Virginia Beach, Virginia

New Issue Report

Ratings

Long-Term Issuer Default Rating	AAA
New Issues	
General Obligation Public Improvement Bonds, Series 2018A	AAA
Virginia Beach Development Authority Public Facilities Revenue Bonds, Series 2018A	AA+
Outstanding Debt	
Virginia Beach General Obligation Bonds	AAA
Virginia Beach Development Authority Public Facilities Refunding Revenue Bonds	AA+

Rating Outlook

Stable

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New Issue Summary

Sale Date: The GO public improvement bonds competitively on Feb. 27; Virginia Beach Development Authority revenue bonds competitively on March 14.

Series: $67,580,000 GO Public Improvement Bonds, Series 2018A, and $33,055,000 Virginia Beach Development Authority Public Facilities Revenue Bonds, Series 2018A.

Purpose: To reimburse Virginia Beach (the city) for previous expenditures for various capital projects.

Security: The public improvement bonds are a general obligation of the city backed by its full faith and credit and unlimited taxing power. Virginia Beach Development Authority (VBDA) revenue bonds are backed by annual payments from the city to VBDA pursuant to a support agreement, subject to annual appropriation.

Analytical Conclusion

The 'AAA' 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, strong reserves, moderate but rising fixed costs associated with debt and retiree liabilities 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 the VBDA bonds reflects the slightly higher degree of optionality associated with appropriation payments to be made by the city compared with 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. The city continues to experience moderate population growth, with a 2016 census estimate of 452,602 residents, which makes it the most populous city in the commonwealth. Economic activity is heavily influenced by the federal government, owing to the presence of several U.S. naval installations in addition to tourism, real estate, trade and retail.

Key Rating Drivers

Revenue Framework: 'aaa'
The city has complete legal control over key revenue streams; its revenue base is dominated by property taxes and supplemented by consumption-related sales, meals and hotel taxes. Revenue growth has accelerated in recent years following a period of recessionary declines and slow recovery. The city's revenue prospects are sensitive to fluctuations in the real estate market, tourism and activity related to the U.S. Navy.

Expenditure Framework: 'aa'
The city has significant control over spending, including the power to dictate 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 can be found in a history of pay-as-you-go capital spending.

Long-Term Liability Burden: 'aa'
Virginia Beach's overall debt position, coupled with its allocated portion of the liability associated with state administered pension plans, is moderate. Net pension liabilities are expected to increase moderately in the near term, but Fitch expects the city's liability burden

Rating History — IDR and GO Bonds

Rating	Action	Outlook/ Watch	Date
AAA	Affirmed	Stable	12/14/17
AAA	Revised	Stable	4/30/10
AA+	Affirmed	Stable	5/13/03
AA+	Assigned	—	6/28/99

Rating History — VBDA Public Facilities Revenue Bonds

Rating	Action	Outlook/ Watch	Date
AA+	Affirmed	Stable	12/14/17
AA+	Upgraded	Stable	10/3/16
AA	Affirmed	Stable	6/2/15
AA	Revised	Stable	4/30/10
AA–	Affirmed	Stable	11/6/09
AA–	Assigned	Stable	8/22/03

Related Research
Fitch Rates Virginia Beach, VA's $67.5MM GO Bonds 'AAA' & $33MM Rev Bonds 'AA+'; Outlook Stable (February 2018)

Related Criteria
U.S. Public Finance Tax-Supported Rating Criteria (May 2017)

will remain fairly stable based on its history of prudent debt management and continued growth in the economic resource base.

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 strong budget flexibility.

Rating Sensitivities

Revenue Outlook: A weakening of Fitch's view of the city's revenue framework, most importantly the long-term prospects for revenue performance, would pressure the IDR, GO and VBDA ratings.

Credit Profile

The federal government and real estate remain the largest drivers of economic activity within the Virginia Beach economy. The city is home to the Naval Air Station Oceana, the East Coast's 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 U.S. Department of Defense supports between 35% and 40% of all regional employment. A strong federal presence has helped insulate the city from prior periods of economic contraction, but defense spending levels have been fairly flat since 2011, which has had a dampening effect on job and income growth.

The city's tax base continues a modest rebound, registering its fourth consecutive year of growth in fiscal 2018, with annual increases ranging from 2%–4% over the period. The tax base 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. Improvement in the city's tax base reflects a combination of price appreciation and new construction activity. Home prices have demonstrated steady improvement since the middle of 2012 but remain about 10% below prerecession highs, according to Zillow. Resident per-capita income levels are favorable relative to the commonwealth and other Hampton Road localities.

Tourism is also an economic mainstay of the region, due to the city's beachfront location and year-round convention center events. Such activity translates into additional revenue for the city, primarily in the form of hotel, amusement and restaurant taxes, which have performed well over the past several years. The Port of Virginia, in nearby Portsmouth, supports a large trade component of the regional economy and appears poised to benefit from 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 $3.3 billion expansion of the I-64 Hampton Roads Bridge Tunnel.

Revenue Framework

Virginia Beach's general fund budget is largely supported by real and personal property taxes, which collectively account for about 54% of total 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. Slightly less than 10% of general fund revenue is received from the commonwealth, representing a portion of the state’s contribution to the operating budget of the Virginia Beach City Public Schools, a component unit of the city.

Fitch expects general fund revenue growth to remain above the rate of inflation over time. In addition to a rebounding tax base, the long-term commitment of the federal government's naval operations in Virginia Beach is expected to be a source of economic stability and moderate revenue growth in the long term. Revenues are also expected to benefit from continued growth in population and the popularity of Virginia Beach as a tourist attraction, along with recently completed or in-progress upgrades to hotel facilities and other associated tourist amenities. A history of low joblessness, high per-capita personal income and high educational attainment further support Fitch's view on 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, thus minimizing revenue risk to periodic downturns in the real estate markets. The adopted real property tax rate for fiscal 2018 of $1.0025 per $100 of assessed value (AV), which reflects a 1.25 cent increase from the fiscal 2017 rate, is very competitive relative to other municipalities in the Hampton Roads region.

Expenditure Framework

The city maintains healthy expenditure flexibility, with moderate spending associated with fixed debt service and retiree liability costs. Education is the largest single expenditure category in the general fund budget, accounting for roughly 40% of spending. State law establishes a required local effort (RLE) of funding for K-12 education for each municipality across the commonwealth. The bulk of other general fund spending is driven by salaries and benefits for city employees.

Fitch expects expense growth to be moderate and generally in line with to slightly above revenues without policy action. Virginia public schools are largely funded by a mix of state and local aid contributions.

Fitch views the city's general fund expenditure flexibility as solid. The main expenditure lever for the city is its complete legal control over employee wages, benefits, headcount, work rules and so on, as there is no collective bargaining. Fitch views the city's ability to defer its general fund contributions for pay-as-you-go capital investment as another source of near-term expenditure flexibility. General fund capital contributions are supported by dedicated revenue streams, ensuring a consistency of funding from year to year for this purpose. The fiscal 2018 budget includes a general fund transfer out of almost $38 million, or 3.5% of total general government spending, to the capital projects fund, and close to $6 million is transferred out for stormwater improvements.

General fund contributions for public education are consistently significantly above the RLE; for example, in fiscal 2017 general fund spending for education was nearly $410 million, compared to the RLE of $168 million. Fitch recognizes that local governments and school districts generally provide a base level of service well above legal requirements that may complicate (from a practical and political point of view) any effort to achieve material cost savings in this area.

Fixed costs associated with debt service, pensions and other post-employment benefits (OPEB) contributions were moderate, at 14% of fiscal 2017 total governmental spending. Debt service, which approximates 10% of spending, is expected to increase moderately based on the city's five-year capital improvement plan and existing debt amortization.

The city makes the full actuarially determined contribution to the state-administered pension plan, the Virginia Retirement System (VRS). Pension payments have consumed about 4% of governmental spending. VRS had established employer contribution rates below the annual actuarially determined contribution (ADC) for several years to help alleviate state budget pressures; this practice has been corrected as of fiscal 2018, however the city has continued to fund the full ADC. The city funds above the full actuarially determined payment for OPEB, which is fairly modest.

Long-Term Liability Burden

Long-term liabilities for debt and unfunded pension liabilities are estimated by Fitch at 11% of resident personal income, which is comfortably within the 10%–20% guidance for Fitch's 'aa' long-term liability burden assessment. The metric includes roughly $1 billion in general governmental debt, or 4% of personal income. A similar amount is attributed to the proportionate share of the Fitch-adjusted net pension liability (NPL) of the cost-sharing multiple-employer retirement plan for teachers, with the balance derived from separate cost-sharing pools within VRS for city employees and nonprofessional school employees (Fitch's NPL estimates are based on a 6% investment rate of return, compared with the 7% VRS rate).

The city's Fitch-adjusted teacher plan NPL has increased more than $100 million, or roughly 12%, in the past two years alone due to investment performance and the aforementioned contribution deferrals, despite reforms enacted in 2012 that affected required contributions and plan design.

While the city's pension-related liabilities are likely to grow in the near term, Fitch expects the direct debt component of the long-term liability metric to remain fairly stable. The capital improvement program (CIP) for fiscal years 2019–2023 totals roughly $1.3 billion and is mostly funded with debt, including almost $550 million of GO and public facility revenue bonds. However, outstanding principal is repaid at a healthy rate, which increases capacity for additional long-term liabilities over the forecast period. More than $800 million in spending is allocated to address routine maintenance on basic infrastructure, facility replacement and renovations, and technology upgrades that have been deferred since the recession.

The city is undertaking a comprehensive study on the impact of sea level rise (SLR) and has dedicated approximately $360 million in the current CIP for improving flood control and protection via various stormwater improvements, dredging and beach restoration. The cost of the SLR program may be substantial, but it will likely be financed and developed over an extensive period, allowing the city the ability 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.

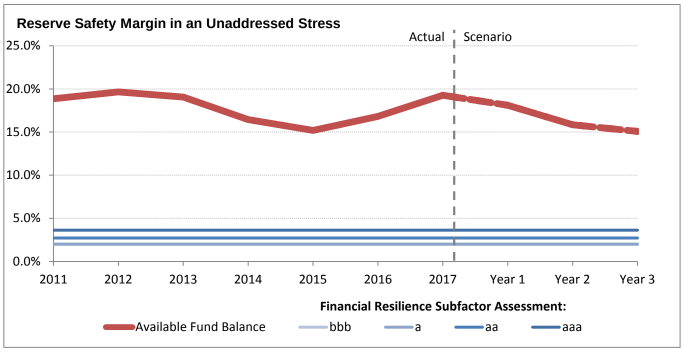
Operating margins are consistently positive, with reserve drawdowns in four of the past seven fiscal years driven by capital investments and other one-time outlays. The city has exercised a variety of budgetary actions in response to changing operating environments, including spending cuts, tax and fee increases and a reasonable use of reserves in support of nonrecurring capital investment. Unrestricted general fund reserves have remained solid, ranging from 15%–20% of general fund spending from fiscal years 2010–2017.

Fiscal 2017 operating results produced a $32.7 million surplus in the general fund, equivalent to 3% of spending, boosting the unrestricted fund balance to more than $205 million, or 19% of spending. The city's fiscal 2018 budget increased by just under 3% over the prior year, to almost $1.1 billion. The budget appropriates about $33 million in reserves, compared with $46 million last year. The city routinely appropriates a portion of its reserves for contingency and capital use — the budget for fiscal 2018 commits close to $70 million for pay-as-you-go capital. There are no major revenue enhancements in the budget, and the budget funds wage increases of about 2% across the board and a 1% increase in citywide staffing. Based on year-to-date results, management is projecting an operating surplus at year end.

Virginia Beach (VA)

Scenario Analysis

v. 2.0 2017/03/24



Analyst Interpretation of Scenario Results:

Fitch believes the city will maintain a high level of financial flexibility through economic cycles. The city has demonstrated commitment to compliance with an unassigned reserve policy set at 8%-12% of budgeted expenditures. The city's reserve position provides a strong cushion against relatively low revenue volatility via the Fitch Analytical Sensitivity Tool (FAST) under the standard -1% U.S. GDP scenario. Furthermore, the city has superior budget flexibility, most notably evident in its broad legal revenue raising power and flexibility with respect to key expenditure drivers, mainly employee wages and benefits and school spending.

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%)	0.8%	3.5%
Inherent Budget Flexibility	Superior		

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2011	2012	2013	2014	2015	2016	2017	Year 1	Year 2	Year 3
Total Revenues	979,178	955,793	969,639	969,424	1,009,190	1,045,950	1,078,381	1,058,819	1,067,787	1,105,245
% Change in Revenues	-	(2.4%)	1.4%	(0.0%)	4.1%	3.6%	3.1%	(1.8%)	0.8%	3.5%
Total Expenditures	826,268	909,371	869,161	885,445	908,103	917,275	943,271	962,136	981,379	1,001,007
% Change in Expenditures	-	10.1%	(4.4%)	1.9%	2.6%	1.0%	2.8%	2.0%	2.0%	2.0%
Transfers In and Other Sources	12,662	10,786	9,749	7,929	7,855	9,900	20,267	19,899	20,067	20,771
Transfers Out and Other Uses	170,207	55,936	112,729	108,930	116,987	116,879	122,710	125,164	127,667	130,221
Net Transfers	(157,545)	(45,150)	(102,980)	(101,001)	(109,132)	(106,980)	(102,443)	(105,265)	(107,600)	(109,449)
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	(4,635)	1,272	(2,502)	(17,022)	(8,045)	21,696	32,667	(8,582)	(21,192)	(5,211)
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	(0.5%)	0.1%	(0.3%)	(1.7%)	(0.8%)	2.1%	3.1%	(0.8%)	(1.9%)	(0.5%)
Unrestricted/Unreserved Fund Balance (General Fund)	188,047	189,822	187,199	163,492	155,647	173,904	205,489	196,907	175,715	170,505
Other Available Funds (Analyst Input)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Analyst Input)	188,047	189,822	187,199	163,492	155,647	173,904	205,489	196,907	175,715	170,505
Combined Available Fund Bal. (% of Expend. and Transfers Out)	18.9%	19.7%	19.1%	16.4%	15.2%	16.8%	19.3%	18.1%	15.8%	15.1%

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)	21.8%	10.9%	7.3%	4.5%	2.7%
Reserve Safety Margin (a)	14.5%	7.3%	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.