S&P Global Ratings

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Summary:

Virginia Beach, Virginia; Appropriations; General Obligation

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Credit Profile		
US$96.5 mil GO pub imp bnds ser 2019A due 07/15/2039		
Long Term Rating	AAA/Stable	New
US$55.2 mil GO pub imp rfdg bnds ser 2019B dtd 07/15/2019 due 07/15/2029		
Long Term Rating	AAA/Stable	New
Virginia Beach GO		
Long Term Rating	AAA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AAA' rating and stable outlook to Virginia Beach, Va.'s series 2019A general obligation (GO) public improvement bonds and series 2019B GO public improvement refunding bonds and affirmed its 'AAA' rating, with a stable outlook, on the city's existing GO debt.

S&P Global Ratings also affirmed its 'AA+' rating, with a stable outlook, on Virginia Beach Development Authority's appropriation-backed debt, supported by the city.

The city's full-faith-credit-and-resources pledge and agreement to levy ad valorem property taxes, without limitation as to rate or amount, secure the GO bonds. Annual payments made by Virginia Beach to the authority, pursuant to a support agreement and subject to appropriation, secure the authority's bonds; we rate these obligations one notch lower than the city's general creditworthiness to account for appropriation risk associated with annual payments.

We understand officials intend to use series 2019A and 2019B bond proceeds to finance various city governmental capital improvements and refund certain maturities for interest savings.

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 nation 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's GO pledge is the primary bond security; this severely limits the possibility of negative sovereign intervention of the city's debt payments or operation.

The institutional framework in the nation is predictable for local governments, allowing them significant autonomy and independent treasury management, coupled with no history of government intervention. Virginia Beach has considerable financial flexibility, demonstrated by its very high general fund balance as a percent of expenditures and very strong liquidity.

The rating affirmation reflects our opinion of Virginia Beach's very strong local property tax base and economy, supporting a history of strong budgetary performance and very strong budgetary flexibility. Management attributes these positive results to its very strong management team's prudent planning and budgeting while the local economy expands. Virginia Beach recognizes ongoing challenges related to rising sea levels, flooding, and other risks present in coastal communities and dedicates a growing portion of its additional capital plans to address these issues. In our opinion, the very strong management team and local economy stabilize Virginia Beach during our two-year outlook period and the near future.

The rating reflects our opinion of Virginia Beach's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA), coupled with 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 a slight operating surplus in the general fund and an operating surplus at the total governmental-fund level in fiscal 2018;
- Very strong budgetary flexibility, with available fund balance in fiscal 2018 at 18% of operating expenditures;
- Very strong liquidity, with total government available cash at 56.7% of total governmental-fund expenditures and 6x governmental debt service, and access to external liquidity we consider exceptional;
- Strong debt-and-contingent-liability position, with debt service carrying charges at 9.4% of expenditures and net direct debt that is 63.9% of total governmental-fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with roughly 80% of debt scheduled to be retired within 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 455,533, is in Virginia Beach City County in the Virginia Beach-Norfolk-Newport News MSA, which we consider 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 at 101.4% of the national level and per capita market value of $134,548. Overall, market value grew by 3% during the past year to $61.3 billion in fiscal 2018. County unemployment was 2.9% in 2018.

Virginia Beach is the commonwealth's largest city based on population and an integral part of Hampton Roads' regional economy. Tourism and several military facilities anchor the economy. With 38 miles of shoreline, Virginia Beach is a prime tourist destination, particularly for East Coast vacationers. 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 recent 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. Furthermore, economic diversification continues with various projects beyond the traditional tourism and military sectors.

Following several tax base decreases due to the recession, assessed value has increased during the past six fiscal years, which we do not expect to change during our outlook period. The city is experiencing expansion in housing and hotels, coupled with the expected expansion of Virginia Beach Sports Center in November 2020. Expansion continues in the city's Town Center area with future projects including a proposed office tower, Columbus Village I, and Columbus Village II. In our opinion, ongoing and future commercial or residential developments will likely add to the tax and economic bases significantly, contributing 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.

Since Virginia Beach is a coastal community, it has dealt with rising sea levels, coastal flooding, and other unique challenges noncoastal communities do not face. The city recently completed a comprehensive rising sea level and recurrent flooding study. Management also maintains master drainage stormwater models. The city, as part of its "sea level wise" response to the study, has identified seven goals; 29 objectives; and 175 action items, including zoning changes, beach nourishment, marsh restoration, drainage changes, and seawall creation. To fund these initiatives, the city has dedicated 2.5 cents of its real estate tax and an expected 54% increase in stormwater fees from 2018-2025.

Virginia Beach is also addressing cybersecurity concerns. Its cybersecurity framework reflects the National Institute of Standards & Technology's cybersecurity framework.

Through conservative management and well-adhered-to policies, finances remain, what we consider, strong. The formal reserve policy requires maintaining an unreserved, undesignated 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 it 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 program identifies all revenue sources. The 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.

Strong budgetary performance

Virginia Beach's budgetary performance is strong, in our opinion. The city had slight surplus operating results in the general fund at 1% of expenditures and surplus results across all governmental funds at 5.1% of expenditures in fiscal 2018.

Management attributes surplus operations in fiscal 2018 to various major revenue streams meeting, if not exceeding, the budget, including business licenses and hotel-and-meal taxes, coupled with expenditure savings. Financial performance benefits from, what we consider, strong reserves and experienced management. We consider the city's revenue stream relatively stable with property taxes accounting for roughly 54% of total general fund revenue. Other local taxes, which we consider more economically sensitive, include sales, utility, telecommunication, hotel room, and restaurant meals taxes. After property taxes, sales taxes generate 5.8% of general fund revenue followed by business licenses at 4.4%, utility taxes at 4.3%, and restaurant meal taxes at 3.7%. Apart from some modest fluctuations recently, these year-over-year taxes have increased.

Although city projections remain conservative, it historically budgets conservatively, assuming worst-case scenarios. The adjusted fiscal 2019 budget is $2 billion. As of April 2019, the city received 58.2% of revenue, slightly higher than year-to-date 2018. Based on current expectations, officials are projecting positive fiscal year-end 2019 results.

The fiscal 2020 budget totals $2.07 billion, most of which is for $1.1 billion for city operations and $938.1 million for the school district. Officials have budgeted for additional public-safety officers; transportation projects, including 17 roadway projects; continuing to phase in universal kindergarten; and money for infrastructure projects. To support increased infrastructure projects, the budget includes a six-year, 3.5-cent increase in stormwater equivalent residential units. To support additional infrastructure projects further, specifically stormwater, the budget includes a 1.5-cent increase of real estate taxes, providing new project capacity. Overall, the approved fiscal 2020 budget is $73.2 million, or 3.7%, more than the adjusted 2019 operating budget.

Regarding the May 31, 2019, tragic event that occurred at building 2 of the municipal center, the city was able to relocate employees and provide public services previously provided in building 2 within 10 business days. Plans to repurpose building 2 are underway. Despite this tragedy, we do not expect this to have an effect on the city's performance. With a history of strong performance and continuous tax base expansion, we do not expect budgetary performance will likely deteriorate during the next few fiscal years.

Very strong budgetary flexibility

Virginia Beach's budgetary flexibility is very strong, in our view, with available fund balance in fiscal 2018 at 18% of operating expenditures, or $199.5 million.

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 during fiscal years 2016-2018. Management does not currently plan to spend down reserves significantly. Unassigned fund balance was $114.3 million, or 9.9% of expenditures, in fiscal 2018. The city's formal reserve policy requires maintaining unreserved, undesignated 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 56.7% of total governmental-fund expenditures and 6x governmental debt service in fiscal 2018. In our view, the city has exceptional access to external liquidity if necessary.

In our opinion, Virginia Beach has exceptional access to external liquidity, 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 we consider aggressive nor is it party to a lawsuit 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 9.4% of total governmental-fund expenditures, and net direct debt is 63.9% of total governmental-fund revenue. Overall net debt is low at 1.4% of market value and roughly 80% 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, 2019, the city will have $1.1 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.

Virginia Beach's combined required pension and actual other-postemployment-benefits (OPEB) contribution totaled 4% of total governmental-fund expenditures in fiscal 2018: 3.2% represented required contributions to pension obligations and 0.8% represented OPEB payments. The city made its full annual required pension contribution in fiscal 2018.

Virginia Beach participates in Virginia Retirement System (VRS), a commonwealth-administered pension plan. The city makes the annual required contribution. The city's proportionate share of VRS' liability, measured at June 30, 2017, was $350.2 million; this resulted in a fiduciary net position, as a percent of total pension liability, of 82%. The school district's position was 72.9% with a net pension liability of $639 million at June 30, 2018.

Virginia Beach offers OPEB to its city and school employees. The city's OPEB trust liability was 43.6% funded and the school's OPEB trust was 32.4% funded for a combined 38.1% funding ratio at June 30, 2018. The city and school's net OPEB liability, at June 30, 2018, was $118 million. We note the net OPEB liability increased by roughly $26 million from previous measurements due to assumption changes. 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 Virginia municipalities is very strong.

Outlook

The stable outlook reflects S&P Global Ratings' opinion of Virginia Beach's consistent financial performance and very strong economy, supported by very strong management. We do not expect to change the rating during the next two years because we believe management will likely maintain its very strong budgetary flexibility and liquidity and remain an integral component of the Hampton Roads' MSA economy.

However, though unlikely, if management were to draw on reserves significantly due to fiscal pressure from increased capital projects, decreasing below formal policies, with no clear and timely plan to restore reserves, we could lower the rating.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- 2018 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of June 25, 2019)		
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		
Long Term Rating	AA+/Stable	Affirmed
Virginia Beach Dev Auth (Virginia Beach) pub fac rev bnds		
Long Term Rating	AA+/Stable	Affirmed
Virginia Beach Dev Auth (Virginia Beach) pub fac rev rfdg bnds		
Long Term Rating	AA+/Stable	Affirmed
Virginia Beach Dev Auth (Virginia Beach) pub fac rev rfdg bnds		
Long Term Rating	AA+/Stable	Affirmed
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
Virginia Beach Dev Auth (Virginia Beach) GO		
Long Term Rating	AA+/Stable	Affirmed

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 S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.