

CREDIT OPINION

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 Rate this Research

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Virginia Beach (City of) Storm Water Utility

Update to credit analysis

Summary

Virginia Beach, VA's stormwater utility (Aa1 stable) benefits from a large service area with a diverse customer base, healthy debt service coverage, strong liquidity levels, and a manageable debt burden. The rating also incorporates management's frequent rate increases, conservative budgeting practices, and strong capital planning. Although the service area faces significant risks associated with coastal flooding, management continues to take a proactive approach to resiliency, integrating storm water projects into capital plans and economic development. Management's willingness to increase revenues as evidenced by multi-year approved rate increases will help offset increasing operating expenses and system leverage.

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. The City of Virginia Beach, VA's Storm Water Utility is not susceptible to immediate material credit risks related to coronavirus. The longer-term impact will depend on both the severity and duration of the crisis. The situation surrounding coronavirus is rapidly evolving. If our view of the credit quality of the city's storm water utility changes, we will update the rating and/or outlook at that time.

On September 15th, we assigned a Aa1 rating to the city's \$75.2 million Storm Water Utility Revenue Bonds, Series 2020A and \$13.6 million Storm Water Utility Revenue Refunding Bonds, Series 2020B.

Credit strengths

- » Proactive rate management evidenced by multi-year approved increases
- » Strong liquidity and ample financial flexibility
- » Dynamic service area

Credit challenges

- » Service area exposure to cuts in federal defense spending
- » Exposure to impacts of sea level rise and recurring flooding

Rating outlook

The stable outlook reflects the likelihood that the utility's financial position and debt service coverage will remain healthy due to the stability of the service area, management's conservative budgeting practices, and consistent annual rate increases.

Factors that could lead to an upgrade

- » Sustained reduction of the system's outstanding debt
- » Significant improvement of the system's debt service coverage and liquidity
- » Improvement in service area income levels

Factors that could lead to a downgrade

- » Increased debt profile
- » Inability or unwillingness to implement timely rate increases
- » Material reduction in debt service coverage or liquidity

Key indicators

Exhibit 1

Virginia Beach (City of) Storm Water Utility					
System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	63 years				
System Size - O&M (\$000)	\$30,145				
Service Area Wealth: MFI % of US median	115.40%				
Legal Provisions					
Rate Covenant (x)	1.15x				
Debt Service Reserve Requirement	DSRF funded at the lesser of the standard 3-prong test (Aa)				
Management					
Rate Management	Aaa				
Regulatory Compliance and Capital Planning	Aa				
Financial Strength					
	2015	2016	2017	2018	2019
Operating Revenue (\$000)	\$39,153	\$39,470	\$40,039	\$41,718	\$42,192
System Size - O&M (\$000)	\$17,490	\$18,951	\$27,167	\$27,515	\$30,145
Net Revenues (\$000)	\$21,805	\$20,761	\$13,698	\$14,681	\$13,325
Net Funded Debt (\$000)	\$46,880	\$45,220	\$43,520	\$38,392	\$66,116
Annual Debt Service (\$000)	\$2,258	\$3,394	\$3,392	\$3,388	\$3,540
Annual Debt Service Coverage (x)	9.7x	6.1x	4.0x	4.3x	3.8x
Cash on Hand	487 days	610 days	427 days	508 days	501 days
Debt to Operating Revenues (x)	1.2x	1.1x	1.1x	0.9x	1.6x

Source: City of Virginia Beach, VA Audited Financial Statements, U.S. Census American Community Survey, Moody's Investors Service

Profile

The Virginia Beach Storm Water Utility is an enterprise of the [City of Virginia Beach](#) (Aaa stable), the largest city in the [Commonwealth of Virginia](#) (Aaa stable), providing storm water collection and treatment services to a population of 450,135, according to the most recent U.S. Census American Community Survey.

Detailed credit considerations

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Service area and system characteristics: dynamic service area, recurring flooding and sea level rise are a challenge

The system's customer base and service area are expected to remain stable and management does not anticipate any material impact on enterprise performance due to the coronavirus pandemic. Virginia Beach's economy has demonstrated resilience and taxable values continue to grow due in part to the diversity of the local economy, stabilizing military presence and continued strength in tourism activity. Ongoing economic growth and diversification initiatives have attracted a broad range of manufacturing, industrial, retail and service establishments to the area historically anchored by military installations.

The local economy benefits from a large and stabilizing military presence, including four bases employing over 43,000 military personnel and civilians. As a result, the regional economy is susceptible to cuts in Department of Defense (DOD) spending as spending accounts for approximately 45% of the regional economy. The city continues to monitor DOD spending and has developed a plan for dealing with federal sequestration that includes a number of steps to control and reduce expenditures and monitor economic and revenue impacts.

Tourism also plays a vital role in the city's economy. Leading up to the coronavirus pandemic, Virginia Beach had a long history of stable tourism activity with 75% of visitors designated as repeat visitors. As the coronavirus caused the implementation of widespread travel restrictions and voluntary social distancing efforts, Virginia Beach experienced a significant reduction in tourism activity. Management continues to make strategic investments in tourism and recently rolled out a new advertising campaign to promote local tourism.

Management reports ongoing challenges and constraints to the system related to sea level rise and recurring flooding. City management continues to proactively assess its vulnerability to sea level rise including evaluating its policies and engineering to increase resiliency.

Debt service coverage and liquidity: sound system operations with healthy coverage and liquidity

Virginia Beach's storm water utility operations will remain strong due to management's long-range financial and capital planning, practice of reviewing and raising rates annually, and continued growth potential in the service area. City Council recently adopted five-year rate increases of 3.5-cents per day per ERU from fiscal 2020-2025. In light of the COVID-19 pandemic, however, management suspended the planned increase for fiscal 2021 to provide relief to ratepayers. The previously approved rate increases are expected to resume in fiscal 2022 and extend through fiscal 2026.

Net revenues provided 3.8 times coverage of debt service in fiscal 2019, which is healthy. Coverage is expected to remain adequate despite anticipated additional debt issuance to finance capital needs.

Storm water fees are levied on all owners of developed property and are billed monthly along with water and sewer bills. City code allows for a 10% per year interest charge on unpaid fees, although that charge has not generally been applied except for a small number of accounts with long-standing delinquencies that have been referred for collection. System collections have historically been very strong. Any unpaid fees and accrued interest constitute a lien against the property on parity with liens for unpaid taxes, including real estate taxes.

Liquidity

The utility's cash position is strong at 501 days, or \$41.4 million at fiscal year-end 2019. Unrestricted cash has historically been maintained at strong levels compared to the national median. Liquidity will remain healthy despite planned pay-go capital spending given management's conservative budgeting and regular rate increases.

Debt and legal covenants: manageable debt burden despite sizeable capital needs

The utility's debt to operating revenues ratio was 1.5 times at fiscal year-end 2019, but will increase post-issuance to approximately 3.0, which is still manageable. The utility's five-year (2021-2026) capital improvement plan (CIP) includes \$402.7 million in projects, approximately 72% of which are expected to be funded with future bond proceeds. The remainder of projects will be funded as pay-go basis. The CIP is reviewed formally on an annual basis, and quarterly on an informal basis and officials anticipate annual revenue bond issuances ranging between \$30-60 million. Despite the additional debt plans, the utility's overall leverage will remain manageable due in part to regular rate increases.

The storm water utility operates under a MS4 permit effective on July 1, 2016 (through 2021) mandated under the Clean Water Act and monitored by the EPA. [The Commonwealth of Virginia](#) (Aaa, stable) recently enacted new regulatory requirements under the Virginia Stormwater Management Program (VSMP). Officials report new requirements have driven the creation of new projects in the CIP for compliance. Management is not currently aware of any outstanding EPA orders, mandates or consent decrees. A second phase of the Chesapeake Bay TMDL action plan is required by December 2020. The total compliance costs to construct water quality improvements under the Chesapeake Bay TMDL is estimated at \$335 million by 2036, although a large portion of these costs are expected to be mitigated through a credit trading partnership with [Hampton Roads Sanitation District](#) (Aa1,stable).

Debt structure

All of the utility's debt is fixed rate and amortizes over the long-term.

Debt-related derivatives

The utility is not party to any derivative agreements

Pensions and OPEB

The city and city school board employees, including stormwater utility employees, participate in the Virginia Retirement System (VRS), a multi-employer defined benefit pension plan administered by the Commonwealth of Virginia. For fiscal 2019, Virginia Beach's total pension contribution was \$114 million, or 7.5% of city operating fund revenues. The city funds its pensions at the annually required contribution amount. 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 \$3.1 billion over the last three years, representing 2.0 times city operating fund revenues.

ESG considerations

Environmental

The local government sector overall has low exposure to environmental risks. Nevertheless, environmental considerations are material to the utility's credit profile which is notable given that the port and major transportation networks near the coast are economic engines for the city and region. 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 elevated compared to other cities nationwide. Of the physical climate risks Four Twenty Seven evaluates, Virginia Beach's highest exposure is to hurricanes and extreme rainfall. This exposure is partially mitigated by several factors, including management's maintenance of adequate reserves, proactive long-range capital planning, strong regionalized resiliency efforts, strong revenue-raising ability, and federal government support for disaster recovery costs via FEMA.

City management takes a proactive approach to managing environmental risks including undergoing a comprehensive sea level rise study evaluating four major watersheds. The city's CIP includes stormwater infrastructure projects to address flooding issues in areas of the city experiencing recurrent flooding. Additionally, new funding sources have been secured or identified to help combat recurring flooding including 2.5 cents on the Real Estate tax rate and a 54% increase in the stormwater fees through fiscal 2025.

Social

Social considerations are key influencers of all local economies, financial and leverage trends and governance stability. Social factors are incorporated into the system's rating by way of income (median family income) metrics.

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Governance

Governance is a material consideration for all local governments, including the utility. The utility is governed by the City Council, which has autonomous rate setting authority. Management targets to maintain coverage of 1.5 times and liquidity of 80% to 100%. Additionally, management budgets conservatively with regular monitoring of all revenues and expenditures including monthly budgetary tracking and reporting across all funds.

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