S&P Global Ratings

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## Summary:

# Harrisonburg, Virginia; General Obligation

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| US$164.005 mil GO pub imp and rfdg bnds (tax-exempt) ser 2021 A dtd 09/21/2021 due 07/15/2046 | | |
| *Long Term Rating* | AA+/Stable | New |
| US$2.42 mil GO pub imp and rfdg bnds (taxable) ser 2021 B due 07/07/2024 | | |
| *Long Term Rating* | AA+/Stable | New |
| Harrisonburg GO | | |
| *Long Term Rating* | AA+/Stable | Upgraded |
| Harrisonburg GO | | |
| *Long Term Rating* | AA+/Stable | Upgraded |

## Rating Action

S&P Global Ratings raised its rating on the City of Harrisonburg, Va.'s general obligation (GO) debt one notch to 'AA+' from 'AA'. At the same time, S&P Global Ratings assigned its 'AA+' rating to the city's $164.0 million series 2021A (tax-exempt) and $2.4 million series 2021B (federally taxable) GO improvement and refunding bonds. The outlook is stable.

The upgrade is based on the city's continued economic growth and diversification, combined with the maintenance of a very strong financial position that grew stronger during the COVID-19 pandemic and that is supported by formalized financial policies and practices as well as historically conservative budget assumptions. Furthermore, the upgrade reflects our expectation that the city's debt profile could improve over the next couple of years given the lack of significant additional debt plans in the near term, with just $1.6 million in top priority-mandated capital projects identified over the next five years, in addition to Harrisonburg's recent history of pay-as-you-go capital funding.

A full faith and credit pledge, including an agreement to levy unlimited ad valorem taxes on all taxable property within city limits, secures Harrisonburg's GO bonds outstanding, including the current issuance.

Series 2021A and 2021B bond proceeds will be used to fund various capital projects, including a new high school and construction of waterlines. We note the city planned to issue GO bonds last year to fund these capital needs but the bonds never sold due to market conditions following the onset of the pandemic. The series 2021A and 2021B bonds will also refund a portion of previously issued GO debt, including all of Harrisonburg's previously issued privately placed GO bank loans, except for the city's series 2017 GO issuance, which has a remaining principal of $490,000. We understand the portion of debt relating to the city water utility will be self-supporting.

### Credit overview

Harrisonburg has a history of strong financial operations, as well as a stable economy that has demonstrated steady population and assessed value (AV) growth. This growth is driven in large part by the presence and economic impact of James Madison University (JMU), which is in the process of completing a number of large-scale capital projects totaling more than $290 million worth of projects over the past two years, including a $71 million expansion to the business school as well as an $87 million new basketball stadium. In addition to JMU's capital projects, Harrisonburg continues to demonstrate diversification of its economic base, with growth in tourism, both through sports and through annual events and festivals, as well as growth in residential AV. In our view, the city's consistently good economic growth has in turn fueled good revenue growth, which, combined with a very strong and proactive management team and conservative budgeting practices, has led to the maintenance of very strong reserves, averaging above 35% of expenditures in each of the past three fiscal years.

Management indicates the city performed well through the pandemic, including achieving an estimated $8.8 million operating surplus in fiscal 2021 according to unaudited estimates primarily due to conservative revenue estimates as well as operational savings realized during the year. Furthermore, JMU is slated to be open with in-person classes for the start of the 2021-2022 school year, indicating economic activity could normalize in fiscal 2022, thereby providing continued financial stability.

Although debt is moderate relative to Harrisonburg's total market value and moderately high relative to the city's budget size, we believe overall fixed charges, including pension and other postemployment benefit (OPEB) expenses, are very manageable at less than 16% of governmental expenditures in fiscal 2020. We believe the city's debt carrying costs and overall fixed costs will remain in line with current levels, given Harrisonburg's debt management policies and a capital plan that has ample flexibility.

The rating reflects our opinion of the city's:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA) and a local stabilizing institutional influence;
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2020;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2020 of 40% of operating expenditures, including unrestricted reserves held in the capital projects fund that could be reclassified if necessary.
- Very strong liquidity, with total government available cash at 78.1% of total governmental fund expenditures and 6.1x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability profile, with debt service carrying charges at 12.8% of expenditures and net direct debt that is 187.1% of total governmental fund revenue; and
- Very strong institutional framework score.

### Environmental, social, and governance (ESG) factors

We have analyzed Harrisonburg's environmental risks, including health and safety risks posed by the COVID-19 pandemic, along with social and governance risks relative to the city's economy, financial management, budgetary performance, and budgetary flexibility, as well as the debt and liability profile, and have determined all are in line with our view of the sector standard.

Although Harrisonburg is well-insulated from sea-level rise, given its location well inland, we believe the city has demonstrated an exceptional commitment to climate resiliency planning, which is essential to its long-term growth planning. Specifically, Harrisonburg has created a comprehensive Environmental Action Plan that was adopted by city council on Jan. 14, 2020, as a guide for city leaders, staff, and community members to implement principles and visions that are sustainable and environmentally friendly. The action plan is organized into six focus areas, consisting of buildings and energy, land use and green space, regional food systems, sustainable transportation, waste reduction and recycling, and water resources. Each focus area has goals, strategies, and tasks for each strategy, including action steps toward achieving strategies. We believe this guide will significantly help the city mitigate the impacts of environmental degradation.

Finally, we note the city has bolstered its resources devoted to cyber security in recent years, including increased staffing. Harrisonburg uses training programs for employees and maintains redundant backups of data.

## Stable Outlook

### Upside scenario

If Harrisonburg's debt and contingent liability profile were to improve, along with continued growth and diversification of the tax base, leading to materially higher income levels in particular, we could raise the rating.

### Downside scenario

Although we do not expect this, if the city were to materially draw down reserves as a result of weak budgetary performance, the rating could be pressured.

## Credit Opinion

### Strong economy

We consider Harrisonburg's economy strong. The city, with an estimated population of 51,814, is located in the Harrisonburg MSA, which we consider to be broad and diverse. The city also benefits, in our view, from a stabilizing institutional influence. Harrisonburg has a projected per capita effective buying income of 59.8% of the national level and per capita market value of $95,362. Overall, the city's market value grew by 3.6% in 2019 to $4.9 billion in 2020. The city unemployment rate was 5.3% in 2020.

Our view of the city's economic profile changing to strong from adequate is based on our classification of the Harrisonburg MSA changing to broad and diverse due to improved diversification and growth of the labor force.

Harrisonburg encompasses 17.3 square miles and is in the geographic center of the Shenandoah Valley of Virginia. Although it is an independent city, it also serves as the county seat of Rockingham County. The city is supported by the presence of JMU, a commonwealth-supported school with total enrollment of 21,500 students, and with capital investment of more than $1.0 billion since 2000, according to city management. Three other colleges and universities, with a total student population of nearly 10,000, are also within city and county limits. In addition to these stabilizing institutions, Harrisonburg is also supported by Sentara Rockingham Memorial Hospital Medical Center, which is just outside city limits, as well as Harrisonburg Community Health Center, which is within city limits.

Harrisonburg is an integral part of the regional economy, providing significant employment opportunities, not only in education and health care but also in other supporting sectors, such as manufacturing, retail, food, and hospitality services; combined, these sectors account for nearly two-thirds of employment in the city. With Harrisonburg's direct access to Interstate 81 (I-81), which runs through the city, and Interstate 64, which leads into Richmond, residents find additional employment opportunities throughout Rockingham County and neighboring counties. We understand the Virginia Department of Transportation is funding transportation improvements to I-81 in and within proximity to the city, including widening lanes, which will improve traffic flow and serve to enhance economic activity in the region.

The property tax base has historically experienced consistent steady growth, growing by an average of nearly 1.5% annually over the past decade. We understand two hotels opened in 2020 and two more are expected to open this year, reflecting Harrisonburg's strong tourism industry. Furthermore, the city recently launched "Downtown Harrisonburg 2040," which is the start of a comprehensive long-term plan aimed at focusing on the buildout of the city's downtown area. The tax base is diverse, with leading taxpayers accounting for approximately 10% of total AV, consisting primarily of businesses involved in student housing apartments, in addition to the poultry industry. Harrisonburg revalues property annually, preventing significant spikes every few years. In our view, property tax collections remain strong at nearly 100%. Furthermore, per capita retail sales are very strong, in our opinion, at more than twice the national average, which we believe reflects Harrisonburg's role as a regional economic center.

We believe the significant student presence, which accounts for nearly two-thirds of the population, substantially mitigates what we consider the city's low income levels. Based on reports published by JMU, approximately one-third of students come from northern Virginia, in addition to about one-third from outside the commonwealth. We understand that nearly half of student families report an annual income of $125,000 or more. Furthermore, city management indicates that Harrisonburg's AV does not include at least $1.5 billion in tax-exempt property associated with the universities in the city, which, if included, would increase market value per capita to nearly $120,000.

### 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.

Harrisonburg's financial management techniques include several debt affordability policies, including a 15% debt service carrying charge limit of general government and school component unit expenditures and a 6% limitation on net general bonded debt as a percent of AV. The city performs a five-year financial forecast, updated annually, for each fund. In addition, city officials annually update a five-year capital improvement plan (CIP), with funding sources identified.

We believe the city budgets conservatively, including using an assumed property tax collection rate of 97.5% despite a long track record of nearly 100%. Harrisonburg monitors budget-to-actual financial performance, as well as investments, on a monthly basis, with formal reports provided to the board. Harrisonburg also maintains a formal reserve policy, last amended in 2013, to increase the minimum targeted level by 4% of budget. The reserve policy requires a year-end unassigned general fund balance of a minimum 14% of the budget, up from 10%; it also targets an additional 4% for liquidity, for a total of 18% of the general fund budget.

### Strong budgetary performance

Harrisonburg's budgetary performance is strong, in our opinion. The city had balanced operating results in the general fund of negative 0.3% of expenditures, and slight surplus results across all governmental funds of 0.9% in fiscal 2019.

Our analysis accounts for annual recurring transfers in and out of the general fund and governmental funds as well as capital projects funded with bond proceeds or one-time funds.

Harrisonburg closed fiscal 2020 with a $3.8 million surplus, despite a transfer of approximately $4.1 million into the capital projects fund, due in large part to conservative budgeting, including better-than-expected revenues as well as expenses coming in well under budget. Good revenue growth of 3.0% was due primarily to general property tax revenues, which came in $1.3 million above budget, as well as growth in intergovernmental revenues. The city's year-end result was supported by conservative assumptions and a strong local economy.

For fiscal 2021, the city rebalanced its budget in response to the pandemic. Specifically, management decreased general fund revenues by $4.5 million for the year. As a result, Harrisonburg made corresponding expenditure cuts totaling $4.5 million in order to maintain fiscal balance. These cuts included elimination of all planned capital outlay funding, reducing the city's allocation to the school board, and deferring a 1.5% cost-of-living adjustment for employees from July 1, 2020, to Jan. 1, 2021. In August 2020, the city received $4.2 million in CARES Act funding from the commonwealth, which was used to help stabilize financial results for the year and provide funding for business and community assistance. However, management indicates that unaudited revenue estimates for the year came in much better than budget, with total revenues increasing year over year by almost 1.0%, or much better than the reduced revenue projections for the year, while total general fund expenses decreased by 6.2% relative to the previous year. As a result, management anticipates Harrisonburg generating an operating surplus of $8.8 million, increasing available reserves to an estimated $55.0 million, or 46% of expenditures.

The fiscal 2022 budget remains very conservative, with general fund revenues and expenses decreasing by about 4% relative to the previous year's amended budget. We understand the city expects balanced financial operations for the year. Harrisonburg increased its property tax rate by 4 cents for the year to 90 cents per $100 of AV to help fund operating and capital expenses. In addition, we understand the city expects to receive $24 million from the federal government in the form of American Rescue Plan Act of 2021 funds, $11.9 million of which has already been received.

Harrisonburg has a history of transferring excess utility revenue into the general fund from its water and sewer funds. Over the past three fiscal years, transfers into the general fund from the city's utility funds have averaged about $2.5 million annually.

Local tax revenues are the city's primary revenue source, accounting for about 82% of general fund revenue, with property taxes accounting for 44% of revenue, followed by "other" local taxes, which account for 35% of revenue.

### Very strong budgetary flexibility

Harrisonburg's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2020 of 40% of operating expenditures, or $47.9 million. We expect the available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor. The available fund balance includes

$38.1 million (31.8% of expenditures) in the general fund and $9.8 million (8.2% of expenditures) that is outside the general fund but legally available for operations.

The city has a history of maintaining what we consider very strong available general fund balances. At fiscal year-end 2020, unassigned and assigned general fund reserves were $38.1 million, or about 30% of operating expenditures. In addition, Harrisonburg maintains committed reserves in its general capital projects fund equal to $9.8 million at the end of fiscal 2020. We understand that these reserves are unrestricted and have been accumulated over time through general fund transfers. Management indicates that, following board approval, it could use these funds for general expenses. Combined, available general fund reserves and unrestricted reserves held in the general capital projects fund equaled nearly $47.9 million.

Management indicates that it expects to end fiscal 2021 with an $8.8 million surplus, thereby maintaining its very strong reserves at close to 46% of expenditures. In addition, we understand management anticipates balanced operations for fiscal 2022 with the use of very conservative revenue estimates.

We note that, although the city's property tax rate has increased to 90 cents from 59 cents over the past decade, 90 cents still remains about average relative compared with other municipalities in the commonwealth.

### Very strong liquidity

In our opinion, Harrisonburg's liquidity is very strong, with total government available cash at 78.1% of total governmental fund expenditures and 6.1x governmental debt service in 2020. In our view, the city has strong access to external liquidity if necessary.

The city maintains most of its investments in the local government investment pool, which we do not view as aggressive.

Following this issuance, we understand the city will have one outstanding privately placed GO issuance with ZB Bank Ltd., which has a remaining principal balance of $490,000 due Aug. 1, 2022. We understand this issuance is backed by Harrisonburg's full faith and credit GO pledge and there are no unusual provisions. As a result, we do not view this as a contingent liquidity risk that could affect liquidity.

### Very weak debt and contingent liability profile

In our view, Harrisonburg's debt and contingent liability profile is very weak. Total governmental fund debt service is 12.8% of total governmental fund expenditures, and net direct debt is 187.1% of total governmental fund revenue.

The overall debt-to-market-value ratio is, in our view, a moderate 4.8% after accounting for self-supporting utility debt. We understand Harrisonburg does not have any overlapping debt as an independent city. We consider principal amortization of existing and proposed debt to be average, with officials planning to retire slightly more than 50% over existing principal over the next 10 years.

We view the fiscal years 2022-2026 CIP of approximately $156.3 million as manageable. We expect the city's debt profile to remain similar or improve as a result of Harrisonburg's debt management policies and average amortization of existing debt. Harrisonburg has differentiated between priority-one projects, which are defined as "absolutely required," and priority-two projects, which are defined as "highly desirable." We understand that just $1.6 million out of the total CIP is identified as priority-one, providing the city with flexibility in its capital plan.

Pension and OPEB liabilities:

We do not view pension and OPEB liabilities as an immediate credit pressure, because required contributions currently make up a small portion of total governmental expenditures. If required contributions were to materially increase during the next few fiscal years, which we do not expect, we believe the city's fiscal stability would not be greatly affected because of Harrisonburg's sizable reserves.

Harrisonburg and its schools contribute to the Virginia Retirement System Plan (VRS). According to the city's fiscal 2020 financial statement, which uses a measurement date of June 30, 2019, city employees participate in:

- The VRS: 82.9% funded, with a proportionate net pension liability of $23.3 million for city employees, with a current discount rate of 6.75%;
- A group life insurance (GLI) program, which is a multiple-employer, defined-benefit plan administered by VRS, with a net OPEB liability of $2.2 million; and
- A single-employer, defined-benefit OPEB plan that provides medical coverage for retired city employees, which is funded on a pay-as-you-go basis. The unfunded liability totals $11.3 million.

We note contributions exceeded our static funding metrics, indicating the city is making good progress meeting its current and future liabilities. As a result, we do not expect plan contributions to change materially over the next couple of years.

Harrisonburg also participates in a cost-sharing plan for school board employees and an agent multiple-employer plan for school board political subdivision employees. The school board pays all contributions as a discrete component unit of the city. Consistent with our analysis, which does not incorporate the school board's financial performance into Harrisonburg's general financial performance, we elected not to consider the school board's retirement liabilities or contributions as part of the city's liabilities. We note that the school board's two defined-benefit pension plans have a total net pension asset of approximately $631,286 and a net pension liability of $64.8 million, respectively. In addition, the school board has a net OPEB liability of $3.6 million associated with the GLI program, $6.5 million relating to health insurance, and $12.2 million relating to OPEB.

Harrisonburg's combined required pension and actual OPEB contributions totaled 2.8% of total governmental fund expenditures in 2020. The city made its full required pension contribution in 2020.

### Very strong institutional framework

We consider the institutional framework scorefor Virginia cities with populations of more than 3,500 to be very strong.

## Related Research

- Credit Conditions: U.S. Regions' Economies Perk Up As The Pandemic's Impact Ebbs, April 16, 2021
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013

- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- 2020 Update Of Institutional Framework For U.S. Local Governments