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MEMORANDUM

To: Loudoun County Board of Supervisors

From: David P. Rose
Courtney E. Rogers
Davenport & Company LLC

RE: Recent Meetings with the National Bond Rating Agencies

Date: January 31, 2005

cc: Kirby Bowers, County Administrator

Overview

On January 19th, Davenport & Company LLC ("Davenport") in our capacity as Financial Advisor to Loudoun County visited with all three of the national credit rating agencies: Moody's Investors Service; Standard & Poor's Corporation; and Fitch Ratings, at their respective headquarters in New York with two Board Members, Vice-Chairman Tulloch and Supervisor Staton and several key County Staff representatives. The primary purpose of these meetings was to discuss the rating agencies' perspective on the County's use of a bond-financing tool known as Community Development Authorities ("CDAs") for primarily residentially based projects. CDAs are a form of a broad category of debt financing referred to as Special Assessment Bonds. Our party hoped to gauge any impact on the County's recently achieved **Aaa** rating from Moody's and positive, near term AAA rating designations from the remaining two credit agencies.

Information Provided in Advance of Our Meeting

Prior to our visit, in order to better facilitate an exchange of dialogue at the meeting, Davenport distributed a booklet dated November 29, 2004. (The County Administrator will see to it that all Board members receive a copy of this information.) The booklet included a cover memorandum from Davenport, under Tab 1 consisting of our request to discuss the current County Policy; possible modifications to the Policy; a sampling of the proposed CDA(s) being introduced to the County from the private sector and the relative magnitude of those proposals; samples of other recent CDA policies of several surrounding jurisdictions; and a draft of more comprehensive special assessment CDA policy for Loudoun recently developed by Davenport.

Background

Nearly a decade ago, Loudoun County was the location for the first CDA financing to be successfully completed in the Commonwealth of Virginia. Namely, the Dulles Town Center Project: an entirely commercial development that was in part funded using approximately $30 million of such CDA bonds. The proceeds of that deal went toward infrastructure improvements including the building of an interchange off of Routes 7 and 28. Prior to authorizing the issuance of CDA bonds, members of our current Firm who were formerly with Wheat First Butcher Singer, serving as Financial Advisor to Loudoun, led a similar delegation of two Board Members and County Staff to New York to obtain assurances regarding the issuance of the Dulles Town Center CDA Bonds on the County's strong credit standing (i.e. rating). All parties considered the Dulles Town Center Development as a major potential economic development and revenue opportunity for the County.

What are CDA's and Special Assessment Financings?

Special assessment financings such as CDAs are limited obligations issued to fund improvement in a defined district of a municipality and are secured only by assessments on the properties in that district. Credit quality is constrained by the limited nature of the security, as well as by the fact that most special assessment bonds when originally issued are secured by assessments on largely undeveloped property.

CDAs have been and continue to be a practical tool for financing the development of limited areas, generally referred to as "districts", within a municipality by charging, or "assessing", only those properties which derive benefit from the projects financed, and not burdening the larger community or tax base. In Virginia, this funding mechanism has been primarily used for major commercial development. CDA assessment financing in Virginia has basically been used for infrastructure needs such as roads, utilities, or landscaping, but can also be used to fund municipal facilities such as schools and fire stations.

How do these CDA's Work?

Bonds are issued to fund capital projects and a reserve fund. Annual assessments are levied on district properties in an amount which, added together, equal the debt service due on the bonds in that year. In most states there are no or only limited provisions for providing coverage by levying assessments in excess of annual debt service; that is, annual assessments are almost always sum-sufficient. Typically, assessments are levied and collected along with general property taxes, but other collection procedures are used in some localities. The special assessment bonds such as CDAs are secured solely by the assessments paid by the properties in the assessment district; bondholders have no access to the General Fund or general property taxes of the municipality.

What Loudoun County and Davenport Learned in New York

First and foremost all three national rating agencies view Loudoun County as one of the nation's premier "credits". This is underscored by Moody's designation of **Aaa**, the highest rating attainable and Standard & Poor's and Fitch's ratings of **AA+** and **AA+** respectively, both a single notch below their own agencies highest credit ranking.

To that end, all three agencies expect that whatever policy(s) the County decides to either update or implement in anticipation of further CDA financing, it is expected to be consistent with the County's plan for growth management and debt policies. As such, several key questions were asked by the collective agencies that will require policy responses from the Board of Supervisors via Staff. These include:

1. How does a specific CDA(s) impact the County's current multi-year Capital Improvement Program? Does it allow for a minimization of planned General Obligation debt over this period by virtue of a particular CDA?

2. What public purpose does the particular CDA(s) bonding provide for the County?

A ***second*** major watershed observation of all these rating agencies was their view that any CDA debt, however issued, would be counted against the County as a form of "overlapping debt" for purposes of determining the overall debt burden and implications on the overall debt capacity of the County. At this point all three were vague in their method of how they would assign a level of burden to the County's existing debt profile but several further comments in this area were expressed. They included:

1. The nature of a particular CDA project would be important --- generally the more diverse the potential of debt repayment providers and less reliance on a single taxpayer, the more comfort to their credit review.

2. The magnitude of the CDA issuance of bonds relative to the County's overall debt profile will also be of importance. For example, the Dulles Town Center Project financing represented a relatively minor percentage of debt vs. the overall County's debt (at the time under 10%). Collectively, to the extent that CDA or other special assessment financing is in excess of these levels, their particular scrutiny of the County's overall direct, and now, in-direct debt burden becomes a variable weighed by all three during the County's rating review.

3. Questions such as what is the exact structure of the particular CDA and has, for example, an independent feasibility study been prepared on a given project financing are important. Moreover, what are the practical implications to the taxpayers of said district should the build-out proceed slower than planned?

The ***third*** main point we believe the rating agencies expressed to all in attendance is their caution that given Loudoun County's unique position as arguably the nation's fastest growing municipality, the need to plan carefully and deliberately so as to make certain that growth does not overwhelm County resources cannot be underscored. Specifically, all three were concerned that the potential usage of CDA style financing could accelerate the residential growth of the County and must serve, instead, as a part of the growth and facility management tools contained within the policies of the Board of Supervisors and Comprehensive Plan. To the extent that each CDA approved could demonstrate that it is consistent with the County's multi-year Plan of Finance, then the usage of a CDA(s) could be favorably received.

Finally, a ***fourth*** comment by the rating agencies was directed at Loudoun specifically being cognizant of your exemplary credit ratings. That is this; while the repayment of bonds from CDA(s)/special assessment financings are not technically a direct or indirect obligation of the County, practically speaking however, the rating agencies have an expectation that should one or more of these bond issues run into repayment trouble (i.e. flirt with default), it is not "unreasonable" to expect that the County would step into the void. This is, of course, no small expectation but is a vestige of the credit market's expectation of Loudoun County in maintaining its lofty credit standing. In essence, a highly rated jurisdiction like the County would be expected to step in and remedy the problem. This expectation will have an impact on the County's debt capacity.

The Importance of a Coherent and Fundamentally Sound Fiscal Policy

The County has had in place a fiscal policy addressing CDAs that is nearly 15 years old. The policy never contemplated the potential magnitude of the CDA/special assessment financing requests now on the horizon in Loudoun or other growth communities in the Greater Washington region. As a result, the County Board of Supervisors should consider expanding/updating the policy along the lines of a more comprehensive set of conditions. These should include a set of standards that any proposed CDA must meet, that ties directly to overall growth management policies and practices in addition to a purely financial assessment of the particular CDA financing; its likelihood for successful repayment and its impact on County debt levels.

Conclusion

Davenport understands this issue requires further discussion with the Finance/Government Services Committee in the near future. We look forward to assisting you and your staff as you further explore this issue.