FITCH AFFIRMS ISLE OF WIGHT COUNTY (VA)'S IDR AT 'AA'; OUTLOOK STABLE

Fitch Ratings-New York-01 December 2016: Fitch Ratings has affirmed the following Isle of Wight County, VA ratings:

--Issuer Default Rating (IDR) at 'AA';
--$138.2 million general obligation (GO) bonds at 'AA'.

The Rating Outlook is Stable.

SECURITY
The bonds are general obligations of the county, payable by its full faith and credit and unlimited taxing power.

KEY RATING DRIVERS

The 'AA' IDR reflects an unlimited legal ability to raise revenues, solid expenditure flexibility and low debt levels, somewhat tempered by a concentrated tax base. Management's willingness to raise tax rates has enabled the county to return to positive operations after deficits in the past few years. Healthy reserves, even after recent use of fund balance, position the county to exhibit financial resilience throughout the economic cycle.

Economic Resource Base
Isle of Wight County is located in the Hampton Roads region of southeastern Virginia; consequently the local employment base, with its concentration in manufacturing, benefits from the broad regional economy. The population, estimated at 36,314 in 2015, will likely show continued modest growth in the intermediate term. The tax base has nearly recovered to its high in the late 2000s.

Revenue Framework: 'aa' factor assessment
Fitch expects revenue growth will hover around national economic performance and exceed inflation. The county has unlimited legal property taxing authority. A concentrated tax base heightens potential volatility, somewhat weakening the assessment of this key rating factor.

Expenditure Framework: 'aa' factor assessment
The natural pace of spending growth is likely to equal or slightly surpass revenue growth. Moderate carrying costs and ample control over labor wages and benefits underlie solid expenditure flexibility.

Long-Term Liability Burden: 'aa' factor assessment
Modest intermediate-term bonding requirements and participation in a well-funded multiple-employer pension system underscore the county's moderate long-term liability burden. The inclusion of debt issued by an enterprise system reliant upon general fund support slows the county's overall amortization rate.

Operating Performance: 'aaa' factor assessment
Fitch expects that management's demonstrated willingness to raise revenues coupled with solid expenditure flexibility would enable the county to maintain adequate financial flexibility

throughout an economic cycle. During a recent period of structural imbalance, which the county has now addressed, reserves remained healthy.

RATING SENSITIVITIES

FUNDAMENTAL ECONOMIC AND FINANCIAL PROFILES: The IDR is sensitive to shifts in the county's strong operating performance as well as potential volatility within the somewhat concentrated economic base.

CREDIT PROFILE

The county's tax base reflects its manufacturing roots. Fitch anticipates that the growth of the nearby Port of Virginia, with its commercial and military activities, will contribute to increased economic breadth, most notably by encouraging the warehouse and distribution sector. Both labor and wealth indices are generally favorable to those of the nation and hover around state averages.

Revenue Framework

Property taxes are the dominant revenue stream, equal to nearly three-quarters of general fund revenues. Intergovernmental revenues comprise slightly over one-tenth of the revenue base, followed by sales taxes at around 5%. Manufacturing concerns are prevalent among the 10 largest taxpayers, which in total comprise approximately one-fifth of the tax base. International Paper Company, the largest taxpayer, represents about 10% of the tax base, largely due to high personal property valuations.

Tax base performance that has been somewhat sluggish over most of the past decade suggests that future revenue growth will likely fall below national economic performance.

There is no legal limitation on the county's ability to increase its millage or tax levy.

Expenditure Framework

Education is the county's primary expenditure, representing nearly one-half of general fund spending, followed by public safely, which is just shy of one-fifth on spending. Virginia public schools are largely funded by a mix of state and local contributions. The county board determines the amount of the local contributions, based on the state-determined performance standards for the school system.

As is common with many local governments, the natural pace of spending growth should align with or modestly exceed expected revenue growth as a result of moderate increases in the costs of services and a growing population.

Moderate carrying costs and notable maneuverability in addressing workforce compensation and headcount underlies the county's solid expenditure flexibility. Fixed carrying costs associated with debt service, actuarially determined pension payments and other post-employment benefits (OPEB) account for a moderate 12% of government payments and should remain stable.

The general fund provides a necessary subsidy to the public utilities fund, in varying amounts from almost $6 million in fiscal 2015, equivalent to more than half of the fund's expenditures, to less than $1.6 million in fiscal 2016, when higher connection fees and reduced purchases mitigated the need for general fund support. Fitch will continue to monitor for any related pressures on the general fund.

The county has considerable control over workforce spending, due to the absence of collective bargaining and the prohibition against strikes. A state mandate for a minimum funding level for education in theory limits the county's ability to reduce expenditures; however, the county currently funds education above the state's required local expenditure.

The county has proposed a five-year ramp up to allocating 3% of the general fund budget to pay-as-you-go capital funding, which eventually could serve as an additional source of expenditure relief, if required.

Long-Term Liability Burden

Long-term liabilities, inclusive of the school board's proportionate share of its multiple employer pension plan, place a moderate burden on the county, representing about 11.5% of 2015 personal income. Direct debt, including issuance on behalf of the public utilities funds, which require general fund support, accounts for the majority of the burden. The amortization rate of the enterprise system issuances, which has a slower pay-out than that of tax-supported debt, contributes to the county's below-average amortization rate of slightly over 40% of principal retirement within 10 years. The $51.5 million fiscal 2017 - fiscal 2021 capital improvement plan includes limited debt issuance.

County employees and non-professional employees of the school board participate in the statewide Virginia Retirement System (VRS), an agent-multiple employer defined benefit pension plan. These portions of the plan have a joint asset to liability ratio of over 92%, assuming a 7% return on investment assumption. The joint net pension liability is minimal. The school board is a component unit of the county and participates in the VRS Teacher Retirement Plan, which is a cost-sharing multiple-employer plan. It reports a net pension liability for teachers at approximately $48 million, or nearly 3% of personal income. For all pension plan components, the contractually required payments, which equal an actuarially determined contribution, are paid in full.

A limited OPEB program results in a negligible liability as a percentage of personal income.

Operating Performance

A demonstrated willingness to raise revenues, a solid degree of expenditure flexibility, and the commitment to restore structural balance provide the county with the means to address a hypothetical revenue decline while maintaining solid reserves. Fitch anticipates that county reserves will continue to exceed its reserve policy, which equals an unassigned general fund balance at 10% of budgeted governmental funds, excluding certain adjustments.

The county returned to surplus operations in fiscal 2016 after three consecutive years of negative performance, although reserve levels remained solid throughout the period. A combination of revenue raising measures (both one-time and recurring) and spending reductions had been insufficient to stem the operating deficits of fiscal years 2013 and 2014. A three-year plan that the county developed in fiscal 2015 to regain balanced operations combined a property tax hike, the utilization of one-time revenues, and expenditure reductions.

Fiscal 2016 concluded with a $3.8 million surplus, equal to 5.8% of spending, comparing favorably to an adopted budget that appropriated nearly $2.2 million of fund balance. The unrestricted fund balance equaled a healthy 26.7% of spending. The $71 million fiscal 2017 budget represented less than a 1% increase from the prior year and was balanced without the use of reserves.

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In addition to the sources of information identified in the applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

Applicable Criteria
U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016)
https://www.fitchratings.com/site/re/879478