

CREDIT OPINION

12 May 2016

New Issue

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Virginia Beach (City of) VA Water Sewer Enterprise

New Issue: Moody's upgrades to Aa1 Virginia Beach Wtr. & Sew.; Assigns Aa1 to \$84.6M Rev. Bonds, Ser. 2016

Summary Rating Rationale

Moody's Investors Service has assigned a Aa1 rating to the City of Virginia Beach's Water and Sewer System Revenue Bonds Series of 2016A and Refunding Series of 2016B. Concurrently, Moody's has upgraded to Aa1 from Aa2 rating on the system's \$184 million of outstanding parity debt. The outlook is stable.

The upgrade to Aa1 reflects a history of sound financial operations that have resulted in improved debt service coverage, strong liquidity and a manageable debt position with well-developed future borrowing plans. The rating also factors in the stabilizing nature of the service area of Virginia Beach (Aaa stable).

Credit Strengths

- » Strong debt service coverage historically exceeded projections
- » Stable service area with large, diverse tax base stabilized by the presence of military bases

Credit Challenges

- » Local economy exposure to cuts in defense and other federal spending

Rating Outlook

The stable outlook reflects a continued expectation of strong financial operations. The outlook further reflects the stable service area.

Factors that Could Lead to an Upgrade

- » Increased coverage and liquidity to levels in line with Aaa rated entities
- » Growth in service area and customer accounts

Factors that Could Lead to a Downgrade

- » Reduction of liquidity and debt service coverage
- » Significant system leverage

Key Indicators

Exhibit 1

Virginia Beach Water Sewer Ent.

System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	11 years				
System Size - O&M (in \$000s)	78,145				
Service Area Wealth: MFI % of US median	117.17%				
Legal Provisions					
Rate Covenant (x)	1.15				
Debt Service Reserve Requirement	DSRF Funded at MADS				
Financial Strength					
	2011	2012	2013	2014	2015
Operating Revenue (\$000)	99,248	104,229	109,260	115,208	121,612
O&M (\$000)	75,077	76,154	77,834	76,146	78,145
Long-Term Debt (\$000)	135,761	123,449	120,657	156,328	151,508
Annual Debt Service Coverage (x)	2.53	2.79	3.09	3.19	3.26
Cash on Hand	373 days	376 days	409 days	475 days	543 days
Debt to Operating Revenues (x)	1.4x	1.2x	1.1x	1.4x	1.2x

Source: Moody's Investors Service

Detailed Rating Considerations

Service Area and System Characteristics: Dynamic Service Area with Sufficient System Capacity

The stable Virginia Beach economy and sizeable service area will continue performing favorably, given strong institutional presence despite exposure to federal defense spending, ample water and wastewater capacity, and an active economic development program. The city's \$51 billion tax base has demonstrated resilience through the recession, due in part to the diversity of the local economy, stabilizing military presence and continued strength in tourism activity. The city's real property assessed value began to increase in 2015 with a 3.8% increase, following a 0.3% decline in 2014 and a 3% decline in 2013. Officials expect fiscal 2016 assessed value to increase 3.1% to \$52 billion. With a population of 451,672 in 2014 (nearly 15% growth since 1990), Virginia Beach is the largest city in the Commonwealth of Virginia (Aaa stable). Median family income levels are slightly higher than other Hampton Roads jurisdictions and the national average, and approximate state averages. Per capita income is higher than the region, state, and national averages.

Virginia Beach Water and Sewer (VBWS) serves the northern half of the city; by board policy, water and sewer services are not provided to southern portion of the city as long-term plans are for that area to remain rural. The city's primary water supply is the Pea Hill Creek tributary of Lake Gaston. Water supply from Lake Gaston is ample, given average annual usage of 32MGD versus capacity of 49.98 MGD. The city's water is pumped directly from Lake Gaston via a 76-mile pipeline to the City of Norfolk for treatment (pursuant to a long-term contract through 2030) before it is distributed to customers via a system comprised of over 1,499 miles of transmission and distribution mains and nine pumping stations. Customers are charged a monthly minimum service charge and a commodity charge based on actual water usage.

The city's sanitary sewer system consists of over 1,653 miles of sewer mains and 408 sewage pump stations. The Hampton Roads Sanitation District (HRSD) (Aa2 stable) provides treatment and bills customers directly. The city collects a flat monthly charge for sewage collections. The top 10 users of the system make up a manageable 3% of system revenues. The average daily water consumption was approximately 31.8 MGD in fiscal 2014 and 30.8 MGD in fiscal 2015.

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Debt Service Coverage and Liquidity: Solid Financial Operations Expected to Continue

VBWS will remain financially strong given its history of maintaining solid debt service coverage that measures favorably when compared to the Aa1 rating. Debt service coverage for all system debt by fiscal 2015 net revenues (including connection fees) is a strong 3.26 times up significantly from coverage of 2.53 times in fiscal 2010. Maximum annual debt service coverage by fiscal 2015 net revenues on all debt is 2.88 times, including connection fees and adjustments, and 2.59 times excluding any non-operating revenues. The system's operating ratio has historically trended at weaker levels (64.3% for 2015) reflecting ongoing payments from the system to the City of Norfolk that includes reimbursement for debt previously issued by Norfolk to increase water treatment capacity to meet the city's needs.

Individual consumption has dropped, largely due to conservation, and is expected to continue to decline moderately over the near-term. Connection and tap fees have also dropped from peak levels prior to the recession as the system continues to rely less on future growth and has projected regular rate increases to maintain positive operations. The city's outyear projections call for moderate (around 4%) rate increases through 2022.

Conservatively projected, including a slight growth in connections and ongoing declines in individual consumption, debt service coverage is expected to decline to a still satisfactory 2.04 times in fiscal 2017. Despite a projection for coverage declines, the system has consistently outperformed projections in prior years and should continue to do so going forward.

LIQUIDITY

VBWS maintains strong liquidity despite a strong commitment to cash funded capital. Fiscal 2015 days cash on hand totaled 543 and the system projects strong liquidity levels going forward.

Debt and Legal Covenants: Adequate Legal Provisions Strengthened by Debt Service Reserve Requirement

Satisfactory legal provisions include a rate covenant that requires net revenues (including connection fees) cover maximum annual debt service by 1.15 times on all parity revenue bonds and 1.00 times on all debt, including general obligation bonds issued for water and sewer purposes, however actual coverage has historically been well above legal requirements. The system no longer has general obligation debt outstanding. The additional bonds test is the same as the rate covenant, and a debt service reserve will be funded with bond proceeds and equal to maximum annual debt service.

The 6-year CIP totals a manageable \$209 million with 84% of sewer CIP projects related to rehab of aging sewer infrastructure and continued asset management and 47% of the water CIP related to aging infrastructure, storm water and highway coordination. The system maintains adequate capacity with a low debt ratio of 21% in fiscal 2015 and approximately 23% post-issuance.

DEBT STRUCTURE AND DEBT-RELATED DERIVATIVES

All debt is fixed rate and the system is not party to any derivative agreements.

Management and Governance

Virginia Beach's management team is strong and experienced. Majority of the management team for the sewer system is also part of the county's management team. Comprehensive policies and financial operating targets will continue to drive sound operating results. Policies include: working capital 80-100% annual operating expenses, minimum 1.5x debt service coverage and no less than 25% pay go capital.

Legal Security

The bonds are secured by a pledge of net revenues of the water sewer system

Use of Proceeds

Approximately \$42 million of new money proceeds will be used for various capital projects (\$17 million for water projects, \$33 million for sewer projects). \$42 million of refunding bonds will be used to refund the outstanding 2002 and 2005 bonds for an expected net present value savings of \$10 million without extending debt maturity.

Obligor Profile

Virginia Beach is the largest city in Virginia with a dynamic local economy anchored by tourism and strong military presence.

Methodology

The principal methodology used in this rating was US Municipal Utility Revenue Debt published in December 2014. Please see the Ratings Methodologies page on www.moody's.com for a copy of this methodology.

Ratings

Exhibit 2

Virginia Beach (City of) VA Water & Swr Ent

Issue	Rating
Water and Sewer System Revenue Bonds, Series of 2016A	Aa1
Rating Type	Underlying LT
Sale Amount	\$42,075,000
Expected Sale Date	05/23/2016
Rating Description	Revenue: Government Enterprise
Water and Sewer System Refunding Revenue Bonds, Series of 2016B	Aa1
Rating Type	Underlying LT
Sale Amount	\$42,485,000
Expected Sale Date	05/23/2016
Rating Description	Revenue: Government Enterprise

Source: Moody's Investors Service

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REPORT NUMBER 1027078

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