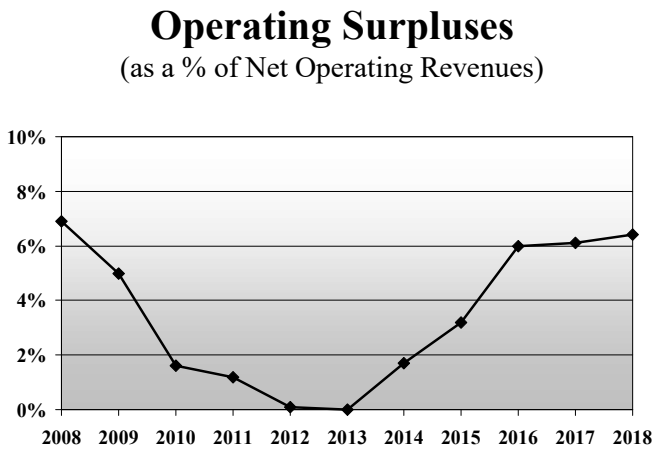
OPERATING POSITION INDICATORS

WARNING TREND: Decreasing amount of General Fund operating surpluses as a percentage of net operating revenues.

Formula:

$$\frac{\text{General Fund Operating Surpluses}}{\text{Net Operating Revenues}}$$



Operating Surpluses:
An operating surplus occurs when current revenues exceed current expenditures. If the reverse is true, it means that at least during the current year, the locality is spending more than it receives. This can occur because of an emergency such as a natural catastrophe that requires a large immediate outlay. It can also occur as a result of a conscious policy to use surplus fund balances that have accumulated over the years. The existence of an operating deficit in any one-year may not be cause for concern, but frequent occurrences may indicate that current revenues are not supporting current expenditures and serious problems may lie ahead.

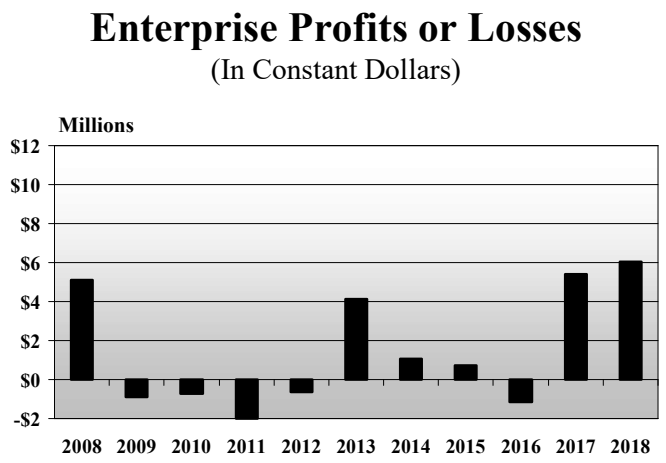
Trends:
The County of Henrico has produced an operating surplus for each of the eleven years presented. In FY08, the surplus was at a peak of 6.9 percent. As clearly seen on the chart above, throughout the economic downturn, beginning in FY08 and continuing through FY13, the County's annual operating surplus consistently declined. In FY09, well into the worst recessionary economic environment since the Great Depression, the County achieved an operating surplus of 5.0 percent. In FY10 and FY11, the County achieved operating surpluses of 1.6 percent and 1.2 percent, respectively. Considering the environment in which these surpluses were achieved, and that it was accomplished without raising taxes, laying off employees, or cutting service levels, the operating surpluses in these two fiscal years is considered in a very positive light. However, as the economy continued to struggle the County continued to face fixed cost increases making the ability to close budget gaps more and more challenging. This is reflected in the FY12 operating surplus of only $535,000, or 0.1 percent of net operating revenues as well as the FY13 operating surplus of $336,000.

With the first moderate signs of recovery in the local economy, particularly real estate, and increases in State Aid, a $17.0 million operating surplus was realized in FY14. This was the first increase in operating surplus as a percentage of net operating revenues since FY07. In FY15, the operating surplus doubled to $34.2 million as a result of fiscal structure added back to the budget baseline that fiscal year. From FY16 to FY18 the trend continued upward, and the operating surplus grew annually from $64.7 million in FY16 to $74.3 million in FY18. With conservative revenue estimates for the FY19 and FY20 budgets, these two fiscal years should yield operating surpluses as well. This, in combination with moderate economic growth, should yield surpluses in future fiscal years. As such, no warning trend is warranted for this indicator.

WARNING TREND: Consistent enterprise losses.

Formula:

Enterprise Profits or Losses in Constant Dollars



Enterprise Losses:
Enterprise losses are a highly visible type of operating deficit. They show potential problems because enterprise operations are expected to function as a "for profit" entity as opposed to a governmental "not for profit" entity. Managers of an enterprise program may raise rates and find that revenues actually decrease because users reduce their use of the service. Enterprises are typically subject to the laws of supply and demand; therefore, operating deficits are distinct indicators of emerging problems. On the graph to the right, the **negative numbers on the scale represent operating losses**. It should be noted that depreciation expenses are included in this analysis.

During the eleven-year period shown, Henrico County's enterprise operations have included Water and Sewer services, and the Belmont Golf Course.

Trends:
After a four-year trend of negative results from FY09 to FY12, the overall trend for FY13-FY15 shown above reflected positive results. FY16 trend showed the first Enterprise loss in four years but was followed in FY17 and FY18 by the two largest years of profit for the entire eleven-year examined period. The Water and Sewer Fund consistently makes up more than 90.0 percent of the total net income or loss reported in the Enterprise Fund.

There are several factors impacting this indicator during this time frame. From FY08 through FY10, operating expenditure growth outpaced revenue growth in each fiscal year, mostly a result of the downturn in the economy which impacted revenue growth. As can be seen in the chart above, FY09 through FY12 all reflect operating revenues that were insufficient to cover operating expenditures. This is not indicating that the Water and Sewer Fund did not make an overall "profit" in these fiscal years. However, it does indicate that operating requirements from FY09 through FY12 required the use of revenue sources that are generally associated with infrastructure, not operations, such as water and sewer connection fees. FY13 saw a return to "profitability." This was the result of a 2.0 percent increase in revenues collected as well as a 0.7 percent decrease in expenditures. The Enterprise Fund maintained a lesser amount of "profitability" in FY14 and FY15. It should be noted that depreciation expenditures are included in this analysis, which are simply accounting entries and do not impact cash flow. To give insight into the impact of depreciation expenses on this indicator, the depreciation expense (unadjusted) for the Water and Sewer Fund in FY11, the lowest level of this indicator in the eleven years examined, totaled $28.4 million. **Excluding depreciation expenditures, this indicator would reflect operating profits for all fiscal years examined in this analysis**.

Even with its operating "losses" posted in the four fiscal years from FY09 to FY12, during this entire eleven-year period the Water and Sewer Fund generated sufficient net revenues each year to exceed the coverage requirements under its Revenue Bond covenants. As a result of the consistent financial results experienced by the Water and Sewer Fund, Fitch IBCA awarded Henrico County an "AAA" rating in 2001. In 2008, Standard & Poor's upgraded its rating to an "AAA" as well. To achieve one "AAA" bond rating is very rare for bonds issued by local utility departments, and Henrico County's Water & Sewer Fund has two of them. In FY16, Fitch changed Henrico County's rating from "AAA Negative Outlook" to "AAA with a Stable Outlook". This change in designation was due to the strong financial health of the system and the increases in the financial metrics. As

such, no warning trend is warranted for the Water and Sewer Fund.

The Enterprise Fund's operating results also reflects the financial performance of the Belmont Golf Course. From FY02 to FY07, the Belmont Golf Course reported net operating losses of varying amounts. These losses were due to several factors. Rounds of play for each of these fiscal years were less than FY99 due to an increase in the number of golf courses in the area. Additionally, expenditures to correct turf damage and capital improvements were incurred in each of these years.

In FY08, the Belmont Golf Course posted its first positive operating result since FY99. In that fiscal year, the course implemented several business model changes that promoted finding efficiencies in its operations to allow for reduced expenditures and the ability to maximize revenues from every source. Despite the operating "profit" in FY08, the FY08 Trends document noted the following observation:

"The current economic environment will likely take its toll on Belmont Golf Course and hinder revenue growth in the near future."

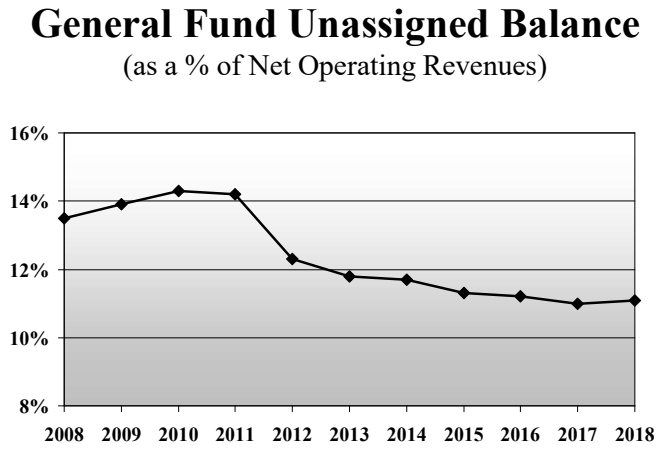
In FY09, the Belmont Golf Course experienced an 8.0 percent decline in the number of rounds of play. The number of rounds played fell another 6.8 percent in FY10 and 0.9 percent in FY11. As such, the Golf Course posted net operating losses in these three fiscal years. Improvement in the economy in FY12 resulted in a 13.2 percent increase in the number of rounds of play, though a net operating loss was again reported. In FY13, rounds dropped 8.0 percent and in FY14 that number decreased by an additional 13.7 percent, yielding the lowest recorded total since 1978 when the County first acquired the golf course. In FY15, as a result of targeted cost reductions at the golf course and slight green fee and cart increases, as well as 1.3 percent increase in rounds played, the Belmont Golf Course nearly achieved profitability. However, Belmont experienced a 2.2 percent decrease in the number of rounds in FY16 to 28,285, a new historical low for the golf course's history with the County and reflective of the downward trend in golf rounds nationwide. Starting in FY17, the golf course underwent the first round of stream restoration repairs through the assistance of State grants that impacted the playability of the course as half of it was closed in order to accommodate these repairs. This resulted in another decline in annual rounds played, dropping to 24,071, or a 14.9 percent decrease. The total number of rounds decreased by an additional 3.5 percent in FY18, meaning that the overall decrease in rounds played was 40.5 percent from FY08 to FY18.

Currently, the County is soliciting public input to examine other alternatives for the Belmont Golf Course property by developing a master plan. This includes finding a private operator to take over operations of Belmont or converting the property to a park and discontinuing golf operations. Until an alternative is decided, the course will continue to operate as is and, as such, a warning trend for the Golf Course continues.

WARNING TREND: Declining unassigned General Fund Balance as a percentage of net operating revenues.

Formula:

$$\frac{\text{Unassigned General Fund Balance}}{\text{Net Operating Revenues}}$$



General Fund Unassigned Balance:
The level of a locality's unassigned fund balance may determine its ability to withstand unexpected financial emergencies, which may result from natural disasters, revenue shortfalls, or steep rises in inflation. It also may determine a locality's ability to accumulate funds for large-scale one-time purchases without having to incur debt. *Note: This historical depiction is reflected differently than the percentages typically referred to in the Annual Fiscal Plan as "net operating revenues."* ***In the Trends document, this includes the General, Special Revenue and Debt Service Funds.*** *As such, the percentage reflected on this page is lower than what is reflected in the Annual Fiscal Plan, which reflects the General Fund Unassigned balance as a percentage of General Fund expenditures.*

Trends:
Henrico County's unassigned General Fund balance as a percentage of net operating revenues remained relatively static from FY08, when it was 13.5 percent, to FY11, where it was 14.2 percent before dropping each year until FY17, when it dropped to 11.0 percent. The percentage rebounded modestly in FY18, rising to 11.1 percent. It should be noted that overall General Fund balance increased $25.9 million in FY18.

As noted above, the depiction of this indicator in the Trends document is different than the indicator reflected in the Annual Fiscal Plan. In FY06, the Board of Supervisors agreed with a policy recommendation to maintain the County's unassigned fund balance at a level of 18.0 percent of General Fund expenditures (again, different than the indicator reflected in this document). Effective June 30, 2012 (FY12), as part of the County's FY13 budget balancing efforts, a policy change was recommended to the Board to reduce the amount of unassigned fund balance maintained to 15.0 percent of General Fund expenditures in an effort to "free up" cash reserves to fund vehicle replacement in the capital budget.

It is of great significance that the County's overall unassigned fund balance grew by 8.3 percent from FY07 to FY11, amidst the worst economic environment since the Great Depression. Again, the decline in FY12 is associated with the County's policy change regarding unassigned fund balance while the decline in FY13 is the result of a drop in unassigned fund balance. FY14, through FY17 reflected unassigned fund balance increases ranging from 1.1 percent, to 2.9 percent, and FY18 saw robust growth of 4.5 percent. It is important to again note that this depiction of General Fund balance is completely different from those referred to in the Annual Fiscal Plan, as "net operating revenues" in this indicator includes the General, Special Revenue, and Debt Service Funds. In the Annual Fiscal Plan, net operating revenues typically refer to just General Fund revenues.

Overall, the County's Unassigned General Fund Balance reflects a positive trend since FY08 that places Henrico in a desirable position for a local government. Henrico County has long held AAA bond ratings by all three bond rating agencies. The maintenance of a healthy fund balance is a critical component examined by rating agencies when assigning bond ratings. Henrico has a long history of maintaining a healthy unassigned General Fund balance and will continue to use prudence in safeguarding this resource.

As a result of the recession and correlated struggling revenue growth, in combination with consistent fixed cost increases, the County was forced to cut expenditures and become more aggressive in its revenue estimates. This

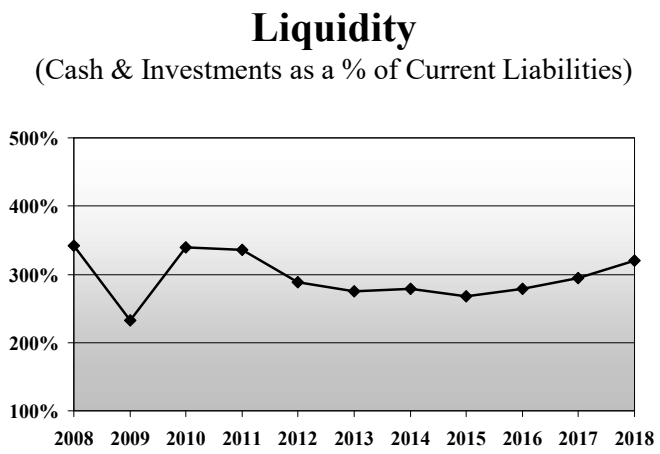
effort was necessary to avoid tax rate increases, service delivery reductions, and layoffs. However, overall fund balance – both assigned and unassigned – declined four consecutive fiscal years by a total of 21.8 percent from FY10 to FY13. This is not necessarily reflected in this indicator, as assigned fund balance levels are not considered in this analysis. Assigned fund balance is important as there are several critical annual appropriations that are made from these balances, including appropriations from the Risk Management Self-Insurance Reserve and funding for specific pay-as-you-go capital projects. Though the intent of a number of these balances are for one-time purposes, annual appropriations of reserves from some of these "buckets" require additional funds to build the reserves back up for the following fiscal year. With unassigned fund balance levels currently calculated as a percentage of General Fund expenditures, when overall fund balance declines, the assigned fund balance levels are impacted on a greater scale.

With the County's revenue picture becoming more positive over the past five fiscal years, unassigned and overall fund balance levels have improved. However, net operating revenues have had greater growth in comparison to the unassigned fund balance. The County decided to utilize this growth in the net operating revenues to strengthen the Risk Management fund by adding 5.0 million to its operating budget, fund the vehicle replacement funds for Police, Fire, and Schools with current revenues, and fund the Technology Replacement Fund again with current revenues after years of utilizing only reserves. These decisions justify the slight decreases in this indicator for FY15, FY16, and FY17. In review of the current fiscal year there is a great indication that the operating revenue will continue to grow, which verifies that these funding decisions are sustainable and will place the County in an improved fiscal position moving forward. As such, no warning trend is warranted for this indicator.

WARNING TREND: Decreasing amount of cash and short-term investments as a percentage of current liabilities.

Formula:

$$\frac{\text{Cash and Short-term Investments}}{\text{Current Liabilities}}$$



Liquidity:
A good measure of a locality's short-run financial condition is its cash position. "Cash position" includes cash on hand and in the bank, as well as other assets that can be easily converted to cash, such as short-term investments. The level of this type of cash is referred to as liquidity. It measures a locality's ability to pay its short-term obligations.

Short-term obligations include accounts payable, the principal portion of long-term debt and other liabilities due within one year of the balance sheet date. The effect of insufficient liquidity is the inability to pay bills or insolvency. Declining liquidity may indicate that a locality has overextended itself.

Trends:
A liquidity ratio of greater than 1:1 (more than 100 percent) is referred to as a "current account surplus." Henrico County has been successful in achieving a current account surplus for the eleven-year period shown.

From the chart above, this indicator reflects a large "dip" downward in FY09 mostly in the area of "principle due in 12 months." It should be noted, however, that the spike in "principle due in 12 months" is misleading, as it mostly reflects two bond refunding's in CY09. The County's bond refunding's do not increase the County's outstanding long-term debt or the length of time to pay off the debt. "Principal due in 12 months" related to newly issued debt is minimal by comparison. In fact, ignoring the impact of the bond refunding's in CY09 altogether, current liabilities only increased 13.6 percent instead of 58.1 percent, and the Liquidity indicator would have been 323.2 percent in FY09, much higher than the recorded 232.2 percent. In FY10 this indicator increased to 339.4 percent which was an overall decline in current liabilities. and in FY11, the indicator dropped slightly to 335.4 percent. In FY12, the indicator dropped significantly to 288.2 percent, mostly due to the large debt issuance in that fiscal year, as the County combined two planned General Obligation debt issues into one as a result of the attractive interest rates at the time. This debt issuance finalized the County's March 2005 General Obligation Bond Referendum. Over the most recent six fiscal years, FY13 to FY18, this indicator averaged 286.1 percent, with FY18 being 320.0 percent, the highest level since FY11.

Over the past eleven years, the County has maintained an average liquidity ratio of 2.94:1, which is more than *twice* the defined "current account surplus" above. The low point in this indicator of 2.32:1 was experienced in FY09. By performing annual debt capacity reviews, compiling a five-year Capital Improvement Program that encompasses all funds, and by ensuring that those capital projects that obtain funding are appropriately cross-walked to the annual operating budget, the County of Henrico will not incur liabilities at a rate that cannot be supported within established resources. Based on the upward path of this trend, no warning is warranted for this indicator.