

22 NOV 2022

Fitch Affirms Hampton Roads Sanitation Dist, VA Wastewater Revs at 'AA+'/'AA'; Outlook Positive

Fitch Ratings - New York - 22 Nov 2022: Fitch Ratings has affirmed the following ratings on the Hampton Roads Sanitation District, VA (HRSD or the district) revenue bonds:

--\$158.4 million senior wastewater revenue bonds at 'AA+';

--\$376.9 million subordinate wastewater revenue bonds at 'AA';

--\$50 million variable-rate subordinate wastewater revenue bonds, series 2016B at 'AA'/F1+.

In addition, Fitch has affirmed the district's Issuer Default Rating (IDR) at 'AA'.

The Rating Outlook is Positive.

ANALYTICAL CONCLUSION

The affirmation of the bond ratings at 'AA+'/'AA' and the IDR at 'AA' reflect the district's 'aa' financial profile in the context of its 'aa' revenue defensibility assessment and very low operating risk profile, also assessed at 'aa'. The Positive Outlook reflects Fitch's belief that despite an acceleration in capital projects (as decided by the district), leverage will ultimately stabilize below 6.0x times, although higher and later than previously expected.

Peak spend in the next few years with further implementation of a regulatory-driven capital improvement program (CIP) and associated borrowing may drive leverage briefly above 6.0x. Results, however, are not expected to be sustained, and should again drop below 6.0x with continuation of planned rate increases, low-cost debt and cash preservation. Fitch could revise the Outlook back to Stable should higher leverage occur or continue longer than anticipated.

Revenue defensibility is supported by the district's fundamental role as the regional wastewater treatment provider to a broad service area with generally favorable demographic trends. HRSD's operating risk profile is supported by a very low operating cost burden and adequate capital investment given regulatory mandates.

Fitch makes a one-notch distinction between the senior and subordinate-lien obligations given the difference in the financial profile between the two liens is considered meaningful and the priority of payments to senior-lien bondholders' is preserved in all circumstances. The senior lien was officially closed in 2019 and nearly all outstanding senior lien debt is expected to be retired by fiscal 2030. The 'F1+' short-term rating is driven by the 'AA' long-term rating.

CREDIT PROFILE

HRSD is the Hampton Roads, VA region's wastewater interception, treatment and disposal provider. The district serves a population of 1.9 million. Local collection utilities operate within the service area and provide

wastewater collection services that are then conveyed to the district. The district bills retail customers directly for its services and, in some areas, bills on behalf of the local collection utility as well.

The customer base is mostly residential, and there are no concentration concerns. The district's service area is economically sound and has ongoing development. The largest municipalities include the cities of Virginia Beach (water and sewer revenue bonds rated AAA/Stable), Norfolk (water revenue bonds rated AA+/Positive) and Chesapeake (water and sewer revenue bonds rated AAA/Stable). In 2022 the service area was expanded to include Accomack County.

Wastewater is treated via nine major treatment plants and several smaller treatment facilities dispersed throughout the service area. Total average daily flows approximate about 60% of the total 248.5 million gallons per day capacity, leaving plenty of treatment capacity for the long term.

The district operates under the direction of its governing body, the HRSD Commission, comprised of eight members appointed by the governor of the Commonwealth of Virginia (IDR AAA/Stable) for staggered terms of four years. Members of the commission may be reappointed without limitation and may be suspended or removed by the governor at will. Under the enabling act, the eight members of the commission must be residents of the cities and counties of the district.

KEY RATING DRIVERS

Revenue Defensibility 'aa'

Large Regional Service Provider

The district's revenue defensibility is characterized by its fundamental position as the sole provider of wastewater service to a broad healthy service area. Rates are deemed affordable to the vast majority of the population despite historical and planned ongoing annual rate adjustments.

Operating Risks 'aa'

Very Low Cost Burden, Substantial Capital Needs

A very low operating cost burden and low life cycle ratio support the operating risk assessment. Substantial capital needs and regulatory demands will serve to keep the life cycle metric level to declining in the near term.

Financial Profile 'aa'

Very Low Leverage Expected

Leverage is currently exceptionally low but will increase modestly over the forward look as the system enters into a peak of its ongoing capital spending program to meet long-term regulatory deadlines. The liquidity profile is sound, albeit neutral, to the assessment.

Asymmetric Additive Risk Considerations

No asymmetric additive risk considerations affected this rating determination.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Leverage over the forward look that is sustained below 6.0x, inclusive of the accelerated capital plan, in Fitch's base case and stress case.

Factors that could, individually or collectively, lead to a negative rating action/downgrade:

--Leverage over the forward look that is sustained above 8.0x.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

SECURITY

The senior bonds are payable from a first lien on the net revenues of the district's sewer system and other funds related to the operation of the district. The subordinate bonds are payable by a lien on the net revenues after payment of operating expenses and senior debt service. The senior lien is legally closed.

Revenue Defensibility

Revenue defensibility is very strong and assessed at 'aa' with all revenue derived from business lines exhibiting monopolistic characteristics in a service area with demographic trends deemed to be favorable. The district serves a large regional base generally characterized by midrange customer growth, income levels and unemployment. Based on the Virginia Beach-Norfolk-Newport News commercial business statistical area demographic information, area income levels are a favorable 105% of the national average while unemployment is about 85% of the national rate. Customer growth is modest, with a five-year average annual compound growth rate of 0.6% percent.

Rates are based on metered water consumption and have been consistently increased historically. After a pause in fiscal 2021 due to pandemic considerations, rates were increased 9% in fiscal 2022. Additional annual rate increases in the 7%-9% range per year are currently expected.

A customer bill based on Fitch's 6,000 gallons per month standard consumption rate costs around \$60 in fiscal 2022 for wastewater treatment and is considered affordable for over 85% of the service area's population, depending on the customer's locality. Customers pay additional costs according to a respective locality's sewage collection charges.

Operating Risks

The district's operating risk profile is assessed as very strong at 'aa', supported by a very low operating cost burden in conjunction with moderate investment needs that are supported by adequate capital investment. The operating cost burden is very low at \$4,860 per million gallons (mg) in fiscal 2022, which is higher than historical levels as treated flows declined. Operating costs are expected to increase based on the inflationary

environment. Despite stable-to-declining demand, the operating cost burden will likely remain below \$6,500 per mg and continue supporting the operating risk assessment for the foreseeable future.

Capital planning and management reflects a life cycle ratio of 41% for fiscal 2022. Given the requirements under a 2010 federal consent decree (CD), the five-year average of capital expenditures to depreciation has been a very strong 260%. With the near-term outlays fulfilling ongoing CD milestones, capital spending will remain elevated relative to annual depreciation. The fiscal 2023-2027 CIP approximates \$2.4 billion, with the system entering into a peak spending phase. The majority remains regulatory driven. About half of near-term CIP funding is expected to be derived from borrowed resources, including a Water Infrastructure Finance and Innovation Act (WIFIA) loan and state revolving fund loans. Significant grant funding is also anticipated which may offset some borrowing.

The district had sought to modify and re-sequence its long-term CD requirements with the implementation of the "Sustainable Water Initiative for Tomorrow" (SWIFT) program. With an estimated project cost of \$2 billion supported by WIFIA funding, SWIFT is a large-scale water recycling project that will provide long-term water quality improvements at up to six of the major treatment plants. SWIFT's treatment processes are expected to fulfill a portion of existing CD requirements, as well as preempt increasingly stringent future water quality regulations, reduce regional land subsidence and buffer the water table against saltwater intrusion. In July 2022 HRSD broke ground on the first large-scale SWIFT facility at the James River Treatment plant. Two more facilities will be constructed.

As anticipated, a fifth amendment to the CD was approved in February 2022 and served to reduce long term costs beyond 2030 by over \$1 billion. Updates require that HRSD implement \$200 million worth of sewer overflow control projects between 2020 and 2030 and then another \$200 million in projects between 2030 and 2040. HRSD has until 2032 to complete the SWIFT program. The amendment further provides that if HRSD does not fully implement the project or delays full implementation past 2032 then the Environmental Protection Agency can require HRSD to accelerate some or all of the second group (\$200 million) of projects.

Financial Profile

The district's financial profile is very strong, assessed at 'aa'. After annual declines for four fiscal years, leverage rose to 4.2x in fiscal 2021 as an additional borrowing phase began. In fiscal 2022 FADS growth, assisted by the rate increase, improved leverage to 3.6x. The liquidity profile is neutral to the assessment. In fiscal 2022, coverage of full obligations (COFO) registered a healthy 2.4x, consistent with the five-year average, supported by 331 current days cash.

Fitch Analytical Stress Test (FAST)

The FAST considers the potential trend of key ratios in a base case and a stress case. The base case reflects Fitch's expectation of both historical financial results and expected performance in a normal operating environment while the stress case is designed to impose capital costs 10% above expected base case levels and evaluate potential variability in projected key ratios. The base and stress cases were informed by the district's financial forecast including annual rate increases, capital spending assumed at an 83% execution rate, and additional debt financing of over \$950 million.

Given these assumptions leverage peaks in the base case at about 6.0x in fiscals 2024 and 2025, but declines thereafter to 5.0x in fiscal 2027. Peak leverage rises to about 6.6x in fiscal 2025 of the stress case, falling to 5.7x by fiscal 2027. Fitch expects that subsequent to the district's long-term capital peak in fiscal 2025, ongoing rate increases and healthy financial performance should result in a steady leverage decline below 6.0x, supportive

of a Positive Outlook. Additional anticipated grant funding, should it materialize, will further serve to strengthen results. The liquidity profile is expected to remain neutral to the assessment.

Sources of Information

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

Fitch Ratings Analysts

Allison Clark

Director

Primary Rating Analyst

+1 646 582 4562

Fitch Ratings, Inc. Hearst Tower 300 W. 57th Street New York, NY 10019

Gabriela Payne, CPA

Director

Secondary Rating Analyst

+1 512 215 3731

Audra Dickinson

Senior Director

Committee Chairperson

+1 512 813 5701

Media Contacts

Sandro Scenga



New York

+1 212 908 0278



sandro.scenga@thefitchgroup.com

Rating Actions



ENTITY/DEBT	RATING	RECOVERY	PRIOR
-------------	--------	----------	-------

ENTITY/DEBT	RATING		RECOVERY	PRIOR
Hampton Roads Sanitation District (VA)	LT IDR	AA 	Affirmed	AA 






- Hampton Roads Sanitation District (VA) /Sewer Revenues (2nd Lien)/1 LT

	LT	AA 	Affirmed	AA 
--	----	--	----------	--

- Hampton Roads Sanitation District (VA) /Sewer Revenues/1 LT

	LT	AA+ 	Affirmed	AA+ 
--	----	---	----------	---

RATINGS KEY OUTLOOK WATCH

POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

[Public Sector, Revenue-Supported Entities Rating Criteria \(pub.01 Sep 2021\) \(including rating assumption sensitivity\)](#)

[U.S. Water and Sewer Rating Criteria \(pub.18 Mar 2021\) \(including rating assumption sensitivity\)](#)

Additional Disclosures

Solicitation Status

Endorsement Status

Hampton Roads Sanitation District (VA) EU Endorsed, UK Endorsed

DISCLAIMER & DISCLOSURES

All Fitch Ratings (Fitch) credit ratings are subject to certain limitations and disclaimers. Please read these limitations and disclaimers by following this link: <https://www.fitchratings.com/understandingcreditratings>. In addition, the following <https://www.fitchratings.com/rating-definitions-document> details Fitch's rating definitions for each rating scale and rating categories, including definitions relating to default. ESMA and the FCA are required to publish historical default rates in a central repository in accordance with Articles 11(2) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

Published ratings, criteria, and methodologies are available from this site at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the Code of Conduct section of this site. Directors and shareholders' relevant interests are available at <https://www.fitchratings.com/site/regulatory>. Fitch may have provided another permissible or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with

respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided “as is” without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the “NRSRO”). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the “non-NRSROs”) and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

Copyright © 2022 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved.

Endorsement policy

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's [Regulatory Affairs](#) page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.