Arlington County, Virginia
Presentation to the County Board
Reserve Policy Review

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Overview

Objective: Review Arlington's existing reserve policies

- Adequacy to provide financial flexibility
- Benchmark vs. triple-A peer group & credit agency medians
- Credit rating agency metrics & perspectives

Scope of Review

- General Fund
- Enterprise Funds: Utilities Fund, Ballston Garage Parking Funds, CPHD Fund
- Capital Projects Fund: Transportation Capital Fund, Tax Increment Funds, Stormwater Fund
- Internal Service Funds, including Self Insurance Fund

Results

- Arlington's reserve policies for non-general funds are robust & comprehensive
- General Fund reserve policy threshold of 5% is below triple-A medians and among the lowest in peer group
- A lower policy threshold for the General Fund is not recommended
- Despite low policy minimum, actual levels of reserves in the General Fund are adequate to maintain the County's current Aaa/AAA/AAA ratings, despite recent trends
- Recommend creation of reserve policy for Ballston Parking Garage Enterprise Fund

Why Have Reserves?

- All municipalities are subject to a number of risks and areas of pressure, although the nature of those risks vary
- Maintaining reserves is a way to mitigate against risks
- Credit rating agencies and investors view reserves as readily available financial flexibility

Arlington's Risk Factors

- Arlington's financial strength, including sound reserves, has enabled the County to weather many uncertainties over the years
  - Great Recession
  - BRAC
  - Sequestration
  - Federal Government shutdown(s)
  - September 11th
  - Loss of major employers (Gannett, USAir, NSF, etc.)
  - Limitations/unfunded mandates from the Commonwealth
- What are potential concerns in the future?
  - Potential for recurrence for any of the above & variations/combinations thereof
  - High commercial vacancy rate with a slow return to historical norms
  - Competitiveness in the region
  - Preserving Arlington's triple-A credit ratings (Aaa/AAA/AAA)
- Maintaining adequate reserves is an important tool in the toolbox, if/when risks are realized

Credit Agency Perspectives on Arlington's Reserves

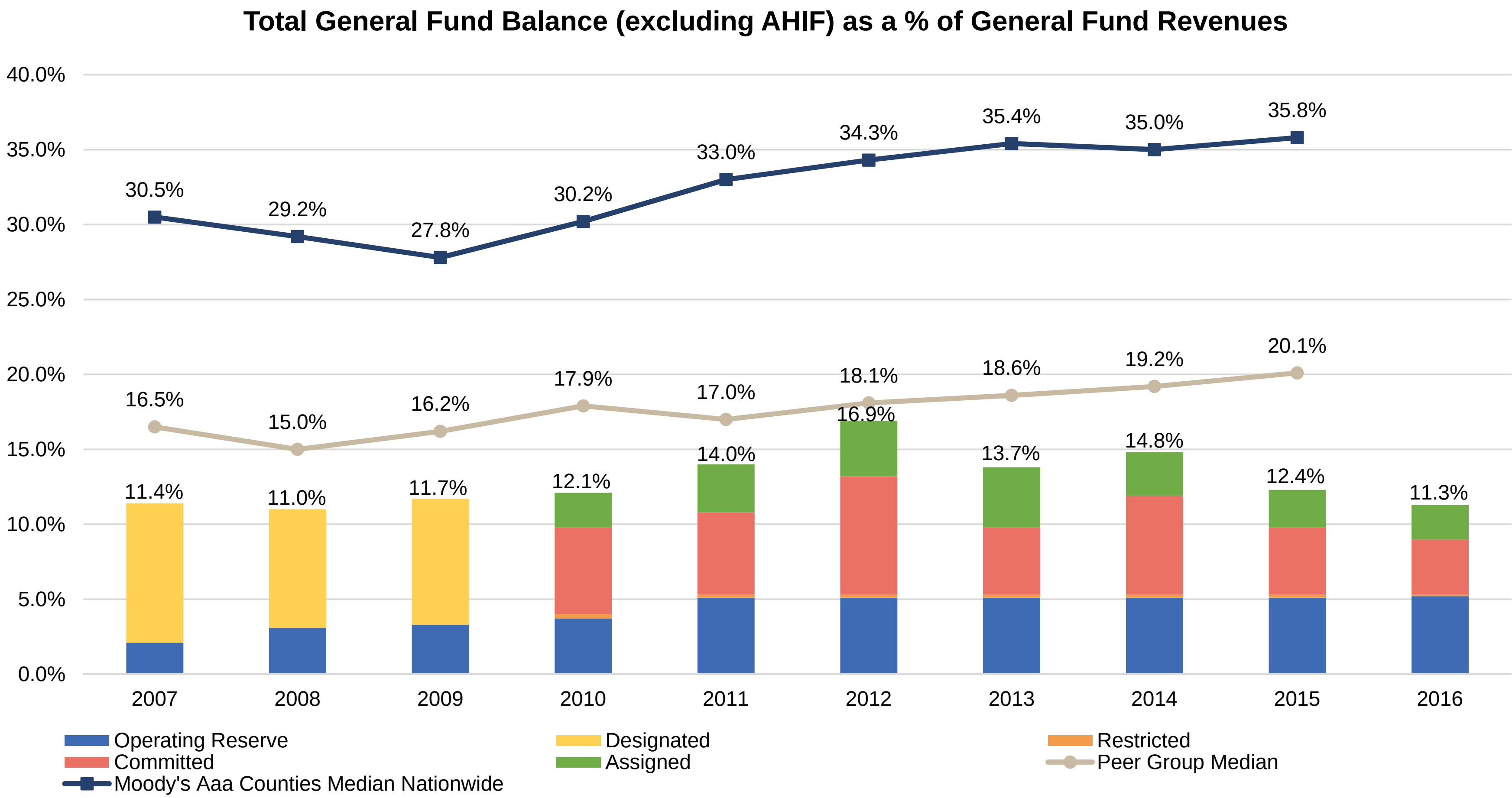
- Moody's
  - "The Aaa rating reflects the County's strong credit characteristics, including a solid financial position with sound reserves."
  - "The County has additional reserves beyond its General Fund which total $227.8 million. When factoring in these outside available reserves, total available fund balance equaled 20.1% of fiscal 2015 revenues. We will monitor the county's ability to maintain adequate reserves."
  - "Planned use of reserves could limit fiscal flexibility."
  - "Substantial decline in reserve levels" is a "factor that could lead to a downgrade."
- S&P
  - "Arlington County has a history of maintaining what we consider to be very strong available general fund balance."
- Fitch
  - "The County's strong revenue and expenditure flexibility, evidenced by its conservative budgeting and close monitoring of expenditures, has consistently produced surplus results leading to solid reserve levels and liquidity."
  - "The rating is sensitive to the County's stable financial performance and the maintenance of adequate reserves."
  - "The County was able to increase reserves following the recession through a combination of conservative budgeting, implementing a hiring freeze, maintaining vacant positions and applying timely rate increases."

Source: Fitch Report, "Arlington County, Virginia General Government Full Rating Report," June 9, 2016. S&P Report, "Arlington County, Virginia; Appropriations; General Obligation," April 4, 2016. Moody's Report, "Arlington County, VA Credit Opinion," April 1, 2016.

Existing General Fund Reserve Policies

- Operating Reserve
  - The County's current policy states that the Operating Reserve will be maintained at no less than 5% of the County's General Fund budget, with appropriations only made by a vote of the County Board to meet a critical, unpredictable financial need
  - Any draw on the operating reserve will be replenished within the subsequent three fiscal years
- Economic and Revenue Stabilization Contingent
  - The County's current policy states that the minimum amount of the contingent will be $3 million and will be revisited annually as part of the budget process
  - Any draw on the economic revenue stabilization contingent will be replenished within the subsequent two fiscal years
  - Serves to address short-term revenue declines and economic disruptions
- PFM Observations and Recommendations
  - Current reserve policy thresholds are below medians for triple-A peers
  - Broadening and enhancing the Economic & Revenue Stabilization Contingent adds flexibility

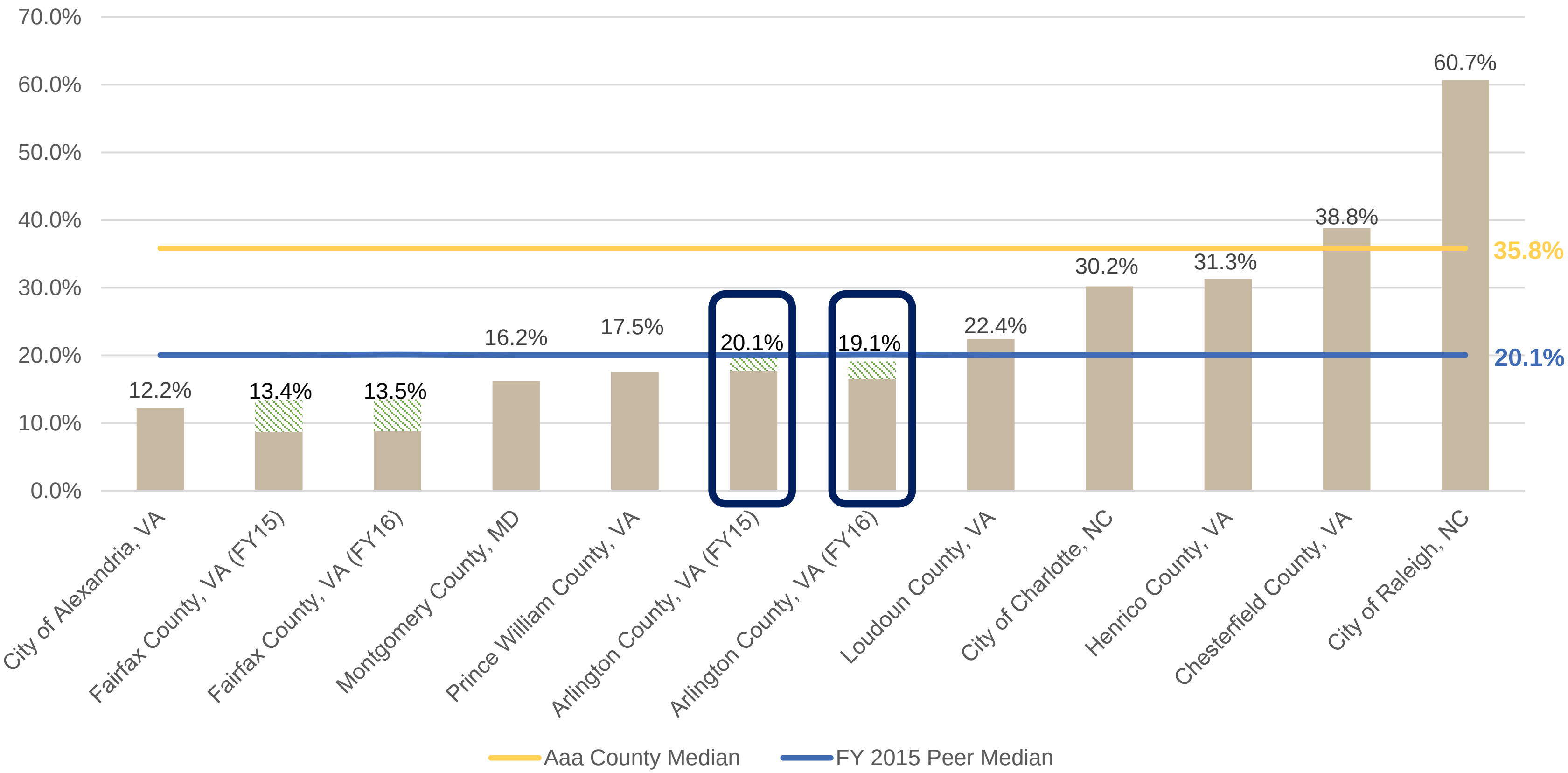
County's Historical Trend: General Fund Balance Excluding Affordable Housing Investment Fund ("AHIF")



Source: Arlington Comprehensive Annual Financial Reports FY2006-2016. Moody's MFRA Database. FY2016 Median is not yet available.

Peer Group Analysis: Total General Fund Balance

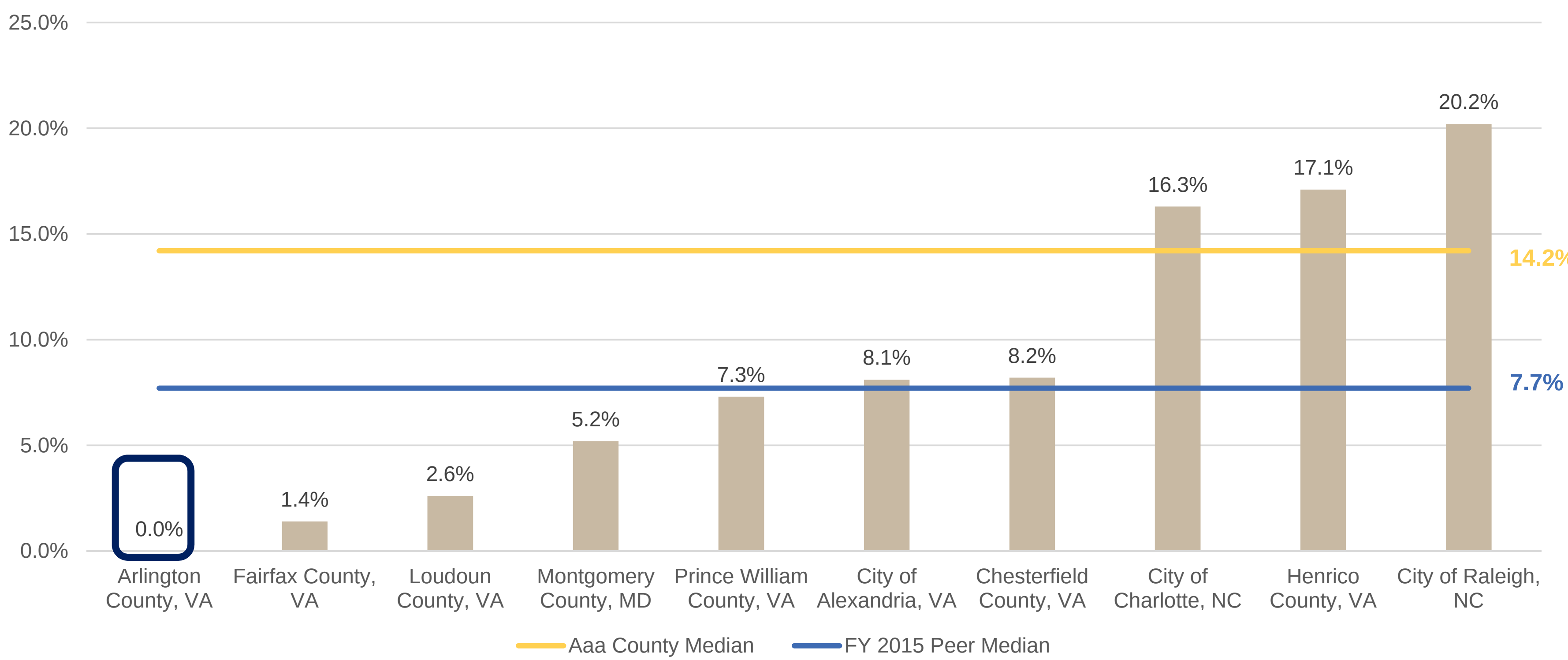
Arlington's Total General Fund Balance metric is below the Moody's Aaa-rated Counties' median but consistent with the peer median.



Source: Moody's Financial Ratio Analysis database, all data is as of FY2015 unless otherwise noted.
Note: For Fairfax County & Arlington County, Moody's includes certain reserves outside of the General Fund as Available Fund Balance, illustrated by the additional shaded green area of the bar.

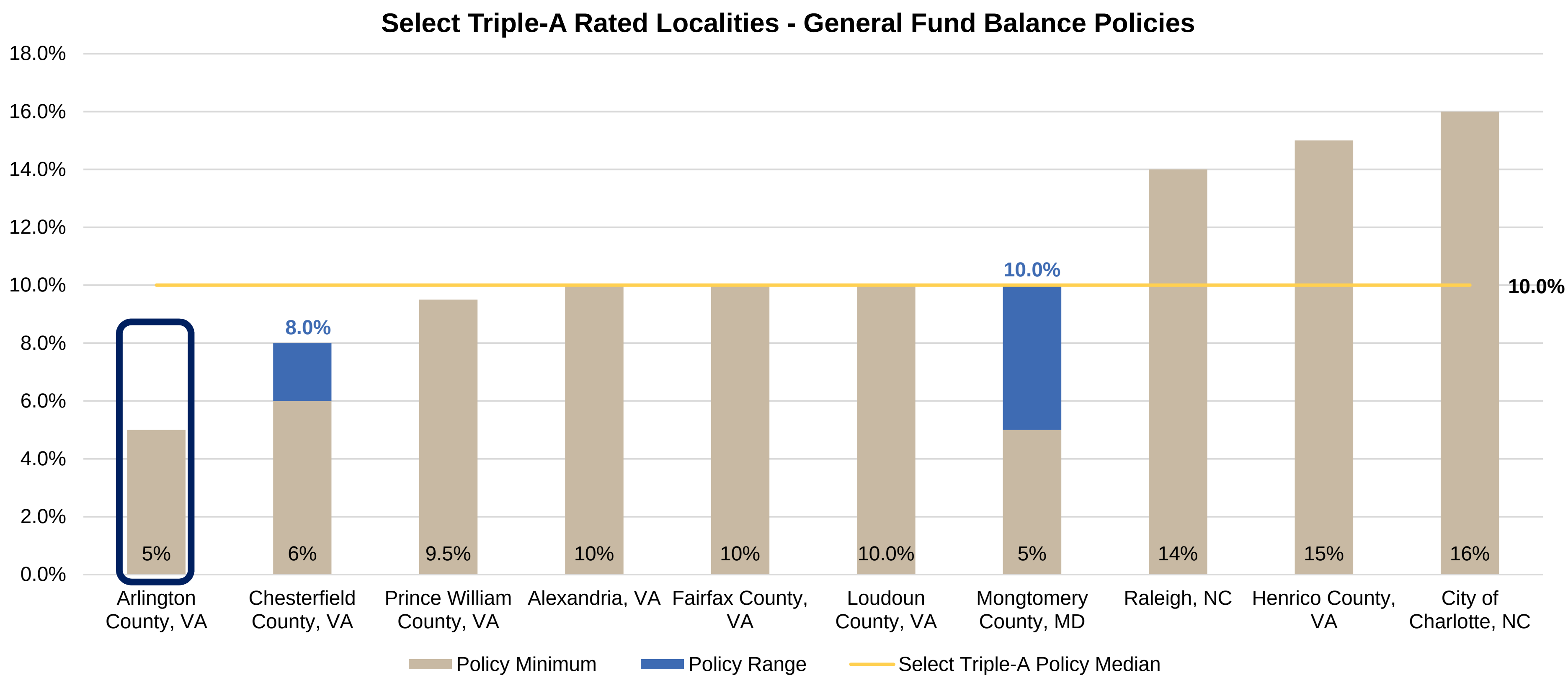
Peer Group Analysis: Unassigned General Fund Balance

Arlington has a long-standing practice of assigning or committing all dollars in its General Fund, while all of the County's triple-A rated peers report some amount of unassigned balances in their General Fund.



Source: Moody's Financial Ratio Analysis database, all data is as of FY2015.

Summary of General Fund Balance Policies



Note: For Arlington, Chesterfield, Fairfax, Henrico Counties and Raleigh & Charlotte. NC, the denominator is general fund expenditures. All others use general fund revenues.

Sample General Fund Balance Policies

Typical Policy Approach

Fairfax County, VA

- Managed Reserve at 4%. For catastrophic emergency nature only.
- Revenue Stabilization Fund at 5%. Withdrawal can be made if projected revenues reflect more than 1.5% decrease vs. current year estimate. No more than half of balance may be drawn.
- Economic Opportunity Reserve at 1%. For use to provide strategic investment opportunities identified as priorities by the Board.

Prince William County, VA

- Unassigned General Fund Balance at 7.5%. To address local & regional emergencies.
- Revenue Stabilization Fund at 2%. Withdrawal can be made if unexpected decline in the revenue of more than 3% compared to current Budget.

Loudoun County, VA

- Committed portion of Unrestricted Fund Balance at 10%. Committed FB can be only used in the event of unexpected & non-routine circumstances. Unrestricted FB may be considered if total projected GF revenues reflect more than 3% decrease vs. current year estimate.

Arlington's General Fund Reserve Policy: PFM Observations

- The County's General Fund reserve policy levels are below the median level and among the lowest in the triple-A group
- Lowering the 5% policy threshold for the General Fund is not recommended
- Arlington's Total General Fund reserve levels are comparable to the peer triple-A group but below the national Moody's triple-A median
- Credit agencies have viewed Arlington's positive budget to actual performance, willingness & ability to control both revenue and expenditures as credit strengths which offset median reserve levels & lower than typical reserve policies
- FY 2016 is the second consecutive year of decline in the General Fund balance ratio
  - Could begin to concern Moody's, if it becomes a trend, and in combination with other credit uncertainties
  - Underperformance versus the peer median will raise scrutiny from Moody's, a lesson learned from post credit action taken by Moody's in the Northern Virginia region
  - Emphasizing available reserves outside of the General Fund is one proven approach to help mitigate concerns

Ballston Garage and Ballston Garage 8th Level Funds

- Given the shared purpose of the two parking enterprise funds, they can be considered together for reserve policy purposes
- Typically, structured parking enterprises seek to set aside reserve funds for three general purposes
  - Operating reserves, i.e., to smooth economic cycles which may disrupt revenue collections
  - For any debt paid from garage revenue
  - To set aside amounts for future maintenance & capital costs as the garage ages
- Existing debt on the garage totals $5.8 million with a final maturity on August 1, 2017
  - A fully funded DSRF is in place in the amount of $3.34 million
  - Existing bond documents require an O&M reserve, currently funded at $2 million
  - Once the bonds mature, County plans on releasing the O&M reserve to use for capital projects
- Improvements to garage will occur as part of the Ballston Quarter redevelopment project
  - Garage revenue is expected to be used to pay debt service on approximately $6 million of garage improvements financed by the Ballston Quarter CDA
  - Garage related debt service ranges from $580k to $720k over FY 2020 to FY 2032

Ballston Parking Enterprise Funds: PFM Observations

- Adopted financial policies for municipally owned parking garages is a limited universe
- Policies should reflect the specific uses and nature of the parking enterprise
  - Single garage vs. system of garages
  - Attached vs. detached to adjacent uses
  - Multi-use vs. single use
  - Public vs. private operation
- Ballston Garage is unique among municipally owned parking garages for myriad reasons & policy should reflect it
- Format of Arlington’s utility and stormwater policies is a reasonable template for parking garage financial policy

Thank You

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