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Ratings

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Summary:

Virginia Beach Development Authority, Virginia
Virginia Beach; Appropriations; General Obligation

Primary Credit Analyst:
Lauren Freire, New York (1) 212-438-7854; lauren.freire@spglobal.com

Secondary Contact:
Danielle L Leonardis, New York (1) 212-438-2053; danielle.leonardis@spglobal.com

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Credit Profile		
US$154.16 mil pub fac rev bnds (Virginia Beach) ser 2020A dtd 06/17/2020 due 04/15/2040		
Long Term Rating	AA+/Stable	New
US$36.355 mil pub fac rfdg rev bnds (Virginia Beach) ser 2020B dtd 06/17/2020 due 04/15/2040		
Long Term Rating	AA+/Stable	New
Virginia Beach GO		
Long Term Rating	AAA/Stable	Affirmed
Virginia Beach Dev Auth, Virginia		
Virginia Beach, Virginia		
Virginia Beach Dev Auth (Virginia Beach) GO		
Long Term Rating	AA+/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' rating and stable outlook to Virginia Beach Development Authority, Va.'s roughly $154.16 million series 2020A public facility revenue bonds and roughly $36.355 million series 2020B public facility refunding revenue bonds, issued for Virginia Beach, and affirmed its 'AA+' rating, with a stable outlook, on the city's existing appropriation-backed debt for the authority.

S&P Global Ratings also affirmed its 'AAA' rating, with a stable outlook, on the city's general obligation (GO) debt.

Annual payments by Virginia Beach to the authority, pursuant to a support agreement and subject to appropriation, secure the public facility revenue bonds. 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. 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 bond proceeds will fund various capital projects throughout the city as well as provide savings on certain maturities.

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, titled "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 GO 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 general fund balance as a percent of expenditures, as well as very strong liquidity.

Credit overview

The affirmation of the rating and outlook reflect Virginia Beach's very strong management and financial metrics, that we believe are poised to respond to current recessionary pressure, exacerbated by the tourism-heavy local economy. The city has maintained very strong reserves as part of its operations since the Great Recession. We anticipate the city will draw on these reserves as part of its operations for 2020 and into its 2021 fiscal year, however, we expect the city to make the necessary budget adjustments to keep reserves at policy levels.

Virginia Beach, a coastal community in southern Virginia, has capitalized on its location through ongoing tourism development, with a recent focus on tourism for youth sports. In addition, the city is experiencing light manufacturing growth and tech developments, as the city is the landing spot for three underground internet cables coming from Europe. Virginia Beach recognizes ongoing challenges related to rising sea levels, flooding, and other risks present in coastal communities, and it dedicates a growing portion of its additional capital plans to address these issues. We will continue to monitor the rating, because we believe management will likely maintain its very strong budgetary flexibility and liquidity and remain an integral component of the Hampton Roads' metropolitan statistical area (MSA) economy.

The rating also reflects the city's:

- Very strong economy, with access to a broad and diverse MSA and a local stabilizing institutional influence;
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with balanced operating results in the general fund and a slight operating surplus at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 17% of operating expenditures;
- Very strong liquidity, with total government available cash at 50% of total governmental fund expenditures and 5.4x governmental debt service, and access to external liquidity that we consider exceptional;
- Strong debt and contingent liability profile, with debt service carrying charges at 9.3% of expenditures and net direct debt that is 71.2% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 75.3% of debt scheduled to be retired within 10 years; and
- Very strong institutional framework score.

Environmental, social, and governance factors

Our rating action incorporates our view regarding the health and safety risks posed by the COVID-19 pandemic. Absent the implications of COVID-19, we consider the social risks in line with those of the sector. Environmental risks are somewhat elevated for the city due to its exposure to rising sea levels. Virginia Beach proactively manages these risks and includes ongoing remediation efforts as part of its rolling capital projects. The city also collaborates with other Oceanside communities and the commonwealth for larger-scale projects. We view Virginia Beach's governance risks as being in line with the sector and it has historically maintained a strong management and policy framework to respond to developing risks.

Stable Outlook

Downside scenario

If management were to draw on reserves significantly due to pressure from the current recession or increased capital projects, decreasing below formal policies, with no clear and timely plan to restore reserves, we could lower the rating.

Credit Opinion

Very strong economy

We consider Virginia Beach's economy very strong. The city, with an estimated population of 455,090, is in the Virginia Beach-Norfolk-Newport News MSA, which we consider to be broad and diverse. The city also benefits, in our view, from a stabilizing institutional influence. The city has a projected per capita effective buying income of 105.4% of the national level and per capita market value of $140,558. Overall, the city's market value grew 4.4% over the past year to $64 billion in 2019. Furthermore, despite a historically low city unemployment rate of 2.7% in 2019, rapidly evolving economic conditions because of the pandemic have already affected the labor market. (For further information, please see the article, titled "U.S. Jobs Market Buckles Under The Coronavirus Pandemic," published April 2, 2020.) Given the city's historical exposure to increased unemployment during the Great Recession, which grew to 6.5% by 2010 from 2.7% in 2007, we will monitor the long-term effects of the current downturn on the labor market and the economy overall.

A significant portion of Virginia Beach's economic activity involves tourism, with beach access and a growing destination for sports venues. With 38 miles of shoreline, Virginia Beach is a prime tourist destination, particularly for East Coast vacationers. The city's local economy is vulnerable to the effects of social distancing and other decisions made to protect the health and safety of the community from the spread of COVID-19. The city has seen the cancellation of 685 events through August 2020. (For further information, please see the article, titled "The COVID-19 Outbreak Weakens U.S. State And Local Government Credit Conditions," published April 2, 2020.)

However, Virginia Beach has a multifaceted local economy, as the commonwealth's largest city based on population and an integral part of Hampton Roads' regional economy. Along with tourism, several military facilities anchor the economy. Oceana Naval Air Station, Oceana Naval Air Station Dam Neck Annex, and Joint Expeditionary Base Little Creek-Fort Story are in the city. Virginia Beach has a significant military presence, with more than 43,000 service and civilian employees and an annual payroll of more than $2.7 billion spread across several installations.

With the completion of the second transoceanic fiber cable connection to Virginia Beach, data-orientated development will likely continue, bolstered by the regional connectivity ring steering committee that serves communities such as

Norfolk, Chesapeake, Portsmouth, and Suffolk. The city projects the Dunant-Google-owned third cable will be complete by the end of 2020. With the three subsea cables, the city has, and continues to draw data centers and other technology companies within city limits, with 155 acres for a prospective light industrial park. Additional economic diversification continues, with various projects beyond the traditional tourism and military sectors.

The city is experiencing expansion in housing and hotels, coupled with the expected expansion of Virginia Beach Sports Center. Expansion continues in the city's Town Center area. In our opinion, ongoing and future commercial or residential developments will likely slow in light of the recession, but the expansion of other sectors within Virginia Beach's economy will help anchor the city during the current recessionary period. Furthermore, we note that construction is considered an essential business so that many developments remain on track.

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 management and well-adhered-to policies, we believe Virginia Beach's finances remain will remain stable. The formal reserve policy requires maintaining an unassigned general fund balance between 8% and 12% of next year's revenue. The city measures its formal debt-issuance policy in multiple ways. 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 the city just recently raised from $2,800 for the fiscal 2016 budget to account for the cost of several major projects; and
- A general governmental expenditure debt-service-carrying-charge limit at 10% of expenditures, which it recently revised downward from 12.5%.

The six-year rolling capital improvement plan (CIP) identifies all revenue sources. The city's conservative investment policy does not permit derivatives. Officials provide updates to the city council throughout the year. Management uses formal historical trend analysis when preparing the budget and makes amendments only when necessary.

As Virginia Beach is a coastal community, it has dealt with sea level rise, coastal flooding among other unique challenges, which other non-coastal communities do not face. The city recently completed a comprehensive sea-level-rise-and-recurrent-flooding study. It also maintains master drainage stormwater models. The city, as part of its "Sea Level Wise" response to the study, identified seven goals, 29 objectives, and 175 action items. These items include, but are not limited to: zoning changes, beach nourishment, marsh restoration, drainage changes, and the creation of a seawall. To fund these initiatives, the city has dedicated 2.5 cents of its real estate tax, coupled with an expected 54% increase in stormwater fees. The city has also been addressing concerns related to cyber security; it has a framework based on National Institute of Standards and Technology's (NIST) and Cyber Security Framework (CSF).

Adequate budgetary performance

Virginia Beach's budgetary performance is adequate, in our opinion. The city had balanced operating results in the general fund, and slight surplus results across all governmental funds in fiscal 2019. However, we anticipate the city's performance will be negatively affected as a result of the current pandemic.

COVID-19 and the ensuing national recession presents an event risk for Virginia Beach's budgetary performance. However, we believe a strong management team with conservative budgeting practices paired with expenditure flexibility, will allow the city to manage the budgetary impact of the pandemic. In light of the current pandemic, the city has implemented several changes to existing policy surrounding the collection of revenue. It delayed penalties and interest on late personal property tax to August, while also delaying the late payments and penalties for the meal admission and hotel trustee taxes for 60 days after the due date. In addition, the city also eliminated its meal tax of 5.5% for May and June of the current year. The city is projecting a revenue decline of $64.5 million, (5.4% of revenue), a combination of COVID-19, and council tax holidays and penalty delays. However, these revenue declines are offset by expenditure savings of roughly $60.8 million, the city anticipates using $3.7 million of its unassigned fund balance by year-end. The city has spent roughly $4.3 million related to COVID-19, the majority of this reimbursable by the Federal Emergency Management Agency, and under the Coronavirus Aid, Relief, and Economic Security Act; Virginia Beach is slated to receive $39 million.

Prior to the onset of pandemic, the city proposed its 2021 budget, but in light of current revenue pressure, the city revised its revenue and expenditure assumptions. The overall budget of $2.09 billion is up slightly by 0.26%, which translates to $5.5 million. The city has revised its revenue downward by roughly $70 million while reducing costs for personnel, delaying certain expenses. The city has also established a reserve for COVID-19 revenue reductions by delaying cash-financed CIP projects. Included in the budget is the use of $54.8 million of the city's unassigned fund balance, which is historically is higher than in previous years.

We have adjusted the city's 2019 results for transfers and capital. The city's revenue came in as anticipated, with slight variances of 0.01% to the negative. However, expenses were under budget with expenses under budgeted levels by $80.6 million or 6.4%. Despite the city's strong track record of performance, we believe the current COVID-19 pandemic is an event risk, and will negatively affect the city's financial performance for the current and future fiscal years. However, based on conservative budgeting practices and close monitoring of expenses, we expect the city will manage through the recession.

Very strong budgetary flexibility

Virginia Beach's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 17% of operating expenditures, or $199.4 million. Over the past three years, the total available fund balance has remained at a consistent level overall, totaling 18% of expenditures in 2018 and 18% in 2017.

Our calculation of available fund balance includes assigned fund balance. Budgetary flexibility remains, what we consider, very strong: Reserves averaged almost 17.1% of expenditures from fiscal years 2017-2019. Management plans to use $ 58.5 million in fund balance over the next two years as a result of the current pandemic. The city expects that by fiscal year-end 2020 unassigned fund balance will be roughly 8.16% of fiscal 2021 revenue. That said, because of conservative budgeting practices, Virginia Beach has historically used less fund balance than what it appropriates. Furthermore, the city's strong assigned fund balance will likely allow it to maintain very strong flexibility despite the drawdowns of unassigned fund balance. The city's formal reserve policy requires maintaining unassigned general fund balance between 8% and 12% of next year's revenue; it is currently complying with that policy.

Very strong liquidity

In our opinion, Virginia Beach's liquidity is very strong, with total government available cash at 50% of total governmental fund expenditures and 5.4x governmental debt service in 2019. In our view, the city has exceptional access to external liquidity if necessary.

Virginia Beach has exceptional access to external liquidity, in our opinion, reflected by its frequent issuance of GO bonds, appropriation-backed debt, and water-and-sewer-revenue bonds during the past 15 years. Management confirmed it does not currently have any contingent-liquidity risks from financial instruments with payment provisions that change upon the occurrence of certain events. In addition, the city does not hold investments that we consider aggressive nor is it party to a lawsuit that we believe would have a significant effect on liquidity. Due to historical and current trends, we expect liquidity will likely 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 9.3% of total governmental fund expenditures, and net direct debt is 71.2% of total governmental fund revenue. Overall net debt is low at 1.5% of market value and more than 75% of direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

In our opinion, debt should increase modestly due to the size and scope of Virginia Beach's currently planned projects. At June 30, 2020, the city will have $1.14 billion of debt outstanding. The six-year bond program has annual issuances scheduled. The electorate has already authorized this debt, and the project schedule is mostly set. However, we expect the city's debt score will likely remain strong.

Pension and other postemployment benefits

- We do not view pension and other postemployment benefits (OPEB) liabilities as an immediate credit pressure, because required contributions currently make up a relatively small portion of total governmental expenditures. If required contributions materially increase during the next few fiscal years, we believe the city's fiscal stability would not be greatly affected because of its sizable reserves.
- We note contributions approximated our static funding metrics, which we view as likely to maintain current funding levels without making progress toward full funding.
- The city made its full annual required pension contribution in 2019.

As of June 30, 2019, the latest measurement, city and school employees participated in:

- The Virginia Retirement System (VRS): 83% funded, with a proportionate net pension liability of $347.5 million for city employees, with a current discount rate of 7%;
- The Virginia Retirement System (VRS): 75% funded, with a proportionate net pension liability of $609 million for school board employees, with a current discount rate of 7%; and
- A single-employer, defined-benefit OPEB plan that provides medical coverage for retired city and school employees, which is funded on a pay-as-you-go basis; the combined unfunded liability totals $125.4 million.

Virginia Beach's combined required pension and actual OPEB contributions totaled 4.1% of total governmental fund expenditures in 2019. Of that amount, 3.3% represented required contributions to pension obligations, and 0.8%

represented OPEB payments. The city made its full annual required pension contribution in 2019. We note that with a change in the system's discount rate, we anticipate fund levels to decrease and the city's proportionate share of the liability will grow.

The city's OPEB trust liability was 43.4% funded and the school's OPEB trust was 31.9% funded for a combined 37.7% funding ratio at June 30, 2019. While we expect OPEB costs will likely grow over time, we expect future costs will likely be manageable due to currently low pay-as-you-go costs.

Very strong institutional framework

The institutional framework score for city is very strong.

Related Research

2019 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of May 27, 2020)		
Virginia Beach GO pub imp bnds		
Long Term Rating	AAA/Stable	Affirmed
Virginia Beach Dev Auth, Virginia		
Virginia Beach, Virginia		
Virginia Beach Dev Auth (Virginia Beach)		
Long Term Rating	AA+/Stable	Affirmed
Virginia Beach Dev Auth (Virginia Beach) pub fac rev bnds		
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Virginia Beach Dev Auth (Virginia Beach) pub fac rfdg bnds		
Long Term Rating	AA+/Stable	Affirmed
Virginia Beach Dev Auth (Virginia Beach) pub fac rfdg bnds (Virginia Beach) ser 2016A due 10/18/2036		
Long Term Rating	AA+/Stable	Affirmed
Virginia Beach Dev Auth (Virginia Beach) APPROP		
Long Term Rating	AA+/Stable	Affirmed
Virginia Beach Dev Auth (Virginia Beach) APPROP		
Long Term Rating	AA+/Stable	Affirmed
Virginia Beach Dev Auth (Virginia Beach) GO		
Long Term Rating	AA+/Stable	Affirmed

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