

RatingsDirect®

Summary:

Virginia Beach, Virginia; Appropriations; General Obligation

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Credit Profile

US\$92.195 mil GO pub imp bnds ser 2021A due 09/01/2041

Long Term Rating AAA/Stable New

Virginia Beach GO pub imp bnds

Long Term Rating AAA/Stable Affirmed

Virginia Beach GO

Long Term Rating AAA/Stable Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' rating and stable outlook to the City of Virginia Beach, Va.'s \$92.2 million series 2021A general obligation (GO) public improvement bonds.

At the same time, S&P Global Ratings affirmed its 'AAA' rating on the city's GO debt outstanding as well as its 'AA+' rating on Virginia Beach Development Authority's public facility revenue bonds, issued for Virginia Beach. The outlook is stable.

A pledge of the city's full faith credit 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 city and school capital projects throughout Virginia Beach.

The authority's public facility revenue bonds are secured by annual payments 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's 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.

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 has a predominately locally derived revenue source, with over 83% of general fund revenue derived from local revenue sources. In addition, 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

Virginia Beach's general creditworthiness is characterized by very strong financial metrics, that we believe have been well maintained through the COVID-19 pandemic, due in part to very strong management in addition to a resilient local economy. Throughout the pandemic, the city has maintained its very strong reserves while preserving financial flexibility through a low tax rate and continued pay-as-you-go capital spending. In addition, the city received \$228.9 million in state and federal pandemic-related funding that will help offset any financial impact. We anticipate the city will continue making budget adjustments as necessary to keep reserves at or above minimum policy levels.

The city, 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, Virginia Beach is experiencing light manufacturing growth and tech developments, as it is the landing spot for three underground internet cables, two from Europe and one from South America. The city 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;
- Strong budgetary performance, with an operating surplus in the general fund and at the total governmental fund level in fiscal 2020, in addition to a planned drawdown in general fund reserves in fiscal 2021;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2020 of 25% of operating expenditures;
- Very strong liquidity, with total government available cash at 62.9% of total governmental fund expenditures and 6.0x governmental debt service, and access to external liquidity we consider exceptional;
- Strong debt and contingent liability profile, with debt service carrying charges at 10.6% of expenditures and net direct debt that is 67.7% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of market value and rapid amortization, with 76.5% of debt scheduled to be retired in 10 years; and
- Very strong institutional framework score.

Environmental, social, and governance (ESG) factors

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.

Because Virginia Beach is a coastal community it has dealt with sea-level rise and coastal flooding, among other unique challenges, that non-coastal communities do not face. The city has completed a comprehensive sea-level-rise

and recurrent-flooding study. It also maintains master drainage stormwater models, which assess future system performance and vulnerabilities. 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 increase in stormwater fees. Furthermore, city council voted to adopt new public works design standards with higher standards to safeguard against sea level rise. The city has also been addressing concerns related to cyber security; it has a framework based on the National Institute of Standards and Technology and Cyber Security Framework.

Stable Outlook

Downside scenario

If management were to draw on reserves significantly, below formal policy levels, 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 452,407, is located 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. It has a projected per capita effective buying income of 102.9% of the national level and per capita market value of \$146,720. Overall, the city's market value grew by 3.8% in 2019 to \$66.4 billion in 2020. The city's unemployment rate was 6.2% in 2020.

Virginia Beach has a multifaceted local economy, and is the commonwealth's largest city based on population and an integral part of Hampton Roads' regional economy. 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. 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 third 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. 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 military sector, most notably the Cavalier Resort, a \$438 million investment that includes hotels, restaurants, and retail; and the Dome Site Redevelopment, a \$325 million investment in a mixed-use, multi-venue entertainment complex. Management also highlights the completion of the Virginia Beach Sports Center, a \$68 million investment in a sports venue geared toward attracting year-round sports tourism.

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 will remain stable. The formal reserve policy requires maintaining an unassigned general fund balance of 8%-12% of next year's revenue. The city measures its formal debt issuance policy in multiple ways. Debt affordability policies (net of self-supporting utility debt) include:

- 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.

The six-year rolling capital improvement plan (CIP) identifies all revenue sources. Virginia Beach'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.

Strong budgetary performance

Virginia Beach's budgetary performance is strong in our opinion. The city had operating surpluses of 6.7% of expenditures in the general fund and 11.0% across all governmental funds in fiscal 2020, while unaudited general fund results for fiscal 2021 show a planned use of reserves.

We have adjusted the city's 2020 results for transfers and capital funded with bond proceeds.

Virginia Beach's strong management team, with conservative budgeting practices paired with expenditure flexibility, has allowed the city to effectively manage the budgetary impact of the pandemic. At the start of the pandemic in the fourth quarter of fiscal 2020, the city implemented several changes to existing policies 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, Virginia Beach eliminated its meal tax of 5.5% for May and June of fiscal 2020. Despite these changes, general fund revenues remained resilient, increasing by 1.3% while expense savings were more substantial, with expenses declining by 3.7% compared with the previous year. As a result, the city ended fiscal 2020 with a surplus of \$75.2 million, or nearly 7% of expenditures.

According to fiscal 2021 year-end estimates, the city anticipates using about \$52 million of reserves for the year, primarily for planned one-time capital expenditures. General fund revenues again remained resilient for the year, increasing by 2.2% relative to the prior year according to projected year-end results. In addition, management indicates the city has received or will receive \$228.9 million in pandemic-related federal and state grants, consisting primarily of \$136.4 million in American Rescue Plan Act of 2021 funds and \$88.6 million in CARES Act funds. Although Virginia Beach anticipates the use of \$52 million of reserves for the year, we note year-end reserves remain

in line with policy levels.

The fiscal 2022 net operating budget, including schools, totals \$2.3 billion, and is up by about 10% relative to the prior year, or by about \$210.7 million. Virginia Beach remains conservative in its revenue and expense projections even though management anticipates a return to economic normalcy throughout the year. Specifically, management is projecting increases of 15% in sales taxes and business license revenues, a 21% increase in amusement taxes, and a 27% increase in hotel room taxes. Included in the budget is the use of \$30 million of the city's unassigned fund balance, which is in line with historical budgets and is less than the budgeted pay-as-you-go capital spending for the year (\$66.5 million). We believe Virginia Beach will continue to remain compliant with reserve policy levels.

Very strong budgetary flexibility

Virginia Beach's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2020 of 25% of operating expenditures, or \$276.5 million.

Our calculation of the available fund balance includes an assigned fund balance. Budgetary flexibility remains what we consider very strong: Reserves averaged more than 17% of expenditures from fiscal years 2017-2020. Although management plans to use \$52 million of the fund balance in fiscal 2021 and has budgeted the use of \$30 million in fiscal 2022, the city expects that the unassigned fund balance will remain at or above 10% of revenue. That said, because of conservative budgeting practices, Virginia Beach has historically used less of the 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 the unassigned fund balance. The city's formal reserve policy requires maintaining unassigned general fund balance of 8%-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 62.9% of total governmental fund expenditures and 6.0x governmental debt service in 2020. 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 on 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 10.6% of total governmental fund expenditures, and net direct debt is 76.5% of total governmental fund revenue. Overall net debt is low at 1.4% of market value, and approximately 66.6% of the 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, 2021, the city will have \$1.3 billion of debt outstanding. The six-year CIP totals \$1.9 billion and has annual

bond issuances programmed. The city expects to fund 57% of the CIP with additional debt. However, given the amortization of existing debt, we do not anticipate a material change to the city's debt profile.

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 Virginia Beach's fiscal stability would not be greatly affected because of the city's 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.

As of June 30, 2020, the latest measurement, the city participated in:

- The Virginia Retirement System (VRS): 80.6% funded, with a proportionate net pension liability of \$417.7 million for city employees, which increased from \$347.5 million in the prior year primarily due to a change in the current discount rate to 6.75% from 7.00%.
- A single-employer, defined-benefit OPEB plan that provides medical coverage for retired city employees, which is funded on a pay-as-you-go basis; the unfunded liability for the city totals \$38.6 million.

Virginia Beach's combined required pension and actual OPEB contributions totaled 3.8% of total governmental fund expenditures in 2020. Of that amount, 3.1% represented required contributions to pension obligations, and 0.7% represented OPEB payments. The city made its full required pension contribution in 2020.

The city's OPEB trust liability was 54% funded as of June 30, 2020. While we expect OPEB costs will likely grow over time, future costs will likely be manageable due to currently low pay-as-you-go costs.

Virginia Beach also participates in a cost-sharing plan for school board employees and an agent multiple-employer plan for school board political subdivision employees. The board pays all contributions as a discrete component unit of the city. Consistent with our analysis, which does not incorporate the school board's financial performance into the city's general financial performance, we elected not to consider the board's retirement liabilities or contributions as part of Virginia Beach's liabilities. We note that the school board's proportionate share of its VRS Teacher Employee Retirement Plan stands at \$657.8 million. The board's non-profession liability totals \$21.0 million. In addition, the school board has a net OPEB liability of \$49.0 million.

Very strong institutional framework

The institutional framework score for Virginia cities is very strong.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013

- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- 2020 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of July 22, 2021)

Virginia Beach Dev Auth, Virginia

Virginia Beach, Virginia

Virginia Beach Dev Auth (Virginia Beach) pub fac rev bnds

<i>Long Term Rating</i>	AA+/Stable	Affirmed
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Virginia Beach Dev Auth (Virginia Beach) pub fac rev bnds

<i>Long Term Rating</i>	AA+/Stable	Affirmed
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Virginia Beach Dev Auth (Virginia Beach) pub fac rev rfdg bnds

<i>Long Term Rating</i>	AA+/Stable	Affirmed
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Virginia Beach Dev Auth (Virginia Beach) pub fac rev rfdg bnds

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Virginia Beach Dev Auth (Virginia Beach) pub fac rfdg bnds

<i>Long Term Rating</i>	AA+/Stable	Affirmed
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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
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Virginia Beach Dev Auth (Virginia Beach) APPROP

<i>Long Term Rating</i>	AA+/Stable	Affirmed
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Virginia Beach Dev Auth (Virginia Beach) APPROP

<i>Long Term Rating</i>	AA+/Stable	Affirmed
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Virginia Beach Dev Auth (Virginia Beach) GO

<i>Long Term Rating</i>	AA+/Stable	Affirmed
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Virginia Beach Dev Auth (Virginia Beach) GO

<i>Long Term Rating</i>	AA+/Stable	Affirmed
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