

RatingsDirect®

Summary:

Virginia Beach, Virginia; Appropriations; General Obligation

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Table Of Contents

Rationale

Outlook

Summary:

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Credit Profile

US\$67.580 mil GO pub imp bnds ser 2018A due 03/01/2038

Long Term Rating AAA/Stable New

Virginia Beach GO

Long Term Rating AAA/Stable Affirmed

Rationale

S&P Global Ratings assigned its 'AAA' rating to Virginia Beach, Va.'s 2018A general obligation (GO) public improvement refunding bonds. At the same time, we affirmed our 'AA+' rating on the city's outstanding appropriation-backed debt for the Virginia Beach Development Authority and our 'AAA' GO debt rating on the city's outstanding bonds. The outlook is stable.

A pledge of the city's full-faith-credit-and resources and an agreement to levy ad valorem property taxes without limitation as to rate or amount secure the GO bonds.

The public facility revenue bonds are secured by annual payments made by Virginia Beach to the authority, pursuant to a support agreement and subject to appropriation. We rate these obligations one notch lower than the city's general creditworthiness to account for the appropriation risk associated with the annual payment. We considered the affordability and likelihood of the annual payment, which is reflected in the 'AA+' rating and in our view of Virginia Beach's general creditworthiness. In our view, the support agreement features and terms are standard with no unusual risks regarding timely payment of debt. Under the agreements, the city cannot abate annual payments in the event of damage or destruction to the related property.

We understand proceeds from this issue will be used to provide funding for various city and school improvements.

Virginia Beach's GO bonds are eligible to be rated above the sovereign because we believe the city can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above the Sovereign: Corporate and Government Ratings--Methodology and Assumptions" (published Nov. 19, 2013, on RatingsDirect), U.S. local governments are considered to have moderate sensitivity to country risk. The city general obligation pledge is the primary source of security on the debt; this severely limits the possibility of negative sovereign intervention in the payment of the debt or in the operations of the city. The institutional framework in the U.S. is predictable for local governments, allowing them significant autonomy, independent treasury management and no history of government intervention. Virginia Beach has considerable financial flexibility, as demonstrated by the very high fund general balance as a percentage of expenditures, as well as very strong liquidity.

The rating reflects our opinion of the city's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA) and a local stabilizing institutional influence;
- Very strong management, with "strong" financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with an operating surplus in the general fund and a slight operating surplus at the total governmental fund level in fiscal 2017;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 18% of operating expenditures;
- Very strong liquidity, with total government available cash at 30.5% of total governmental fund expenditures and 3.0x governmental debt service, and access to external liquidity we consider exceptional;
- Strong debt and contingent liability position, with debt service carrying charges at 10.3% of expenditures and net direct debt that is 65.2% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 77.8% of debt scheduled to be retired in 10 years; and
- Very strong institutional framework score.

Very strong economy

We consider Virginia Beach's economy very strong. The city, with an estimated population of 455,193, is in Virginia Beach City County in the Virginia Beach-Norfolk-Newport News MSA, which we consider to be broad and diverse. It also benefits, in our view, from a stabilizing institutional influence. The city has a projected per capita effective buying income of 108.5% of the national level and per capita market value of \$130,666. Overall, market value grew by 3.5% over the past year to \$59.5 billion in 2017. The county unemployment rate was 3.9% in 2016.

Virginia Beach is the commonwealth's largest city based on population and is an integral part of the Hampton Roads regional economy. Tourism and several military facilities anchor the economy. With 38 miles of shoreline, Virginia Beach is a prime tourist destination, in particular for East Coast vacationers. Despite the recent recession, tourist activity remains solid. As per the city's convention and visitors bureau, all major hotel indicators are up from 2014, including occupancy, average daily rate, revenue per available room (RevPAR), and revenue.

Also in the city are Oceana Naval Air Station, Oceana Naval Air Station Dam Neck Annex, and Joint Expeditionary Base Little Creek-Fort Story. Furthermore, The Bipartisan Budget Act of 2015 lifted the sequestration cap on defense spending by \$40 billion over the next two fiscal years.

Virginia Beach has a significant military presence with more than 32,000 service and civilian employees and an annual payroll of more than \$1.7 billion spread across several installations. Although the military provides stability to the economy, the effects from federal sequestration have been moderate, with the expectation of stabilization in the near term. With the recent first transoceanic fiber cable connection to Virginia Beach, the city has seen an increase in data center development. Furthermore, economic diversification continues with various projects that span beyond the traditional tourism and military sectors.

Following several years of declines in the tax base because of the recession, assessed value increased over the last three years. The growth would reflect an increase in building permits and a reduction in home foreclosures. Moderate-term economic development plans (not all approved, to date) are significant in scope. Phase VI of Town Center is on target, expected to be completed in the summer of 2018. The city is evaluating a proposal to redevelop the Dome site into a mixed-use, multi-entertainment complex that includes offices, parks, apartments, retail, and a live entertainment venue. In addition, it recently approved a project called CityView Two, which will bring in an estimated

\$60.5 million in private investment, and have three separate phases with each phase addressing additional economic generators such as commercial, residential, and office space. In our opinion, if these projects come to fruition, they will significantly add to the tax and employment bases; and contribute to the city being a year-round destination.

Very strong management

We view the city's management as very strong, with "strong" financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Through conservative practices and well-adhered-to policies, the city's financial position remains strong. The formal reserve policy requires the maintenance of an unreserved-undesignated general fund balance between 8% and 12% of next year's revenues. The city measures its formal debt issuance policy in multiple ways. Some major debt affordability policies include (net of self-supporting utility debt) an overall net debt-to-market value cap of 3.5%; an overall net debt per capita ceiling of \$3,000, which it just recently raised from \$2,800 per capita for the fiscal 2016 budget to account for the cost of several major projects; and a general governmental expenditure debt service carrying charge limit of 10%, which was recently revised downward from 12.5%. The six-year rolling capital improvement program identifies all revenue sources. The investment policy is conservative and does not permit derivatives. Officials provide updates to the city council throughout the year. The city uses formal historical trend analysis when preparing the budget and makes amendments only when necessary.

Strong budgetary performance

Virginia Beach's budgetary performance is strong, in our opinion. The city had surplus operating results in the general fund of 3.1% of expenditures, and slight surplus results across all governmental funds of 1.2% in fiscal 2017.

Management attributes the surplus in operations in fiscal 2017 to various major revenue streams meeting, if not exceeding, budget, including business licenses and hotel and meal taxes, coupled with savings on the expense side. Virginia Beach's financial performance benefits from strong reserves and management by an experienced team. We consider the city's revenue stream relatively stable, with property taxes accounting for roughly 54% of total general fund revenues. Other local taxes, which we consider more economically sensitive, include sales, utility, telecommunication, hotel room, and restaurant meals taxes. Property taxes are the city's largest general fund revenue source, accounting for 54% of total general fund revenues, followed by sales (5.8%), utility (4.3%), business license (4.4%), and restaurant meal (3.8%) taxes. Apart from some modest fluctuations in recent years, these taxes have not had any significant volatility.

Although the city remains conservative with its projections, it historically budgets conservatively and assumes worst-case scenarios. Its adopted fiscal 2018 operating budget totals \$1.97 billion (\$1.08 billion for city and \$894.5 million for schools). Overall, the 2018 budget is a 3% year-over-year increase from 2017. The city has included additional public safety officers, the first year of a five-year phase-in of universal kindergarten, and additional monies for infrastructure projects. It does include a tax rate increase of 1.25 cents to fund the first year of full-day kindergarten. A 2.5-cent increase in the storm water equivalent residential unit (ERU) is the first since 2014. The ERU rate will rise by 2.5 cents each year through 2021-2022 for the city to fund its plan to support its storm water mandates as well as flood control initiatives. Currently, management reports revenues and expenses are on track. Nonetheless, we do not expect the city's budgetary performance to deteriorate in the near term.

Very strong budgetary flexibility

Virginia Beach's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 18% of operating expenditures, or \$188.2 million.

In our opinion, the city's budgetary flexibility is very strong, with reserves averaging almost 16% of expenditures over the past three fiscal years (2015-2017) and no plans to significantly spend them down. Its unassigned balance was \$118.4 million, or 11.0% of expenditures in fiscal 2017. The city's formal reserve policy requires the maintenance of an unreserved-undesignated general fund balance at between 8% and 12% of next year's revenues and it is in compliance with that policy.

Given the projections for fiscal 2018, we do not expect the city's budgetary flexibility score to change in the near term.

Very strong liquidity

In our opinion, Virginia Beach's liquidity is very strong, with total government available cash at 30.5% of total governmental fund expenditures and 3.0x governmental debt service in 2017. In our view, the city has exceptional access to external liquidity if necessary.

We believe the city has exceptional access to external liquidity. It has issued bonds frequently during the past 15 years, including GO bonds, appropriation-backed debt, and water and sewer revenue bonds. Management has confirmed it has no contingent liquidity risks from financial instruments with payment provisions that change on the occurrence of certain events. In addition, the city does not hold any investments we consider aggressive. Given historical and current trends, we expect liquidity levels to remain very strong.

Strong debt and contingent liability profile

In our view, Virginia Beach's debt and contingent liability profile is strong. Total governmental fund debt service is 10.3% of total governmental fund expenditures, and net direct debt is 67.5% of total governmental fund revenue. Overall net debt is low at 1.5% of market value, and approximately 77.8% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

In our opinion, debt levels are projected to rise modestly, given the size and scope of projects currently planned. The six-year bond program has issuances scheduled annually. The debt has already been authorized and the project schedule is mostly set. However, we expect the city's debt score to remain strong.

The city currently has \$216.9 million of GO debt and \$136.2 million of revenue debt authorized but unissued. These numbers do not include the current issuance of debt.

Virginia Beach's combined required pension and actual other postemployment benefit (OPEB) contributions totaled 3.8% of total governmental fund expenditures in 2017. The city made its full annual required pension contribution in 2017.

The city participates in the Virginia Retirement System (VRS), a commonwealth-administered pension plan and makes the annual required contribution (ARC). This city's proportionate share of the VRS liability is \$411 million, resulting in a fiduciary net position as a percentage of the total pension liability of 78.8%, while school's position was 89%, with net pension liability of \$22.8 million. The city offers OPEBs to its employees on the city and the school sides. Recently, it

adopted GASB Statement No. 74, Financial Reporting for Postemployment Plans. For the city's OPEB trust, the fiduciary net position as a percentage of total OPEB liability was 45.2% as of June 30, 2017. The net OPEB liability for the city as of June 30, 2017 was \$46.7 million. For its OPEB plan for the school board, the fiduciary net position as a percentage of total OPEB liability was 37.4% as of June 30, 2017. The net OPEB liability for the city as of June 30, 2017 was \$45.3 million.

Very strong institutional framework

The institutional framework score for Virginia cities with a population of more than 3,500, such as Virginia Beach, is very strong.

Outlook

The stable outlook reflects our view of Virginia Beach's consistent financial performance and very strong economy, which is supported by very strong management. We do not expect to revise the rating in the next two years because we believe the city will maintain its very strong budget flexibility and liquidity and remain an integral component of the Hampton Roads MSA economy. However, although unlikely, if the city were to significantly draw on reserves due to fiscal pressures of future increased capital projects, falling below its own formal policies and lacking a clear and timely plan to restore reserves, the rating may be lowered.

Ratings Detail (As Of February 20, 2018)		
Virginia Beach GO pub imp bnds		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Virginia Beach Dev Auth, Virginia		
Virginia Beach, Virginia		
Virginia Beach Dev Auth (Virginia Beach)		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Virginia Beach Dev Auth (Virginia Beach) pub fac rev bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Virginia Beach Dev Auth (Virginia Beach) pub fac rev rfdg bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Virginia Beach Dev Auth (Virginia Beach) pub fac rev rfdg bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Virginia Beach Dev Auth (Virginia Beach) pub fac rfdg bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Virginia Beach Dev Auth (Virginia Beach) pub fac rfdg bnds (Virginia Beach) ser 2016A due 10/18/2036		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Virginia Beach Dev Auth (Virginia Beach) APPROP		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Virginia Beach Dev Auth (Virginia Beach) APPROP		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Virginia Beach Dev Auth (Virginia Beach) GO		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Virginia Beach Dev Auth (Virginia Beach) GO		

Ratings Detail (As Of February 20, 2018) (cont.)

<i>Long Term Rating</i>	AA+/Stable	Affirmed
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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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