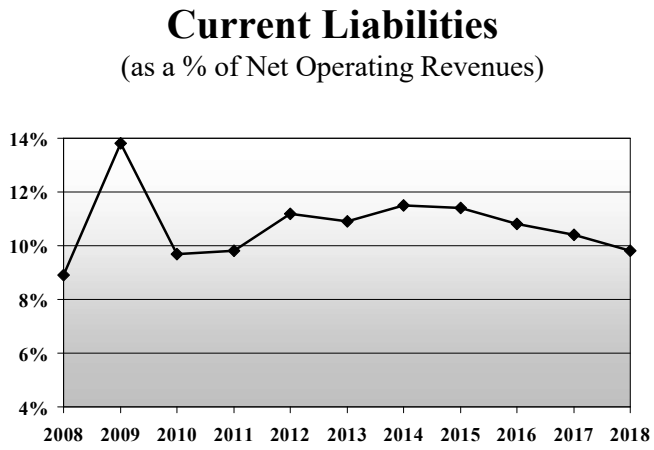
DEBT INDICATORS

WARNING TREND: Increasing current liabilities at end of year as a percentage of net operating revenues.

Formula:

$$\frac{\text{Current Liabilities}}{\text{Net Operating Revenues}}$$



Current Liabilities:
Current liabilities include short-term debt, the current principal portion of long-term debt, accounts payable and other current liabilities due within one year of the balance sheet date. A major component of current liabilities may be short-term debt in the form of tax or bond anticipation notes. Although the use of short-term borrowing is an acceptable way to handle erratic flows of revenues, an increasing amount of short-term debt outstanding at the end of successive years can indicate liquidity problems, deficit spending, or both.

Trends:
In the eleven-year trend depicted above, the indicator has ranged from a low of 8.9 percent in FY08 to a high of 13.8 percent in FY09. As noted in the "Liquidity" indicator narrative, total current liabilities increased 58.1 percent in FY09. However, this increase is misleading, as it is mostly attributed to an increase in "principal due in 12 months" as a result of two significant bond refundings in CY09, with only minimal impact, by comparison, due to newly issued debt. This indicator fell back to more "normal" levels at 9.7 percent in FY10. Over the past eleven years the indicator has been, on average, 10.7 percent. The decline from FY14 to FY18 has been the result of year-end balances of accounts payable and other current liabilities.

In November 2000, the voters approved a $237.0 million G.O. Bond Referendum. In March of 2005, the voters approved a $349.3 million G.O. Bond Referendum. Both referenda included School, Fire, Roadway, Public Library, and Recreation and Parks projects. The County of Henrico chose to phase in this debt over a seven-year time frame). By taking this approach, the County has been able to pay required debt service costs and ancillary operating expenses without negatively impacting its operating budget and this indicator is reflective of that planning.

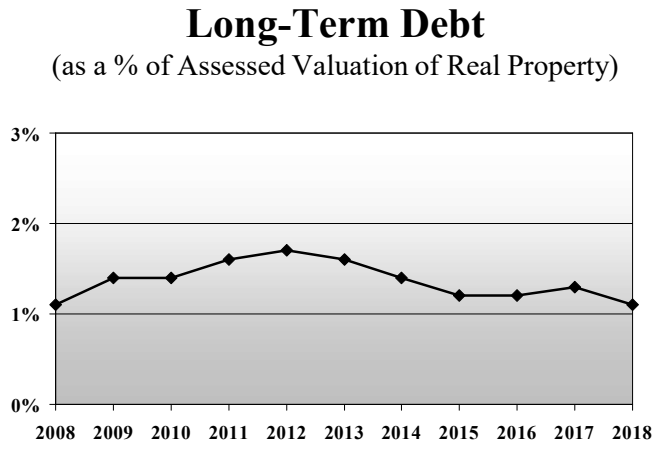
In November 2016, the voters approved a $419.8 million G.O. Bond Referendum. This referendum also included projects for Schools, Fire, Roadway, Public Library and Recreation and Parks. The plan developed will issue this debt over a six-year time period and the debt service is projected to be covered with current revenues – those that are freed up due to paying off debt obligations or revenues not currently appropriated.

For this eleven-year period, this ratio has been between 8.9 percent and 13.8 percent of net operating revenues. Although the general trend from FY08 to FY14 was slightly upward, there has been a downward trend for the past four fiscal years. The fact that the County has not experienced significant annual changes in this indicator, excluding the misleading increase in FY09, is reflective of the County's continuation of conservative financial management. Also, this consistency is reflective of the County's prudent debt management practices, and successful long-term planning for infrastructure improvements. This indicator is very much aligned with the next two indicators: 1) long-term debt as a percentage of assessed valuation and 2) debt service as a percentage of net operating revenues. For these reasons, no warning trend is noted.

WARNING TREND: Increasing amount of net direct long-term debt as a percentage of assessed valuation of real property.

Formula:

$$\frac{\text{Net Direct Bonded Long-term Debt}}{\text{Assessed Valuation of Real Property}}$$



Long-Term Debt:
A locality's ability to repay its debt is determined by comparing net direct long-term debt to assessed valuations. Net direct long-term debt is direct debt minus self-supporting debt such as revenue bonds or special assessment bonds, which have a repayment source separate from general tax revenues. An increase in net direct long-term debt as a percentage of real property valuation can indicate that a locality's ability to repay its obligations is diminishing.

Another way to monitor the growth in debt is to measure it on a per capita basis. As population increases, it would be expected that capital needs, and hence, long-term debt needs may increase. The underlying assumption is that a locality's revenue generating ability, and ability to repay debt, is directly related to its population level. The concern is that long-term debt should not exceed the locality's resources for paying the debt. If this occurs, the locality may have difficulty obtaining additional capital funds, may pay a higher rate of interest for them, and therefore may have difficulty in repaying existing debt.

Trends:
As seen above, Henrico County's percentage of net long-term debt to real property valuations has remained relatively stable. During the eleven-year period shown above, the long-term debt indicator reached a high point of 1.7 percent in FY12 due to the County combining two years of planned debt issuances into one, while experiencing declining real property valuations. The combined issuance in FY12 completed the County's March 2005 General Obligation Bond Referendum. The FY08 and FY18 indicators of 1.1 percent reflect the low points in this eleven-year period.

In FY09, the indicator reflects a sharp increase to 1.4 percent due to a 27.1 percent increase in long-term debt, as the County issued $137.5 million in General Obligation and VPSA Bonds. In FY10, this indicator remained constant at 1.4 percent; however, this statistic is slightly misleading as the County deferred its schedule bond issuance that year – and is solely due to an unprecedented drop in the County's real estate tax base. In fact, net long-term debt dropped 8.5 percent that fiscal year. In FY11, the indicator grew to 1.6 percent as the debt that was deferred in FY10 was issued, in the amount of $72.2 million, and real estate values declined yet again. For FY13 and FY14, no new debt was issued. Since its peak, this indicator has fallen back to 1.1 percent for FY18. For FY16, it is important to note that outstanding debt reflected a net decrease of $5.3 million as a result of the County issuing $34.0 million in Lease/Revenue Bonds to fund the County's share of the regional 800 MHz Public Safety Communication System. In FY17, this indicator experienced a slight increase in long-term debt due to the first issuance of bonds related to the 2016 Bond Referendum.

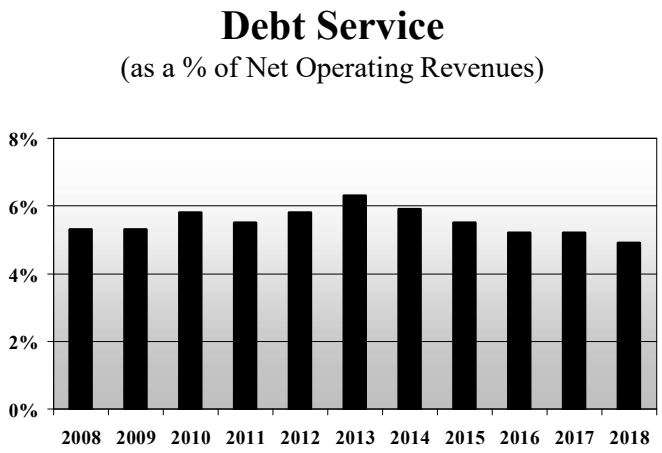
As stated in the section "Current Liabilities", in November 2016 the voters overwhelmingly approved a $419.8 million G.O. Bond Referendum to fund significant capital infrastructure projects for Schools, Fire, Roadway, Public Library and Recreation and Parks. Before the County put forward this plan, a debt affordability analysis above was conducted to insure the County's ability to repay the proposed debt that will be issued over a six-year period. It should be noted that for the debt affordability analysis for the referendum (and for any new debt issue the County undertakes) personal property is added to real property when determining "long-term debt as a percent of total assessed value." Adding the assessed value of personal property to real property lowers the percentage

slightly, but this is the current methodology utilized by the Bond Rating Agencies for Virginia localities. The debt affordability analysis also includes calculations for and debt service as a percentage of General Fund expenditures, which is used by the Bond Rating Agencies to determine a locality's ability to issue debt. The analysis verified the affordability of the debt issuance plan put forward to the voters. No long-term warning trend is noted at this time, though this trend will be closely watched.

WARNING TREND: Increasing amount of net direct debt service as a percentage of net operating revenues.

Formula:

$$\frac{\text{Debt Service}}{\text{Net Operating Revenues}}$$



Debt Service:
Debt service is the amount of principal and interest that a locality must pay each year on net direct long-term debt, plus the interest it must pay on direct short-term debt. As debt service increases, it adds to a locality's obligations and reduces the locality's expenditure flexibility.

Debt service can be a major part of a locality's fixed costs, and its increase can indicate excessive debt and fiscal strain. If debt service on net direct debt exceeds 20.0 percent of operating revenues, it is considered a potential problem. Below 10.0 percent is the rate preferred by bond rating agencies. **It should be noted that "net operating revenues" used in this indicator include the General, Special Revenue and Debt Service Funds**. Debt service for this indicator includes principal and interest payments for General Obligation bonds, Virginia Public School Authority (VPSA) debt, Literary Loan debt, and Lease Revenue bonds including the Regional Jail and the Public Safety Communication System. The indicator does not include Enterprise Fund debt.

Trends:
As shown in the graph above, the debt service percentage reached the high point of 6.3 percent in FY13 with the low point of 4.9 percent in FY18. It is important to note that in this eleven-year time period, this indicator has fluctuated within a narrow range. The indicator average over the 11-year period is 5.5 percent.

This indicator will trigger a warning if the increase in debt service consistently exceeds the increase in net operating revenues. The issuance of debt normally results in a slight increase in this indicator, because in the year following the issuance of debt, the amount of debt service generally grows at a faster rate than operating revenues, however the consistency reflected above is indicative of the meticulous analysis that is performed before any debt issue is undertaken.

In November of 2000, the County's voters approved a $237.0 million General Obligation (G.O.) Bond Referendum and in the spring of 2005, the County's voters approved a $349.3 million G.O. Bond Referendum. These referenda included School, Fire, Roadway, Public Library, and Recreation and Parks projects. The financial plan that coincided with the approval of these projects assumed that the County would issue this debt over a multi-year period for each of the approved referenda. In FY01, the County issued the first of these planned issues totaling $37.1 million. In FY02, the County issued $27.0 million in G.O. bonds, the first of six issues in support of the 2000 G.O. Bond Referendum. In FY06, the County issued $77.8 million in support of both the 2000 G.O. Bond Referendum and the first of seven planned issues for the 2005 G.O. Bond Referendum. In FY09, the County issued $44.4 million in VPSA Bonds for a number of Schools projects approved on the March 2005 referendum that required additional funding due to unanticipated increases in construction costs. The County delayed by one year the sale of $77.5 million in new debt originally scheduled for FY10 as a result of the economic downturn and its impact on revenue streams. In FY11 this G.O. debt was issued, in the amount of $72.2 million. In FY12, the final $66.1 million in new debt associated with the March 2005 G.O. Bond Referendum was issued.

In November 2016, the voters overwhelmingly approved a $419.8 million G.O. Bond Referendum. This referendum included projects for Schools, Fire, Roadway, Public Library and Recreation and Parks. In FY17, the first debt issuance for the approved Bond Referendum totaled $114.6 million. This was alongside a refunding of bonds that were originally issued in 2010 and 2011. The impact of the issuance of this new debt will occur with the FY18 and FY19 budgets. It is currently estimated that $53 million will be issued in FY19. The remaining $252.2 million in G.O. Bonds will be issued over the following five years as they are needed for the projects to be undertaken.

There are important differences between this indicator and the "Long-Term Debt" indicator. The "Debt Service" indicator reflects the amount of principal and interest the County pays annually on its long-term debt as a percentage of operating revenues. The "Long-Term Debt" indicator reflects the County's total outstanding debt as a percentage of assessed real estate valuation. The "Long-Term Debt" indicator graph reflects a sharp uptick in FY09 due to the large amount of debt issued in that fiscal year. However, that spike is not evident in the "Debt Service" indicator chart. This is due to the County's two bond refunding's in CY09 that achieved substantial debt service savings. The realized savings were mostly allocated in FY09 through FY11 to help the County offset anticipated revenue reductions as a result. It should be noted that the County has taken part in several additional bond refundings since 2009 that have generated ongoing significant savings.

In FY10, the "Debt Service" indicator increased to 5.8 percent despite debt service savings attributed to the bond refundings and not issuing any new long-term debt during that fiscal year. The reason for this increase is twofold. First, debt service costs increased from the previous year due to the first full-year payment of the 2008 VPSA issue. The FY09 debt service payment associated with this issue was only for six months of interest. Second, significant declines in State aid and real estate tax revenue in FY10 yielded a significant reduction in net operating revenues.

In FY11, the County issued $72.2 million in new debt, but the first principal payment wasn't due until FY12, and only six months of interest was due in FY11, which resulted in a reduction of $4.0 million in debt service payments when compared to FY10. In FY12, $66.1 million in new debt was issued. Although operating revenues experienced a slight increase, the Debt Service indicator increased to 5.8 percent. In FY13, this indicator reached its peak at 6.0 percent as debt service expenses increased at a faster rate (10.1 percent) than net operating revenues (1.5 percent). As with the "Long-Term Debt" indicator, <u>no long-term warning trend is noted at this time</u>. But as debt is scheduled to be issued over the next six years, this indicator will be an important part of the debt affordability analysis conducted outside of the <u>Trends</u> document to assure the County's ability to afford new debt.

It should be emphasized that this indicator is <u>different</u> than a similar measure included in the annual debt affordability analysis – which is "debt service as a percentage of General Fund Expenditures." However, this examination in the <u>Trends</u> document does cross-verify the results of the debt affordability analysis.