NOTES

TO: Honorable Mayor and City Council Members

FROM: Ann E. Wall, City Manager

DATE: May 6, 2020

SUBJECT: Materials for Your Information

Please find attached the following materials for your information:

1. A memo from Byron Hayes, Director of Financial Services, regarding the City of Greenville's long term bond ratings

mc

Attachments

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MEMORANDUM

To: Ann E. Wall, City Manager

From: Byron C. Hayes, Financial Services Director BH

Date: April 29, 2020

Re: City of Greenville's Long Term Bond Ratings

Over the past two months, staff has provided financial information to Standard & Poor's and Moody's to assist them in updating the City of Greenville's credit rating. In April, the City's **AA credit rating and stable outlook was affirmed** by the Standard & Poor's. The City's **Aa2 credit rating was affirmed** by Moody's.

As advised in the notification from S&P, the "AA" long-term rating reflects their assessment of the following factors, specifically the City's:

- Adequate economy as it serves as a regional economic center for eastern North Carolina;
- Very strong management conditions with what they consider "strong" financial policies and practices based on their Financial Management Assessment (FMA) methodology;
- Very strong budgetary flexibility with an available fund balance in Fiscal Year 2019 of 17%.
- Adequate budgetary performance, with a slight operating surplus in the general fund, but an operating deficit at the total governmental fund level in fiscal year 2019.
- Very strong liquidity providing very strong cash levels to cover both debt service and expenditures;
- Very strong debt and contingent liabilities position, which includes overall net debt at less than 3% of market value and rapid amortization of principal.

The stable outlook reflects Standard & Poor's expectation that Greenville will continue to adjust its budget to maintain structural balance while maintaining its very strong reserves as it plans to use reserves for capital improvements and tax stabilization. However, should the city stabilize its annual appropriation of reserves and improve budgetary performance, they could raise the rating. Conversely, it was noted that, should operating performance weaken along with reserves, they may lower the rating. At this time, however, they do not anticipate changing the rating within the two-year outlook horizon.

As advised by Standard & Poor's the rating is not investment, financial, or other advice and the City should not and cannot rely upon the rating as such. The rating is based on information supplied by the City based on Fiscal Year 2019 audited amounts and Fiscal Year 2020 unaudited amounts. This is a confirmation of the City's existing rating with Standard & Poor's.

Please review the enclosed information; should you have any questions, feel free to contact me.

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S&P Global
Ratings

RatingsDirect®

Summary:
Greenville, North Carolina; General Obligation

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Table Of Contents

Summary:

Greenville, North Carolina; General Obligation

Credit Profile		
US$7.85 mil GO st & pedestrian transp bnds ser 2020 dtd 05/14/2020 due 06/01/2040		
Long Term Rating	AA/Stable	New
Greenville GO		
Long Term Rating	AA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA' long-term rating to Greenville, N.C.'s series 2020 general obligation (GO) street and pedestrian transportation bonds. At the same time, we affirmed our 'AA' rating on the city's GO debt outstanding. The outlook is stable.

A pledge of the city's faith and credit and unlimited taxing power secures the GO bonds. The bond proceeds will finance street and pedestrian transportation improvements.

Credit overview

Greenville's rating reflects our view of the city's robust management practices, which have resulted in very strong fund balances and stable budgetary performance. The city's tax base continues to expand as a result of population growth and economic development, particularly with regards to biopharma and the associated research facilities. Similarly to the rest of the state, this has resulted in both property and sales tax growth, the latter of which is vulnerable to the effects of social distancing and other decisions made to protect the health and safety of the community from the spread of COVID-19. (For more information, see "The COVID-19 Outbreak Weakens U.S. State And Local Government Credit Conditions," published April 2, 2020, on RatingsDirect.)

In line with our view of the ongoing economic contraction, the closure of non-essential businesses will temper sales-tax performance and exacerbate unemployment in fiscal 2020. However, we do not expect it to affect Greenville's ability to maintain budgetary balance over the long term in light of the city's very strong cash and reserve position. The city is committed to maintaining its fund balance and it has taken steps to freeze spending to address recessionary pressures, making further modifications if needed. (See the article, titled "It's Game Over For The Record U.S. Run; The Timing Of A Restart Remains Uncertain," published March 27, 2020.) As a result, we expect Greenville to maintain stable performance whilst maintaining its strong reserve position and do not anticipate changing the rating over the outlook horizon.

The rating reflects our view of the city's:

- Adequate economy, with projected per capita effective buying income (EBI) at 82.8% and market value per capita of $71,840, that is gaining advantage from a local stabilizing institutional influence;
- Very strong management, with strong financial policies and practices under our Financial Management Assessment

(FMA) methodology;

- Adequate budgetary performance, with a slight operating surplus in the general fund, but an operating deficit at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 17% of operating expenditures;
- Very strong liquidity, with total government available cash at 1.9x total governmental fund expenditures and 32.7x governmental debt service, and access to external liquidity that we consider strong;
- Very strong debt and contingent liability profile, with debt service carrying charges at 5.7% of expenditures and net direct debt that is 51.8% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of market value; and
- Very strong institutional framework score.

Stable Two-Year Outlook

Downside scenario

Should the city's financial performance deteriorate, leading to sustained and significant draws on its reserves, we could lower the rating.

Upside scenario

Should the city's economic metrics improve to a level commensurate with those of higher-rated peers, while maintaining very strong flexibility and liquidity, we could consider a higher rating.

Credit Opinion

Adequate economy

We consider Greenville's economy adequate. The city, with an estimated population of 93,676, is located in Pitt County. It has a projected per capita EBI of 82.8% of the national level and per capital market value of $71, 840. Overall, the city's market value declined 1.8% over the past year to $6.7 billion in 2020 due to a drop in personal property valuations. However, real property valuations continue to rise in line with new construction given the flat tax rate since 2016. The county will conduct a property revaluation in fiscal 2021, which is projected to increase property tax values by approximately 10.9%.

Greenville is the county seat and 10th-largest city in the state. The city benefits, in our view, from the presence of East Carolina University, which we view as a stabilizing institutional influence given its more than 28,000 students likely depresses the city's income indicators. It is also the city's second-largest employer. Vidant Health, the second-largest hospital in the state, is the city's largest employer with 6,670 employees. With the presence of ODR Burton, Mayne Pharma, and ThermoFisher Scientific, and their respective investments, the city's biopharmaceutical sector has continued to spur regional development and job creation. In 2020, the city along with its regional partners established the Greenville-Eastern North Carolina Alliance with the scope of fostering economic growth in the area through public-private partnerships to support new and existing businesses. To this end, the city raised more than $500 million in new investments for its uptown area to expand its university ($200 million, including $80 million for student housing), as well as hotel development for approximately $79 million. The new and ongoing construction activity corresponds to sustained population growth since 2010, and analogous sales-tax-revenue growth. However, in light of the current economic contraction and vulnerability of sales-tax revenue to protective measures relating to COVID-19, we expect this otherwise expanding economic tax base to slow in the near term.

Furthermore, despite a historically low county unemployment rate of 4.2% in 2018, rapidly evolving economic conditions due to the pandemic have already affected the labor market (see "U.S. Jobs Market Buckles Under The Coronavirus Pandemic," published April 2, 2020). Given the county's historic exposure to high unemployment during the Great Recession, which approached 10%, we will monitor the long-term effects of the current downturn on the labor market and the economy overall.

Very strong management

We view the city's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

In preparation for the budget process, management looks back over 10 years of trend data to prepare a biennial budget alongside NC League of Municipalities sales-tax projections. We believe this approach supports the city's conservative projection of more volatile revenue items, including sales tax. The biennial budget includes the budget for the upcoming year and financial plan for the following year. For longer time horizons, Greenville paused its five-year long-term financial planning in 2017, however the city plans to reintroduce it this year. The city council has the ability to adjust and, if necessary, amend the budget during the fiscal year. It prepares quarterly budget-to-actual results and reports for the general fund and enterprise funds, and conducts variance analysis to evaluate fund and program performance. The city produces its quarterly investment report, outlining historical cash and investment portfolio activity to date, in line with Greenville's comprehensive investment policy that reflects state guidelines and includes quantitative covenants regarding portfolio diversification and maturities. The city also maintains a rolling five-year capital plan that outlines sources and uses of funds, which management updates biennially and includes in the budget.

Greenville's financial reserve policy stipulates that its unassigned fund balanced should be at least 14% of the current annual operating budget, which it adheres to. The city allows for the temporary appropriation of the unassigned fund balance below the 14% threshold in the event of an emergency, with a plan to restore within 36 months from the date of appropriation. Excess reserves can be used to fund one-time capital expenditures or other one-time costs, and the city will maintain an insurance loss reserve totaling $2 million. The city also has an established debt management policy, which includes restrictions on both annual debt service costs and total debt, for example, direct debt should not exceed 2.5% of assessed valuations, and debt service should not exceed 12% of governmental expenditures.

Greenville was subject to a ransomware attack in 2019. Whilst no financial damage was incurred, management took steps to address vulnerabilities and take corrective action, which included the development and adoption of a new computer use procedure, simulation training for employees, antiviral software installation, and contracting of a third party to monitor daily network activity. Officials state that the current-year budget includes capital funding for information technology infrastructure, which will include security features to upgrade the network, as well as hardware for additional storage and load maintenance.

Adequate budgetary performance

Greenville's budgetary performance is adequate, in our opinion. The city had slight surplus operating results in the general fund of 1.3% of expenditures, but a deficit result across all governmental funds of 2.4% in fiscal 2019 due to discretionary spending.

For analytical consistency, we adjusted budgetary performance to account for recurring transfers as well as for capital expenditures paid for with bond proceeds. Greenville's revenue profile is generally stable, in our view, with approximately 44% of fiscal 2019 general fund revenues coming from property taxes. Sales-related taxes accounted for 30% and intergovernmental aid was 13%.

Following two years of slight drawdowns due to reserve appropriations in excess of policy levels for one-time items, Greenville posted operating surpluses in fiscal years 2018 and 2019. The city reports that for fiscal 2020, expenditures are tracking in line with the budget, and ad valorem and sales taxes are currently ahead of the previous year's projections. However, in preparation for a sales tax revenue shortfall in fiscal 2020 relating to COVID-19 protective measures, the city has implemented several cost-curbing measures. These include:

- A mandatory hiring freeze for all non-public safety positions;
- A mandatory spending freeze for non-essential services;
- Pausing the encumbrance of new service contracts unless deemed essential to the delivery of core public services; and
- Recurring pay-as-you-go projects, such as facility improvements, vehicle replacement, and other capital projects, prioritized for freeze in fiscal years 2020 and 2021

Greenville will make further modifications, if needed. The proposed 2021 budget is balanced and currently under review. Given the city's willingness to adjust for any potential budgetary setbacks and the likelihood that the 2021 reassessment will contribute to offsetting any losses, we expect that the city will maintain stable performance.

Very strong budgetary flexibility

Greenville's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2019 of 17% of operating expenditures, or $14.6 million.

The available balance calculation includes the city's unassigned fund balance and committed reserve for catastrophic losses, which we understand could be made available for operations. The city has an unassigned fund balance approaching 15% of expenditures, which it funds through property, sales, and franchise taxes. While the city recognizes the potential impact of COVID-19 on its revenues, it is committed to maintaining fund balance above the 14% threshold and is modifying its budget accordingly. Therefore, management does not anticipate drawing down on the city's fund balance over the next year.

Very strong liquidity

In our opinion, Greenville's liquidity is very strong, with total government available cash at 1.9x total governmental fund expenditures and 32.7x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary.

Greenville has issued GO bonds within the past 20 years, which supports our view of the city's strong access to external liquidity. Its investments include U.S. government agencies and Treasury bonds, which we do not consider risky. Greenville has several bank loans and privately placed issuances. We reviewed the supporting documents and do not believe the purchase agreements create a liquidity risk. We do not anticipate changing our view of Greenville's liquidity profile over the near term.

Very strong debt and contingent liability profile

In our view, Greenville's debt and contingent liability profile is very strong. Total governmental fund debt service is 5.7% of total governmental fund expenditures, and net direct debt is 51.8% of total governmental fund revenue. Overall net debt is low at 0.8% of market value, which is in our view a positive credit factor.

Greenville's overall net debt is $199.8 million, which includes $156 million of revenue-secured debt from the city's utility enterprises (water, sewer, electric, and natural gas) overseen by the city's Utilities Commission, as well as the current issuance. This completes the planned issuances from the voter-approved authorization in the 2015 referendum. The city does not have any plans to issue any additional debt, and it expects the majority of its capital improvement plan to be funded through state grants and enterprise funds. As a result, we do not expect any significant changes to the city's debt profile.

Pensions and other postemployment benefits

- We do not view pension and other postemployment benefits (OPEB) liabilities as an immediate source of credit pressure for Greenville, given our opinion of the city's strong funding discipline and the largest plan's funded status that together limit escalating cost trajectory risk.
- Greenville's combined required pension and actual OPEB contributions totaled 12.4% of total governmental fund expenditures in 2019.Of that amount, 6.5% represented required contributions to pension obligations, and 5.9% represented OPEB payments.
- The city made its full annual required pension contribution in 2019.

As of June 30, 2019, the city participates in the following:

- The North Carolina Local Governmental Employees' Retirement System (LGERS), 90.9% funded, with a proportional share of the net pension liability equal to $13.8 million.
- Law Enforcement Officer (LEO) Special Separation Allowance, a single-employer plan funded ratio pay-as-you-go and carries a liability of $7.9 million.

In general, we expect LGERS contributions to meet our view of minimum funding progress, partially as a result of the plan's closed, level-dollar, 12-year amortization that should result in timely funding progress. Furthermore, North Carolina local governments are required to pay 100% of the actuarially determined contribution as set annually by the LGERS Board of Trustees. Despite this requirement, we believe LGERS' discount rate of 7.0% could lead to some contribution volatility over the long term given that it surpasses our view of a conservative discount rate equal to 6.5%.

The LEO plan is funded on a pay-as-you-go basis with no accumulated assets in a trust. The plan's assumed discount rate is 3.64% and is based on the S&P Municipal Bond 20-Year High Grade Rate Index.

The city provides OPEB in the form of health insurance and contributed $2.9 million in fiscal 2019. As of its June 30, 2019 valuation, the city's net OPEB liability totaled $48 million. Although OPEB liabilities are funded on a pay-as-you-go basis, which could lead to escalating costs given claims volatility and medical cost trends, the contributions are minimal relative to the city's budget and we believe the city has sufficient flexibility to absorb additional contribution costs, if necessary.

Very strong institutional framework

The institutional framework score for North Carolina municipalities is very strong.

Related Research

2019 Update Of Institutional Framework For U.S. Local Governments

MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns a Aa2 rating to Greenville, NC's $7.9M GO Bonds, Ser. 2020

09 Apr 2020

New York, April 09, 2020 -- Moody's Investors Service has assigned a Aa2 rating to the City of Greenville, NC's $7.9 million General Obligation Street and Pedestrian Transportation Bonds, Series 2020. Moody's maintains a Aa2 rating on the city's outstanding parity GO debt.

RATINGS RATIONALE

The Aa2 rating reflects the city's large tax base supported by a significant institutional presence, sound financial position and moderate, but manageable, long-term liabilities.

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. The coronavirus crisis is not a key driver for this rating action. We do not see any material immediate credit risks for the City of Greenville. However, the situation surrounding coronavirus is rapidly evolving and the longer term impact will depend on both the severity and duration of the crisis. If our view of the credit quality of the city changes, we will update the rating and/or outlook at that time.

RATING OUTLOOK

Outlooks are not typically assigned to local government issuers with this amount of debt outstanding.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATING

- Tax base expansion and strengthened income and wealth metrics

- Increases in reserves and liquidity

- Reduction in long-term liabilities

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATING

- Tax base deterioration

- Weakened fund balance or cash positions

- Significant increase in debt or capital needs

LEGAL SECURITY

The bonds are secured by the city's unlimited ad valorem tax pledge.

USE OF PROCEEDS

Bond proceeds will fund improvements to city streets and pedestrian transportation.

PROFILE

Located on the Tar River in the central eastern portion of the state, the city serves as the industrial, financial, medical, legal, educational and transportation regional hub. The land area is 35 square miles with an 2019 population estimate of 93,137.

METHODOLOGY

The principal methodology used in this rating was US Local Government General Obligation Debt published in September 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBM_1191097. Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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