double or two-notch upgrade” and along with the Positive Outlook shows that the City is on the right financial trajectory. S&P has indicated that:

“The upgrade reflects our view of Petersburg's continued achievement in rebuilding a sound financial position, including increased reserves and liquidity, such that short-term cash flow borrowing is no longer necessary.”

During the rating process, S&P evaluates four primary criteria (Economy, Management, Finances, Debt/Pensions).

– As cited above, “increased reserves and liquidity” - which is reflected by the City’s Unassigned Fund Balance - is arguably the single most important financial metric to the rating agencies.

S&P’s positive outlook indicates that the City has a 1 in 3 chance of an additional Bond Rating Upgrade in the next 12 to 24 months, but that future upgrades are based on their expectation that the city's management team will maintain fiscal balance and potentially bolster liquidity and reserve levels, while continuing to adopt structurally balanced budgets and making full and timely payment on all its obligations.
Why Unassigned Fund Balance Matters

- Allows the City to fully cash flow its month-to-month operations and avoid costly Tax Anticipation Notes ("TANs") / Revenue Anticipation Notes ("RANs").

- Enables the City to earn interest income, which helps the General Fund and alleviates pressure on tax rate(s).

- Serves as the single most important factor for credit ratings.

- Enables the City to borrow at lower interest rates, which in turn, provides for lower debt service and potential refunding opportunities for debt service savings.

- Excess Unassigned Fund Balance can be used for one-time capital investment and economic development purposes.
Over the past 4 years, the City fiscal health has rebounded and as such Unassigned Fund Balance (Reserve) levels have dramatically improved.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>UFB Amount ($mil)</th>
<th>UFB % of Expenditures</th>
<th>S&amp;P Credit Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>$6.4</td>
<td>7.9%</td>
<td>A+</td>
</tr>
<tr>
<td>2014</td>
<td>$0.2</td>
<td>0.2%</td>
<td>BBB</td>
</tr>
<tr>
<td>2016</td>
<td>($7.7)</td>
<td>(10.8%)</td>
<td>BB</td>
</tr>
<tr>
<td>2017</td>
<td>($0.1)</td>
<td>(0.2%)</td>
<td>BB</td>
</tr>
<tr>
<td>2018</td>
<td>$2.8</td>
<td>3.8%</td>
<td>BB+</td>
</tr>
<tr>
<td>2019</td>
<td>$8.1</td>
<td>10.6%</td>
<td>BBB-</td>
</tr>
<tr>
<td>2020</td>
<td>$12.9</td>
<td>17.5%</td>
<td>BBB+</td>
</tr>
</tbody>
</table>
Existing Unassigned Fund Balance Policy

Key Tenets - Unassigned Fund Balance shall:

– Be comprised of liquid cash and investments.
– Consist of a sufficient amount to meet the City’s cash flow needs and allow the City to avoid the use of TANs/RANs (i.e. cash flow borrowing).
– Allow for a margin of safety against unforeseen expenditures.
– Not be used for annual recurring expenditures, except in the event of unforeseen emergency circumstances.

Existing Unassigned Fund Balance Policy Target (Adopted July 2020):

– The City shall have a Minimum Initial Target Unassigned Fund Balance that represents 30 days of its General Fund Operating Expenditures.
  • The budget will include $1 Million annually toward the Unassigned Fund Balance; Upon reaching the Minimum Initial Target the City shall budget $500,000 toward Fund Balance Replenishment and $500,000 toward Pay-Go Capital Projects.

– Within 3 years following the City meeting the Minimum Initial Target, the City shall increase the Unassigned Fund Balance to a level that represents 60 days of its General Fund Operating Expenditures.
The City’s FY 2020 and Unassigned Fund Balance levels are compared with selected “Aa” and “A” rated cities below.

<table>
<thead>
<tr>
<th>Peer Comparison</th>
<th>Unassigned Fund Balance</th>
</tr>
</thead>
</table>

**Unassigned Fund Balance ($)**

<table>
<thead>
<tr>
<th>City</th>
<th>Unassigned Fund Balance ($)</th>
<th>Unassigned Fund Balance as a % of General Fund Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Richmond, VA (Aa)</td>
<td>112.8</td>
<td>55.5</td>
</tr>
<tr>
<td>Hampton, VA (Aa)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Norfolk, VA (Aa)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Newport News, VA (Aa)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Portsmouth, VA (Aa)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Roanoke, VA (Aa)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salem, VA (Aa)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Harrisonburg, VA (Aa)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lynchburg, VA (Aa)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Danville, VA (Aa)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manassas, VA (Aa)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Winchester, VA (Aa)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fredericksburg, VA (Aa)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Williamsburg, VA (Aa)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Colonial Heights, VA (Aa)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Blacksburg, VA (Aa)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Culpeper, VA (Aa)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Poquoson, VA (Aa)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purcellville, VA (Aa)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Abingdon, VA (Aa)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bristol (A)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manassas Park (Aa)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Franklin (A)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Covington (A)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Radford (A)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Petersburg (2020)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Petersburg (2019)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Virginia Aa</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Virginia A</td>
<td></td>
<td></td>
</tr>
<tr>
<td>National Aa</td>
<td></td>
<td></td>
</tr>
<tr>
<td>National A</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source:** Moody’s MFRA, FY 2020 audited financial statements.
Finances (i.e. Fund/Cash Balances and trends) is the single most important criteria from the Credit Rating Agency’s perspective and comprise 30% of the credit rating evaluation.
S&P Rating Methodology

<table>
<thead>
<tr>
<th>Category</th>
<th>Rating Percentage</th>
<th>Short-Term Control</th>
<th>Long Term Control</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Institutional Framework</td>
<td>10%</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>2. Economy</td>
<td>30%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>3. Management</td>
<td>20%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>4. Budgetary Flexibility</td>
<td>10%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>5. Budgetary Performance</td>
<td>10%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>6. Liquidity</td>
<td>10%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>7. Debt and Contingent Liabilities</td>
<td>10%</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

- Budgetary Flexibility/Liquidity (i.e. Fund/Cash Balances) are collectively 20% of the credit rating evaluation and are critical factors from the Credit Rating Agency’s perspective.
GFOA recommends that governments establish a formal policy on the level of unrestricted fund balance that should be maintained in the general fund.

The adequacy of unrestricted fund balance in the general fund should be assessed based upon a government's own specific circumstances.

GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures.

Furthermore, a government's particular situation often may require a level of unrestricted fund balance in the general fund significantly in excess of this recommended minimum level.

– Such measures should be applied within the context of long-term forecasting.
Next Steps

- **Fund Balance/Budgeting:**
  - Continue the momentum with structurally balanced budgets and continue to revisit Financial Polices as the City’s finances and needs evolve.
  - Revisit the City’s Unassigned Fund Balance policy levels to include potentially higher targets and the concept of Budget Stabilization Fund.
  - Davenport to assist the City in analyzing and developing potential amendments to its Unassigned Fund Balance policy levels in order to further solidify the City’s positive financial trajectory.

- **General Fund Capital Investment:**
  - Position the City to undertake essential capital investment for both general and utility enterprise needs.
  - Davenport to work the City to undertake capital planning debt capacity and debt affordability analysis for the General Fund in anticipation of potential capital investment which may include financial system upgrades as early as FY 2022.

- **Utility Rate Study:**
  - Davenport/Jacobs continue work on finalizing the 2021 Utility Rate Study (approximate completion in 6 weeks) and present results to City Council.
  - Davenport to work with City staff in the analyzing and implementing funding through various programs (i.e. DEQ/VDH, City Bonds or other financing programs that may be available) for Utility Capital Needs.
The U.S. Securities and Exchange Commission (the “SEC”) has clarified that a broker, dealer or municipal securities dealer engaging in municipal advisory activities outside the scope of underwriting a particular issuance of municipal securities should be subject to municipal advisor registration. Davenport & Company LLC (“Davenport”) has registered as a municipal advisor with the SEC. As a registered municipal advisor Davenport may provide advice to a municipal entity or obligated person. An obligated person is an entity other than a municipal entity, such as a not for profit corporation, that has commenced an application or negotiation with an entity to issue municipal securities on its behalf and for which it will provide support. If and when an issuer engages Davenport to provide financial advisory or consultant services with respect to the issuance of municipal securities, Davenport is obligated to evidence such a financial advisory relationship with a written agreement.

When acting as a registered municipal advisor Davenport is a fiduciary required by federal law to act in the best interest of a municipal entity without regard to its own financial or other interests. Davenport is not a fiduciary when it acts as a registered investment advisor, when advising an obligated person, or when acting as an underwriter, though it is required to deal fairly with such persons.

This material was prepared by public finance, or other non-research personnel of Davenport. This material was not produced by a research analyst, although it may refer to a Davenport research analyst or research report. Unless otherwise indicated, these views (if any) are the author’s and may differ from those of the Davenport fixed income or research department or others in the firm. Davenport may perform or seek to perform financial advisory services for the issuers of the securities and instruments mentioned herein.

This material has been prepared for information purposes only and is not a solicitation of any offer to buy or sell any security/instrument or to participate in any trading strategy. Any such offer would be made only after a prospective participant had completed its own independent investigation of the securities, instruments or transactions and received all information it required to make its own investment decision, including, where applicable, a review of any offering circular or memorandum describing such security or instrument. That information would contain material information not contained herein and to which prospective participants are referred. This material is based on public information as of the specified date, and may be stale thereafter. We have no obligation to tell you when information herein may change. We make no representation or warranty with respect to the completeness of this material. Davenport has no obligation to continue to publish information on the securities/instruments mentioned herein. Recipients are required to comply with any legal or contractual restrictions on their purchase, holding, sale, exercise of rights or performance of obligations under any securities/instruments transaction.

The securities/instruments discussed in this material may not be suitable for all investors or issuers. Recipients should seek independent financial advice prior to making any investment decision based on this material. This material does not provide individually tailored investment advice or offer tax, regulatory, accounting or legal advice. Prior to entering into any proposed transaction, recipients should determine, in consultation with their own investment, legal, tax, regulatory and accounting advisors, the economic risks and merits, as well as the legal, tax, regulatory and accounting characteristics and consequences, of the transaction. You should consider this material as only a single factor in making an investment decision.

The value of and income from investments and the cost of borrowing may vary because of changes in interest rates, foreign exchange rates, default rates, prepayment rates, securities/instruments prices, market indexes, operational or financial conditions or companies or other factors. There may be time limitations on the exercise of options or other rights in securities/instruments transactions. Past performance is not necessarily a guide to future performance and estimates of future performance are based on assumptions that may not be realized. Actual events may differ from those assumed and changes to any assumptions may have a material impact on any projections or estimates. Other events not taken into account may occur and may significantly affect the projections or estimates. Certain assumptions may have been made for modeling purposes or to simplify the presentation and/or calculation of any projections or estimates, and Davenport does not represent that any such assumptions will reflect actual future events. Accordingly, there can be no assurance that estimated returns or projections will be realized or that actual returns or performance results will not materially differ from those estimated herein.

This material may not be sold or redistributed without the prior written consent of Davenport. 01.13.14 | RT | RK | DR