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Ratings

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## Summary:

# Washoe County, Nevada; General Obligation

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|---|---|---|
| US$9.185 mil GO bnds (ltd tax) (Nevada Shared Radio Sys Bnds) ser 2020 due 08/01/2035 | | |
| *Long Term Rating* | AA/Stable | New |
| Washoe Cnty GO Ltd Tax | | |
| *Long Term Rating* | AA/Stable | Affirmed |

## Rating Action

S&P Global Ratings assigned its 'AA' long-term rating to Washoe County, Nev.'s series 2020 limited-tax general obligation (GO) bonds (Nevada Shared Radio System bonds), additionally secured by pledged revenues. At the same time, S&P Global Ratings affirmed its 'AA' long-term rating and underlying rating (SPUR) on the county's existing GO bonds. The outlook is stable.

The county's full faith and credit secures the GO bonds, payable from all legally available funds, subject to statutory limitations on ad valorem taxation that limit the overlapping tax to no more than $3.64 per $100 of assessed value (AV). Currently, the total overlapping tax rate is $3.66 and includes two cents of the state rate exempt from the statutory limitation. The bonds are additionally secured by 15% of all income and revenue derived by the county's consolidated tax (C-Tax) revenue, consisting of certain sales taxes, excise taxes on cigarettes and liquor, a tax on the licensing of motor vehicles, and real property transfer taxes. Based on fiscal 2019 actuals and the preliminary debt service schedule, the additional pledged revenue alone provides 2.6x maximum annual debt service (MADS) coverage, although the current pledged revenue estimates for fiscal 2020 reflect a decline in coverage to about 2.3x and fiscal 2021 projections reflect a decline to 2.0x. Proceeds from the series 2020 bonds will be used to finance the acquisition and installation of the Nevada Public Radio System (NSRS) equipment, a shared statewide public safety radio communications system.

The NSRS infrastructure will be owned by three agencies: the Nevada Dept. of Transportation, NV Energy, and the county. Pursuant to the interlocal agreement, debt service on the series 2020 bonds issued by the county will be largely reimbursed by the 17 partner and sponsored agencies, five of which will prepay their share. The county's remaining share of the debt service will be 35.2%. The interlocal agreement additionally requires the partner and sponsored agencies to make an additional annual payment of 10% of their proportionate share of the debt service to fund an internal debt service reserve to the reserve requirement, equal to 100% of MADS. The agreement term is 16 years, with two additional automatic extensions of 10 years. Our analysis is based on the county alone, as issuer and obligor, but note that a large share of the debt service will be paid from other local agencies.

In our opinion, any limitation imposed on Nevada county's ability to raise revenue is embedded in the financial and economic conditions, and in the factors that we assess in the general creditworthiness of the county. The county will have approximately $130 million in net direct debt outstanding at fiscal year-end 2020.

## Credit overview

Washoe County's tax and employment bases are anchored in tourism given the region's concentration in hospitality and gaming, which we believe may pose budgetary pressure in the near term as a result of the significant reduction in economic activity in response to the COVID-19 pandemic. However, the county has made efforts to diversify its local tax base in recent years, which provides some stability in our opinion, further bolstered by the strong growth trends over the last five years. Although C-Tax revenues represent nearly one-third of the county's operating budget, the largest revenue stream is property taxes, which is projected to remain steady in the near-term. The county has worked to adjust its operating budget to account for anticipated revenue declines, but is projected to utilize a portion of its stabilization fund and unassigned reserves in fiscal 2021. Despite the expected drawdown, we believe that the county's strong reserve and liquidity positions provide a sufficient cushion to offset near-term budgetary pressure without deteriorating credit quality. Generally, our rating outlook period is up to two years; however, given the current uncertainty around the pandemic, our view of the credit risks to the county are centered on the more immediate budget effects in fiscals 2020 and 2021.

S&P Global Economics believes that the U.S. economy has fallen into a recession due to an abrupt shutdown of economic activity to contain the spread of COVID-19, which we forecast will result in a real GDP decline of 5.2% in 2020. Although we believe COVID-19's shocks are temporary, the recovery period is dependent upon the duration of social distancing requirements and consumer demand. For more information on the coronavirus' effect in U.S. Public Finance, please see our reports titled "The COVID-19 Outbreak Weakens U.S. State And Local Government Credit Conditions" (April 2, 2020) and "The U.S. Faces A Longer And Slower Climb From The Bottom" (June 25, 2020).

The ratings further reflect our view of the county's:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Weak budgetary performance, with operating results that we expect could deteriorate in the near term relative to fiscal 2019, which closed with operating surpluses in the general fund and at the total governmental fund level;
- Strong budgetary flexibility, with an available fund balance that we expect will decrease in the near term from its fiscal 2019 level of 21% of operating expenditures;
- Very strong liquidity, with total government available cash at 66.8% of total governmental fund expenditures and 15.9x governmental debt service, and access to external liquidity we consider exceptional;
- Very strong debt and contingent liability profile, with debt service carrying charges at 4.2% of expenditures and net direct debt that is 28.2% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 74.4% of debt scheduled to be retired in 10 years, but a large pension and other postemployment benefit (OPEB) obligation and the lack of a plan to sufficiently address the obligation; and
- Strong institutional framework score.

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

We analyzed the county's ESG risks relative to its economy, management, financial measures, and debt-and-liability profile. Our rating incorporates our view regarding the health and safety risks posed by the COVID-19 pandemic.

Absent the implications of COVID-19, we consider the county's ESG risk to be in line with our view of the sector standard.

## Stable Outlook

### Downside scenario

Should the recession significantly depress the county's economic activity and ongoing revenues and the county be unable to adjust its budget accordingly, causing it to materially reduce its available reserves to levels we no longer consider strong, we could lower the ratings.

### Upside scenario

While unlikely given the current economic environment, we could raise the ratings if the county's tax base continues to diversify away from the volatile hospitality and gaming industries, resulting in what we consider a sustainably strong economic base.

## Credit Opinion

### Strong economy

We consider the county's economy strong. Washoe County, with an estimated population of 469,800, is located in the Reno, Nev., MSA, which we consider broad and diverse. The area's leading employers are concentrated in the downtown core of Reno, the county seat. Due to the county's proximity to Lake Tahoe and Northern California, tourism anchors the economy, including hotel casinos, special events, and outdoor recreation. The county is home to several casinos, which account for six of the 15 largest employers. Leading the list are the Washoe County School District, Renown Regional Medical Center, and the county itself. The county has a projected per capita effective buying income of 109.3% of the national level and per capita market value of $113,421. The county unemployment rate was 3.2% in 2019, below the national average; however, as a result of the spike in unemployment filings spurred by the recession and social distancing efforts related to COVID-19, we expect this figure to rise in 2020. In April 2020, the county's monthly unemployment rate was 19%. Depending on the unemployment trend through the remainder of the calendar year, the annual average rate for 2020 could exceed 10% as it did in the Great Recession, which we consider high.

We note that in recent years, the state and county have made efforts to diversify the taxing bases beyond the volatile gaming and hospitality industries, and the county has experienced significant investment in the manufacturing and high-tech sectors. Recent and planned developments within the county include Deantronics' medical device technology campus, Apple Inc.'s new cloud computing data center, Google's Northern Nevada facility, and Tesla Motors' lithium-ion battery factory, amongst several others. In light of the economic downturn, the county reports that it has experienced a slight slowdown in development, which is expected to be temporary, but reports that it has not seen any material changes to development plans for the growing technology sector.

The county's market value grew by 9.0% over the past year to $52.6 billion in 2020. The fiscal 2021 estimates reflect a 5.2% increase in AV. While we believe there is some potential for commercial properties to appeal their AV based on an income approach, the current property values are set for fiscal 2021 and any such reductions are not expected to be reflected until the fiscal 2022 tax rolls. We consider the county's tax base very diverse, with the leading 10 taxpayers accounting for 4.4% of total AV. The largest taxpayer, NV Energy, represents 1.1% of AV in 2020, while no other taxpayer accounts for more than 0.7% on its own. Two of the top 10 taxpayers are hotel casinos, representing a modest combined 0.9% of AV. Although these facilities temporarily closed in response to the COVID-19 pandemic, casinos reopened in the state as of June 4, 2020.

### Very strong management

We view the county'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.

Highlights of key policies and practices include:

- The county's conservative revenue and expenditure assumptions based on multiple years of historical data, along with data from various external resources for economic data;
- Quarterly review of budget-to-actual reports with the governing board;
- The maintenance of a comprehensive five-year operating forecast and capital improvement plan with funding sources identified for capital projects;
- A formal investment management policy that goes beyond state guidelines, with reviews of investment holdings and earnings with the investment committee quarterly;
- The adoption of a formal debt management policy to help guide large financing decisions, which is silent on variable-rate issuances; and
- The adherence to its formalized reserve policy of maintaining a 10%-17% fund balance, including a $3 million stabilization reserve.

### Weak budgetary performance

Washoe County's budgetary performance is weak, in our opinion. The county had operating surpluses of 4.7% of expenditures in the general fund and of 4.5% across all governmental funds in fiscal 2019. Our assessment accounts for our expectation that budgetary results could deteriorate from 2019 results in the near term. We note that our calculations include an adjustment to increase ongoing expenditures for recurring transfers out of the general fund to its non-major governmental funds for capital projects and its indigent care fund.

Due to the ongoing recession and the expected impact on revenue, the county is currently budgeting for deficit results in fiscals 2020 and 2021. For fiscal 2020, the county anticipates a general fund deficit of approximately 2.5% of estimated expenditures, reflecting a 1.8% decline in operating revenues. In light of the anticipated revenue declines, the county eliminated its transfer to the capital projects fund and implemented various cost containment measures, including a hiring freeze and personnel cost reductions without layoffs. The fiscal 2021 budget forecasts an additional deficit of approximately 4.4% of budgeted expenditures; however, the budget excludes $20.3 million in CARES Act funding that the county was awarded for COVID-19-related expenses incurred from March through December 2020. County officials also indicated that they are continuing to identify other possible expenditure reductions to close the budget gap in fiscal 2021. Given the county's historically conservative projections, we expect the county to outperform its budget at year-end, although this is dependent on the depth and duration of the economic downturn.

Washoe County's general fund revenue is composed largely of property taxes, representing roughly 48% of total revenue in 2019, followed by C-Tax revenue at 33%, which we consider relatively volatile and dependent on consumer spending. C-Tax revenue had been increasing by an average annual rate of 7% over the last four years, supporting the county's previously positive operating performance. However, due to the slowdown in consumer spending spurred by social distancing and the recession, the county is now forecasting 8.5% and 15.8% reductions in C-Tax revenues in fiscals 2020 and 2021, respectively. Conversely, property taxes, which we view as typically more stable, are projected to increase by 5.7% and 7.1% in fiscals 2020 and 2021, respectively, due to ongoing development within the county. We note that the county's overlapping property tax rate is currently at the statutory maximum of $3.64 per $100 of AV, excluding its two cents of the state rate exempt from the statutory limitation, leaving the county with little revenue-raising flexibility. However, the county reports that it could apply $1.0188 of its operating rate toward debt service if needed and debt service has statutory priority on property tax revenues.

### Strong budgetary flexibility

Washoe County's budgetary flexibility is strong, in our view, with an available fund balance that we expect could decrease in the near term from its fiscal 2019 level of 21% of operating expenditures, or $72.3 million.

While we note that the county has a track record of outperforming its budgets at year-end, we calculate that, should the county fully realize the budgeted deficits in fiscals 2020 and 2021, the county's available fund balance could fall below 15% of expenditures, the threshold for what we consider very strong. The county has utilized its $3 million stabilization fund in prior years to offset one-time emergency expenses, including two flooding incidents in 2017. However, the stabilization reserve policy includes a replenishment provision, which the county followed accordingly to replenish the $3 million reserve in fiscal 2019, and management indicated it would continue this practice in coming years should it deplete the stabilization reserve again. Although we note that the county's fund balances could fall to strong levels in the near term, we expect the available reserve to remain above 10%, in line with the county's formal policy.

### Very strong liquidity

In our opinion, Washoe County's liquidity is very strong, with total government available cash at 66.8% of total governmental fund expenditures and 15.9x governmental debt service in 2019. In our view, the county has exceptional access to external liquidity if necessary.

We believe the county has exceptional access to external liquidity, with its practice of issuing limited-tax GO bonds, gas tax bonds, and sales tax bonds frequently over the last 15 years. We do not consider the county's investments aggressive, as the majority of the county's investments are investment-grade U.S. government securities.

Included in the county's outstanding debt burden are several privately placed agreements, including the series 2019A limited-tax GO refunding bonds and the 2019B limited-tax GO refunding bonds. The series 2019A bonds were issued in the par amount of $8.4 million with Zions Bancorporation and the series 2019B bonds were issued in the par amount of $10.7 million with Key Government Finance. We have reviewed the documents associated with both issuances and believe the events of default to be standard, and while acceleration of principal is not expressly prohibited, it is not a remedy of default and we do not believe the agreements to pose a significant liquidity risk to the county. Additionally, the county has about $28 million of governmental activities variable-rate debt outstanding (as of June 30, 2019), representing about 11% of total direct debt.

### Very strong debt and contingent liability profile

In our view, Washoe County's debt and contingent liability profile is very strong. Total governmental fund debt service is 4.2% of total governmental fund expenditures, and net direct debt is 28.2% of total governmental fund revenue. Overall net debt is low at 1.5% of market value, and approximately 74.4% of the direct debt is scheduled to be repaid within 10 years, which are in our view positive credit factors. The county reports that it has no additional debt plans at this time, but it may continue to draw upon its state revolving fund loan as needed. The county is authorized up to $50 million and could issue an additional $23 million under its enterprise fund.

Finally, the county is contingently liable for $87.7 million of the Reno-Sparks Convention and Visitors Authority (RSCVA) general obligation bonds, or 40% of the county's total debt burden. While the RSCVA has historically generated sufficient revenues to cover its annual debt service by more than 1.49x in the last three years. As such, we have considered this debt as self-supporting. However, given the current economic environment, we believe that the self-supporting status could be pressured should RSCVA revenues materially decline due to a reduction in convention center activity. We understand that it is anticipated that, in an event of default, the RSCVA resources would be reallocated to retire the bonds with limited impact on the county's operations. We will continue to monitor the impact on the RSCVA debt and the county.

Pension and OPEB highlights:

- In our opinion, a credit weakness is Washoe County's large pension and OPEB obligation, without a plan in place that we believe will sufficiently address the obligation.
- The pension plan that the county participates in is relatively underfunded, and we believe this could lead to potentially significant cost increases in the future.
- The county makes payments toward the OPEB trust for its OPEB liabilities and has historically paid its actuarially determined contribution, although we understand that the county intends to reduce its trust contributions in fiscal 2021 to alleviate budgetary pressure. Additionally, the legal flexibility to alter OPEB benefits limits adverse credit impacts from its OPEB liability.

Washoe County contributes to the Public Employees Retirement System of the State of Nevada (PERS), a cost-sharing, multiple-employer, noncontributory, defined benefit public employee retirement plan administered by PERS to provide retirement benefits, death benefits, and disability benefits to their beneficiaries. As of June 30, 2019, the PERS plan was 76.5% funded and the county's proportionate share of the net pension liability was $414.6 million. The county made its full annual required pension contribution in 2019 totaling 5.9% of total governmental expenditure. The county's 2019 actuarially determined contributions for the PERS fell short of static funding and minimum funding progress, indicating that the liability is increasing annually. Additionally, the county participates in three OPEB plans and the funded ratio of the largest plan was 48%. The county's OPEB contributions represented 5.0% of total governmental expenditures, bringing the combined pension and OPEB carrying charges to 10.9%, which we consider relatively elevated.

### Strong institutional framework

The institutional framework score for Nevada counties is strong.

## Related Research

- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- 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
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 2019 Update Of Institutional Framework For U.S. Local Governments

| Ratings Detail (As Of July 2, 2020) | | |
|---|---|---|
| Washoe Cnty ltd tax GO bldg bnds ser 2015 due 03/01/2035 | | |
| *Long Term Rating* | AA/Stable | Affirmed |
| Washoe Cnty GO ltd tax rfdg bnds (additionally secured by pledged rev) ser 2012B dtd 08/28/2012 due 03/01/2013 2016-2027 | | |
| *Long Term Rating* | AA/Stable | Affirmed |
| Washoe Cnty GO Ltd Tax | | |
| *Unenhanced Rating* | AA(SPUR)/Stable | Affirmed |
| Washoe Cnty GO Ltd Tax (MBIA) (MBIA of Illinois) | | |
| *Unenhanced Rating* | AA(SPUR)/Stable | Affirmed |
| Washoe Cnty GO (ltd tax) pub safety rfdg bnds ser 2016B due 03/01/2036 | | |
| *Long Term Rating* | AA/Stable | Affirmed |

Many issues are enhanced by bond insurance.