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# Harrisonburg (City of) VA

## Update to credit analysis

## Summary

The City of Harrisonburg, VA's (Aa2) credit profile reflects large and growing tax base that benefits from the stabilizing institutional presence of James Madison University, as well as below-average resident income levels that are impacted by an outsized student population. The city's credit profile also reflects an adequate and stable financial position with satisfactory reserves, management's strong budgeting practices, an above average debt burden, and manageable pension liabilities.

On August 6th, we assigned a Aa2 underlying rating to the city's $164 million General Obligation Public Improvement and Refunding Bonds, Series 2021A (tax-exempt) and $2.4 million General Obligation Public Improvement and Refunding Bonds, Series 2021B (federally taxable).

## Credit strengths

» Large and growing tax base with sizeable institutional presence

» Stable financial position bolstered by formal fiscal policies

## Credit challenges

» Debt burden higher than similarly-rated cities nationwide

» Resident income levels below Aa2 median

## Rating outlook

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

## Factors that could lead to an upgrade

» Substantial reduction in debt burden

» Sustained growth of reserves and liquidity

» Material tax base expansion and improvement in resident income levels

## Factors that could lead to a downgrade

» Trend of operating deficits and narrowing reserve levels

» Material tax base contraction and weakening resident income levels

» Substantial increase in debt burden

## Key indicators

Exhibit 1
**Harrisonburg (City of) VA**

| | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|
| **Economy/Tax Base** | | | | | |
| Total Full Value ($000) | $4,430,664 | $4,539,870 | $4,616,188 | $4,769,128 | $4,941,089 |
| Population | 51,979 | 53,064 | 53,391 | 53,273 | 54,049 |
| Full Value Per Capita | $85,240 | $85,555 | $86,460 | $89,522 | $91,419 |
| Median Family Income (% of US Median) | 81.1% | 84.4% | 83.3% | 82.1% | 82.1% |
| **Finances** | | | | | |
| Operating Revenue ($000) | $139,287 | $144,742 | $154,487 | $161,625 | $168,911 |
| Fund Balance ($000) | $30,145 | $32,535 | $36,031 | $34,972 | $40,424 |
| Cash Balance ($000) | $35,443 | $39,033 | $43,774 | $43,737 | $51,109 |
| Fund Balance as a % of Revenues | 21.6% | 22.5% | 23.3% | 21.6% | 23.9% |
| Cash Balance as a % of Revenues | 25.4% | 27.0% | 28.3% | 27.1% | 30.3% |
| **Debt/Pensions** | | | | | |
| Net Direct Debt ($000) | $182,248 | $172,194 | $163,823 | $156,784 | $181,479 |
| 3-Year Average of Moody's ANPL ($000) | $195,413 | $230,390 | $238,319 | $242,259 | $237,649 |
| Net Direct Debt / Full Value (%) | 4.1% | 3.8% | 3.5% | 3.3% | 3.7% |
| Net Direct Debt / Operating Revenues (x) | 1.3x | 1.2x | 1.1x | 1.0x | 1.1x |
| Moody's - ANPL (3-yr average) to Full Value (%) | 4.4% | 5.1% | 5.2% | 5.1% | 4.8% |
| Moody's - ANPL (3-yr average) to Revenues (x) | 1.4x | 1.6x | 1.5x | 1.5x | 1.4x |

*Sources: US Census Bureau, Harrisonburg (City of) VA's financial statements and Moody's Investors Service*

## Profile

The City of Harrisonburg, VA encompasses 17.4 square miles in the Shenandoah Valley region of Virginia (Commonwealth of Virginia, Aaa stable). The city operates under a council-manager form of government and is governed by a five-member council, including the mayor, who appoint a city manager to oversee day-to-day operations. The city's population totaled 54,049 in 2020 according to the most recent U.S. Census American Community Survey, which represents a 10.5% increase since 2011.

## Detailed credit considerations

### Economy and tax base: growth and diversification continues, tax base anchored by institutional presence

Harrisonburg's $4.9 billion tax base (fiscal 2020) is much larger than the national median for the Aa2 rating category and continues to grow, with a five-year compound annual growth rate of 2.6%, driven by property value appreciation and new developments. The city's economic anchor and largest employer, James Madison University (JMU), is a major educational institution and part of the Commonwealth of Virginia's higher education system. Enrollment has grown to over 22,000 students, mostly located within the city limits, representing over 40% of the city's total population. JMU continues to expand and invest in the local economy with various capital projects including the College of Business Expansion and Renovation ($71.2M), Atlantic Union Banking Center -Sports Arena ($86.7M), and a new retail dining facility ($225.2M).

The city's tax base is also home to a vibrant, increasingly diverse commercial and industrial base that includes retail, auto parts, software, electronics, agribusiness and packaging product manufacturers. Tourism primarily related to the Shenandoah National Park has also driven growth in the local economy. The city has also recently launched its “Harrisonburg Downtown 2040” initiative, with a goal to continue revitalization of the downtown area.

The city's June 2021 unemployment rate of 5% is slightly higher than the state (4.5%) but below the national (6.1%) rates for the same period. According to the most recent U.S. Census American Community Survey, resident income levels fall below the national median for the rating category with median family income equal to just 82.1% of the US in 2019. Additionally, the city's poverty rate is also elevated at 28.2%. The city's income and poverty levels, however, are partially impacted by a sizeable student population.

### Financial operations and reserves: adequate and stable reserve position supported by conservative budgeting and formal fiscal policies

Harrisonburg's financial position will remain stable given management's conservative budget assumptions, adherence to formal fiscal policies, and continued tax base growth. While the city's fund balance reserves are maintained below the national Aa2 medians as a percentage of revenues, they are stable and sizeable on an absolute basis.

Fiscal 2020 ended with a general fund balance of $39.5 million, or 32.5% of revenues. Total available operating fund balance (inclusive of the general and school operating funds) totaled just $40.4 million, or 24% of combined operating fund revenues at fiscal year end 2020, higher than fiscal 2019 fund balance of 21.6%, but still below the national median of 37% for the Aa2 rating category. While fund balance levels fall short of the national medians as a percentage of revenues, they are much larger on an absolute basis. Positively, available operating fund balance has remained steady over the past five fiscal years, averaging 22.5% of revenues. Because Virginia cities' operating funds include school operations, the median operating fund balance is generally lower than national medians.

For fiscal 2021, management reports that revenues are tracking above budget and expenditures below. The city is projecting an estimated surplus of $5.5 million. The fiscal 2022 budget incorporates conservative revenue estimate projecting a 4% decline compared to the fiscal 2021 amended budget.

Management adheres to a formal fund balance policy requiring a minimum level of reserves in the city's unassigned general fund balance. The policy states that the city's unassigned fund balance cannot fall below 18% of expenditures.

#### Liquidity

Harrisonburg's operating funds (inclusive of the general and school operating funds) reported net cash and investments of $51.1 million at fiscal year-end 2020, or 30.3% of combined operating fund revenues, which is below the national medians for the rating category as a percentage of revenues but much larger on an absolute basis. Positively, the city's liquidity position has remained relatively stable, averaging 27% of revenues over the past five fiscal years.

### Debt and pensions: above-average debt burden will remain manageable despite future borrowing plans

Harrisonburg's debt burden is higher than similarly-rated peers nationwide, but will remain manageable, despite future debt plans, given management's adherence to formal debt policies and continued tax base growth. Post issuance of the Series 2021A and 2021B bonds, the city's net direct debt will be approximately 5.5% of fiscal 2020 full value, which is manageable but well above the national Aa2 median of 0.9%. Because Virginia cities are responsible for school operations, including capital borrowing, the median direct debt burden is generally higher than national medians as a percentage of full value. The city's direct debt burden represents 1.1 times operating revenues, which is also above but closer to the national Aa2 median of 0.8 times.

The city's fiscal 2022-2026 capital improvement plan (CIP) totals $156.3 million, including projects for the self-supporting utility funds. Management updates the CIP annually and notes that approximately 40% of the identified projects are anticipated to be cash funded (pay-go), while the balance may be funded through a combination of grants, reimbursements from other organizations, debt, and future operations. Therefore, the city's overall debt burden is not anticipated to shift materially given adherence to formal debt policies, tax base growth, and continued amortization of outstanding debt.

Management adheres to formal debt policies that cap tax supported debt at 6% of total assessed values and annual debt service at 15% of expenditures.

#### Legal security

The city's general obligation bonds are payable from the city's full faith and credit and unlimited property tax pledge.

#### Debt structure

All of the city's outstanding debt is fixed rate and amortizes at an average rate of 58.5% over 10 year period.

#### Debt-related derivatives

The city is not party to any interest rate swaps or other derivative agreements.

**Pensions and OPEB**

The city and the city school board participate in the Virginia Retirement System (VRS), a multi-employer defined benefit pension plan administered by the Commonwealth of Virginia. For fiscal 2020, the city's total pension contribution was $9.06 million, or 5.3% of operating revenues. The city has funded its pensions at the annually required contribution amount in recent years, which is more than the tread water amount (the amount required to prevent the unfunded liability from increasing based on plan assumptions).

Moody's adjusted net pension liability (ANPL) is our measure of a local government's pension burden that uses a market-based interest rate to value accrued liabilities. The city's ANPL has averaged $237 million over the last three years, representing 1.4 times operating revenues, which is comparable to the national median for the rating category.

City and school board employees participate in the city's single-employer defined benefit other post-employment benefit (OPEB) plans: the City of Harrisonburg Post retirement Healthcare Benefit Plan and the Harrisonburg City School Board Postretirement Healthcare Benefit Plan. The Moody's adjusted net OPEB liability was $46.6 million at fiscal year-end 2020. The city's total OPEB contribution was $2.1 million in fiscal 2020.

Total fixed costs (inclusive of pension and OPEB contributions and debt service post-issuance) account for a manageable 16.2% of revenues in fiscal 2020.

## ESG considerations

### Environmental

Similar to the local government sector overall, Harrisonburg has low exposure to environmental risks. According to data from Moody's affiliate Four Twenty Seven, the city's total average exposure to the projected rate of change of five climate risk factors is mid-ranged compared to other cities nationwide. Of the physical climate risks Four Twenty Seven evaluates, Harrisonburg's highest exposure is to extreme rainfall. This exposure is mitigated by several factors, including management's maintenance of strong reserves, the state and federal governments' history of providing disaster relief to local governments following a major weather event, and Harrisonburg's geographic position in the Shenandoah Valley region of the state.

### Social

Social issues, which include demographics, labor force, and income metrics, are material to the city's credit quality and are incorporated by way of full value per capita and median family income. While social issues do not currently pose a credit risk, we will continue to monitor a variety of factors such as demographics, income levels, population trends and employment levels, as these remain important key credit metrics

### Governance

Like issuers across every sector, governance considerations are material to the city's credit quality. Harrisonburg will continue to benefit from strong management, conservative budgeting practices, and adherence to multiple formal fiscal policies. Additionally, Virginia's flexible operating framework and the city's strong management and conservative budgeting will continue to support its sound financial position.

Virginia Cities have an institutional framework score [1] of "Aaa," which is very strong. Property taxes, the primary revenue source, are highly stable and predictable. Cities have strong revenue-raising ability as there are no caps on property tax rates. Operating expenditures for cities tend to be highly stable and predictable and cities have a strong ability to reduce them given a limited presence of unions and moderate fixed costs, which are driven by debt service and pension costs and are generally less than 25% of expenditures.

## Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 2

### Harrisonburg VA

**Harrisonburg VA**

| Scorecard Factors and Subfactors | Measure | Score |
|---|---|---|
| Economy/Tax Base (30%) [1] | | |
| Tax Base Size: Full Value (in 000s) | $4,941,089 | Aa |
| Full Value Per Capita | $91,419 | Aa |
| Median Family Income (% of US Median) | 82.1% | A |
| Notching Adjustments:[2] | | |
| Institutional Presence | | Up |
| Finances (30%) | | |
| Fund Balance as a % of Revenues | 23.9% | Aa |
| 5-Year Dollar Change in Fund Balance as % of Revenues | 8.0% | A |
| Cash Balance as a % of Revenues | 30.3% | Aaa |
| 5-Year Dollar Change in Cash Balance as % of Revenues | 11.5% | Aa |
| Management (20%) | | |
| Institutional Framework | Aaa | Aaa |
| Operating History: 5-Year Average of Operating Revenues / Operating Expenditures (x) | 1.0x | A |
| Debt and Pensions (20%) | | |
| Net Direct Debt / Full Value (%) | 5.5% | Baa |
| Net Direct Debt / Operating Revenues (x) | 1.6x | A |
| 3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%) | 4.8% | Baa |
| 3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x) | 1.4x | A |
| | Scorecard-Indicated Outcome | Aa2 |
| | Assigned Rating | Aa2 |

[1] Economy measures are based on data from the most recent year available.
[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology.
[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication.
*Sources: US Census Bureau, Harrisonburg VA's financial statements and Moody's Investors Service*

## Endnotes

1 The institutional framework score assesses a municipality's legal ability to match revenues with expenditures based on its constitutionally and legislatively conferred powers and responsibilities. See US Local Government General Obligation Debt (July 2020) methodology report for more details.

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