# Virginia Beach, Virginia

## New Issue Report

### Ratings

| | |
|---|---|
| Long Term Issuer Default Rating | AAA |

### New Issues

| | |
|---|---|
| $98,990,000 General Obligation Public Improvement Bonds, Series 2019A | AAA |
| $55,215,000 General Obligation Public Improvement Refunding Bonds, Series 2019B | AAA |

### Outstanding Debt

| | |
|---|---|
| General Obligation Bonds | AAA |
| Virginia Beach Development Authority Public Facilities Revenue Bonds | AA+ |

### Rating Outlook

Stable

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## New Issue Summary

**Sale Date:** July 10 competitively.

**Series:** $98,990,000 General Obligation (GO) Public Improvement Bonds, Series 2019A, and $55,215,000 GO Public Improvement Refunding Bonds, Series 2019B

**Purpose:** To reimburse the city for previous expenditures for various capital projects and future school-related expenditures. The refunding bonds will be used to refund a portion of the city's outstanding series 2009A, 2009B and 2010A2 GO bonds for savings.

**Security:** The bonds are backed by the city's full faith and credit and unlimited taxing power.

## Analytical Conclusion

The 'AAA' Issuer Default Rating (IDR) and GO bond rating reflects Fitch Ratings' view of the city's exceptional financial resilience to risks associated with periodic economic downturns, underpinned by an unlimited legal authority to adjust revenue, a high gap-closing ability, and broad legal control over employee-related expenses. The rating also reflects management's demonstrated ability to control expenditures and achieve balanced results from operations. The 'AA+' rating on Virginia Beach Development Authority obligations reflects the slightly higher degree of optionality associated with appropriation payments to be made by the city compared to the GO bonds.

**Economic Resource Base:** Virginia Beach is located in the Hampton Roads region of Virginia along the Atlantic Ocean and the Chesapeake Bay. It is the most populous city in the Commonwealth with a 2018 census estimated population of 450,189, up almost 3% since 2010. Economic activity is heavily influenced by the federal government owing to the presence of several U.S. naval installations, in addition to a strong tourism component, real estate, agriculture, and trade and retail industry.

## Key Rating Drivers

**Revenue Framework: 'aaa'**

The city has complete legal control over key revenue streams, and its revenue base comprises mostly property taxes, supplemented by consumption related sales, meals and hotel taxes. Revenue growth has accelerated over the past five fiscal years following a period of recessionary declines in the tax base. Fitch expects future growth to trend more in line with recent activity due to projects underway and planned supporting new population and tourism growth.

**Expenditure Framework: 'aa'**

The city has solid control over spending, including the power to set terms of labor given the absence of collective bargaining. Fitch expects growth in expenditures to be in line with to slightly above revenue growth. Fixed costs are a moderate proportion of overall spending, and additional flexibility exists due to a strong history of budgeted pay-go capital spending.

**Long-Term Liability Burden: 'aa'**

Virginia Beach's overall governmental debt position, coupled with its allocated portion of the net pension liabilities (NPLs) associated with state administered pension plans, is approximately 10% of residents' personal income. Fitch expects the city's liability burden will

## Rating History (IDR and GO Bonds)

| Rating | Action | Outlook/ Watch | Date |
|---|---|---|---|
| AAA | Affirmed | Stable | 6/25/19 |
| AAA | Revised | Stable | 4/30/10 |
| AA+ | Affirmed | Stable | 5/13/03 |
| AA+ | Assigned | — | 6/28/99 |

remain fairly stable based on its history of prudent debt management within established policies, continued growth in the economic resource base, and full actuarially determined contributions (ADC) being made to the state pension plans.

**Operating Performance: 'aaa'**
Fitch expects the city to manage through periods of economic decline while maintaining a substantial financial cushion based on its history of sound financial management throughout the economic cycle, high reserves, and a superior level of inherent budget flexibility.

## Rating Sensitivities

**Revenue Growth Outlook:** A weakening of Fitch's view of the city's revenue framework, most importantly the long-term prospects for revenue performance, would be viewed negatively.

## Credit Profile

The city is home to the Oceana Naval Air Station, the Navy's only East Coast master jet base, and the Joint Expeditionary Base Little Creek-Fort Story, the primary East Coast base supporting overseas contingency operations. According to the city and the Hampton Roads Planning District Commission, the Department of Defense supports between 35% and 40% of all regional employment. Department of Defense spending in the Hampton Roads region was up 7.5% in 2018 and slightly higher for 2019 after a period of stagnant levels and is projected to lead to higher defense-related spending in the city.

Tourism is also an economic mainstay of the region due to the city's beachfront location and year-round convention center events, and such activity translates into additional revenue for the city, primarily in the form of hotel room and meal tax receipts. Such taxes have experienced growth since fiscal 2010 as tourism spending and hotel occupancy rates have been strong.

The Port of Virginia, in nearby Portsmouth, supports a large trade component of the regional economy and has experienced increased volume following recent infrastructure investments and the widening of the Panama Canal. Significant infrastructure investments are planned for the region over the next several years, including the Hampton Roads Transportation Accountability Commission's over $3 billion I-64 Hampton Roads bridge and tunnel expansion project, and Fitch expects such activity to support potential economic growth.

The city's tax base continues a moderate rebound, registering its fifth consecutive year of growth in fiscal 2019, and is up 19% from fiscal years 2014–2019. The tax base had experienced a slightly protracted period of weakness triggered by the recession with consecutive declines from fiscal years 2010–2014 yielding a 12% aggregate valuation loss. Fiscal 2019 taxable assessed value of $64 billion is up 4.4%, compared to fiscal 2018, and exceeds pre-recession levels. Improvement in the city's tax base reflects a combination of price appreciation and new construction activity. Resident per capita and median household income levels are similar relative to the Commonwealth and exceed national levels.

### Revenue Framework

Virginia Beach's general fund budget is largely supported by real and personal property taxes, which collectively accounted for about 56% of total fiscal 2018 revenues. The bulk of remaining general fund revenue sources are derived from local taxes on various economic activities such as hotel accommodations, food and beverage sales, and general sales and use transactions. Aid from the Commonwealth represented 14% of fiscal 2018 general fund revenue.

**Related Research**
Fitch Rates Virginia Beach, VA's $154MM GO Bonds 'AAA'; Outlook Stable (June 2019)

**Related Criteria**
U.S. Public Finance Tax-Supported Rating Criteria (April 2018)

Fitch expects future general fund revenue growth to hover between the rate of inflation and GDP over time. In addition to a rebounding tax base, the long-term commitment of the federal government's naval operations in Virginia Beach and the recent increase in defense spending in the Hampton Roads region are expected to contribute to economic stability and solid revenue growth in the long term. Revenues are also expected to benefit from continued moderate growth in population and the popularity of Virginia Beach as a tourist attraction along with recently completed and in-progress upgrades and additions to hotel facilities and other associated tourist amenities. Additional commercial, retail and residential projects planned or underway support the expectation for continued tax base growth. A history of low joblessness, high per capita personal income, and high educational attainment further support Fitch's view of the city's long-term revenue outlook.

The 'aaa' key rating factor assessment for Virginia Beach's revenue framework is supported by the city's broad legal control, as it is not subject to any cap or limit on its property tax rate or levy, nor is it subject to any restriction on its various non-property tax streams. The city has exercised its flexibility to adjust tax rates in response to shifts in the value of its tax base and currently maintains an affordable and competitive tax rate compared to other local governments in the Hampton Roads region.

### Expenditure Framework

The city maintains solid expenditure flexibility supported by a moderate level of fixed spending associated with debt and retiree costs, a history of including capital pay-go in its budgets, and broad control over employee wages and other costs. Education is the largest single expenditure category in the general fund budget, accounting for roughly 39% of spending in fiscal 2018. State law establishes a required local effort (RLE) of funding for K-12 education for each municipality across the Commonwealth, and the city has typically exceeded this minimum required level by a substantial margin. The bulk of other general fund spending is driven by salaries and benefits for city employees.

Fitch expects expenditure growth to be moderate and generally in line with to slightly above revenues without policy action. The Virginia Beach Public Schools, a component unit of the city, is largely funded by a mix of state and city aid contributions.

Fixed costs associated with debt service, pensions and other post-employment benefits (OPEB) contributions were moderate at 13% of fiscal 2018 total governmental spending. Debt service, which approximated 9% of fiscal 2018 total governmental spending, could see moderate upward movement over time based on the city's six-year capital improvement plan (CIP), offset by the city's rapid pace of debt amortization.

The city makes the full ADC to the state administered pension plan, the Virginia Retirement System (VRS). Pension payments have consumed about 3%–4% of governmental spending in recent years. VRS had established employer contribution rates below the ADC for several years to help alleviate state budget pressures, but this practice was corrected as of fiscal 2018. The city funds above the full ADC for OPEB and these obligations are fairly modest.

### Long-Term Liability Burden

Long-term liabilities for debt and Fitch-adjusted NPLs are estimated by Fitch at 10% of personal income. Direct debt of the city accounts for roughly 40% of the metric. The remainder represents the proportionate share of the Fitch-adjusted NPL (excluding for enterprise funds) of the cost-sharing multiple-employer retirement plan for teachers and separate cost-sharing pools within VRS for city employees and non-professional school employees. Fitch's NPL estimates are based on a 6% investment rate of return compared to the 7% VRS rate.

Fitch expects the liability burden to remain around this level of personal income based on future borrowing plans and a rapid pace of principal amortization (79% over ten years). Additionally, management complies with a series of debt management policies that limit debt issuance to prudent levels compared to market value, population and personal income. The CIP for the six fiscal-year period of 2020–2025 totals roughly $1.7 billion and is projected to be funded partially with GO and public facility revenue bonds of approximately $615 million, including this issuance.

The city is undertaking a comprehensive study on the impact of sea level rise (SLR) and has dedicated approximately $395 million in the current CIP for improving flood control and protection via various storm water improvements, dredging, and beach restoration. The CIP includes assumptions for $277 million in storm water revenue bonds to support these initiatives. The cost of the SLR program may be substantial, but it will likely be financed and developed over an extended period, enabling the city to balance this investment against other general governmental needs and its available economic resources.

### Operating Performance

Fitch believes the city will maintain a high level of financial flexibility through economic cycles. For details, see Scenario Analysis, page 5.

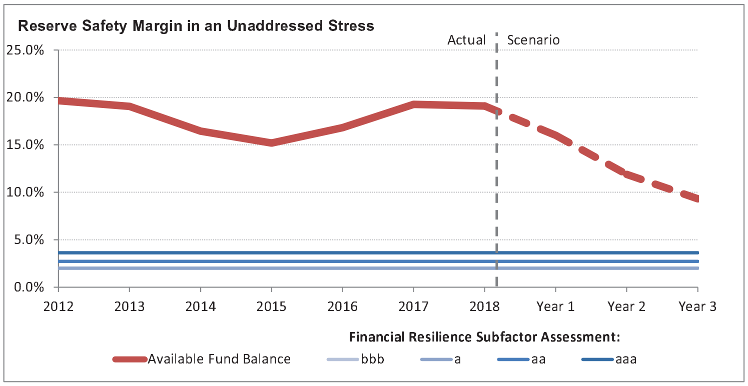
Operating margins are consistently positive with reserve drawdowns in four of the last eight fiscal years driven by capital investments and other one-time outlays. The city has exercised a variety of budgetary actions in response to changing operating environments, including spending cuts, tax and fee increases, and a reasonable use of reserves in support of non-recurring capital investment. Unrestricted general fund reserves have remained solid, ranging from 15% to 20% of spending (expenditures plus transfers out) from fiscal years 2010–2018.

The city outperformed budgetary expectations in fiscal 2018 due mostly to positive expenditure variances. The city's general fund experienced a net operating surplus of close to $12 million, increasing the unrestricted general fund balance to $217 million, representing 19% of spending. The adopted combined city and school operating fiscal 2019 budget of $2 billion was up slightly from the prior year's adjusted budget. The real estate and property tax rate were held flat. Pay-as-you-go capital of $73 million was funded in part from $20 million in fund balance appropriations. Based on preliminary projections from management, unassigned general fund reserves will remain within policy levels.

The combined fiscal 2020 city and school operating budget of $2.1 billion is up 3.7% compared to the adjusted fiscal 2019 budget. It includes a tax rate increase of 1.5 cents earmarked to support the transfer of operational expenses from the storm water enterprise fund to the general fund. Pay-as-you-go capital was budgeted at $80 million, and management appropriated $37 million of reserves. Highlights of the budget include new public safety and education hires and a pay increase for city and school employees. Conservative revenue and expenditure estimates were made, as has historically been the city's practice. Unrestricted fund balance levels are projected to remain sound, and unassigned reserves within policy levels.

## Virginia Beach (VA)

### Scenario Analysis




**Analyst Interpretation of Scenario Results:**

Fitch believes the city will maintain a high level of financial flexibility through economic cycles. The city has demonstrated a commitment to compliance with an unassigned reserve policy set at 8%-12% of budgeted expenditures. The city's reserve position provides the highest level of gap-closing capacity against relatively low revenue volatility via the Fitch Analytical Sensitivity Tool (FAST) under the standard 1% decline in U.S. GDP scenario. Furthermore, the city has superior budget flexibility, evident in its broad legal revenue raising power and solid expenditure flexibility.

| Scenario Parameters: | Year 1 | Year 2 | Year 3 |
|---|---|---|---|
| GDP Assumption (% Change) | (1.0%) | 0.5% | 2.0% |
| Expenditure Assumption (% Change) | 2.0% | 2.0% | 2.0% |
| Revenue Output (% Change) | (1.8%) | 0.9% | 3.6% |
| Inherent Budget Flexibility | | Superior | |

| Revenues, Expenditures, and Fund Balance | Actuals | | | | | | | Scenario Output | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | Year 1 | Year 2 | Year 3 |
| Total Revenues | 955,793 | 969,639 | 969,424 | 1,009,190 | 1,045,950 | 1,078,381 | 1,137,503 | 1,116,903 | 1,126,653 | 1,166,728 |
| % Change in Revenues | - | 1.4% | (0.0%) | 4.1% | 3.6% | 3.1% | 5.5% | (1.8%) | 0.9% | 3.6% |
| Total Expenditures | 909,371 | 869,161 | 885,445 | 908,103 | 917,275 | 943,271 | 987,047 | 1,006,788 | 1,026,924 | 1,047,463 |
| % Change in Expenditures | - | (4.4%) | 1.9% | 2.6% | 1.0% | 2.8% | 4.6% | 2.0% | 2.0% | 2.0% |
| Transfers In and Other Sources | 10,786 | 9,749 | 7,929 | 7,855 | 9,900 | 20,267 | 9,571 | 9,398 | 9,480 | 9,817 |
| Transfers Out and Other Uses | 55,936 | 112,729 | 108,930 | 116,987 | 116,879 | 122,710 | 148,106 | 151,068 | 154,090 | 157,171 |
| Net Transfers | (45,150) | (102,980) | (101,001) | (109,132) | (106,980) | (102,443) | (138,535) | (141,670) | (144,610) | (147,354) |
| Bond Proceeds and Other One-Time Uses | - | - | - | - | - | - | - | - | - | - |
| | | | | | | | | | | |
| Net Operating Surplus(+)/Deficit(-) After Transfers | 1,272 | (2,502) | (17,022) | (8,045) | 21,696 | 32,667 | 11,920 | (31,556) | (44,881) | (28,089) |
| Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out) | 0.1% | (0.3%) | (1.7%) | (0.8%) | 2.1% | 3.1% | 1.1% | (2.7%) | (3.8%) | (2.3%) |
| | | | | | | | | | | |
| Unrestricted/Unreserved Fund Balance (General Fund) | 189,822 | 187,199 | 163,492 | 155,647 | 173,904 | 205,489 | 216,814 | 185,258 | 140,378 | 112,289 |
| Other Available Funds (GF + Non-GF) | - | - | - | - | - | - | - | - | - | - |
| Combined Available Funds Balance (GF + Other Available Funds) | 189,822 | 187,199 | 163,492 | 155,647 | 173,904 | 205,489 | 216,814 | 185,258 | 140,378 | 112,289 |
| Combined Available Fund Bal. (% of Expend. and Transfers Out) | 19.7% | 19.1% | 16.4% | 15.2% | 16.8% | 19.3% | 19.1% | 16.0% | 11.9% | 9.3% |

| Reserve Safety Margins | Inherent Budget Flexibility | | | | |
|---|---|---|---|---|---|
| | Minimal | Limited | Midrange | High | Superior |
| *Reserve Safety Margin (aaa)* | 29.0% | 14.5% | 9.1% | 5.4% | 3.6% |
| *Reserve Safety Margin (aa)* | 21.7% | 10.9% | 7.2% | 4.5% | 2.7% |
| *Reserve Safety Margin (a)* | 14.5% | 7.2% | 4.5% | 2.7% | 2.0% |
| *Reserve Safety Margin (bbb)* | 5.4% | 3.6% | 2.7% | 2.0% | 2.0% |

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's downturn scenario assumes a -1.0% GDP decline in the first year, followed by 0.5% and 2.0% GDP growth in Years 2 and 3, respectively. Expenditures are assumed to grow at a 2.0% rate of inflation. Inherent budget flexibility is the analyst's assessment of the issuer's ability to deal with fiscal stress through tax and spending policy choices, and determines the multiples used to calculate the reserve safety margin. For further details, please see Fitch's US Tax-Supported Rating Criteria.

The ratings above were solicited and assigned or maintained at the request of the rated entity/Issuer or a related third party. Any exceptions follow below.