Tax Supported
New Issue

Newport Beach, California

Ratings

Certificates of Participation, Series 2010A (Tax Exempt; Civic Center Project/Central Library Refunding)	AA+
Certificates of Participation, Series 2010B (Federally Taxable Direct-Pay Build America Bonds; Civic Center Project)	AA+
Implied General Obligation Rating	AAA

Rating Outlook

Stable

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New Issue Details

Sale Information: $28,670,000 Certificates of Participation, Series 2010A (Tax Exempt; Civic Center Project/Central Library Refunding), and $94,130,000 Certificates of Participation, Series 2010B (Federally Taxable Direct-Pay Build America Bonds; Civic Center Project), to sell on or about Nov.18 via negotiation.
Security: A standard lease-leaseback arrangement between the city and the Newport Beach Public Facilities Financing Corporation.
Purpose: To fund a new civic center and refund existing certificates.
Final Maturity: July 1, 2040.

Related Research

Applicable Criteria
For information on Build America Bonds, visit www.fitchratings.com/BABs.

Applicable Criteria
- *Tax-Supported Rating Criteria, Aug. 16, 2010*
- *U.S. Local Government Tax-Supported Rating Criteria, Oct. 8, 2010*

Rating Rationale

- The ‘AA+’ certificates of participation (COP) rating reflects a solid legal structure with essential leased assets and the city of Newport Beach’s very strong financial operations, demonstrated by high fund balances, years of surplus operations, a productive relationship with labor, plans to mitigate likely increases to pension labor costs, and prudent management practices.
- Economic characteristics are very strong, reflective of the area’s low unemployment, very high wealth levels, stable housing market, and resilient tax base.
- The debt profile is strong overall, reflecting low debt levels, progress toward pre-funding the city’s other post-employment benefits (OPEB) liability, a pension rate stabilization fund, and manageable capital needs; however, debt amortization is slow due to a level debt service structure.

Key Rating Drivers

- The city’s financial performance has been very strong and is expected to remain so in spite of a large, planned general fund balance transfer to a new capital projects fund.
- Economic performance has been impressive, and Fitch Ratings believes it will likely remain so through the economic downturn.

Credit Summary

Newport Beach serves a population of about 87,000 along the Orange County coast. The economy benefits from the city’s maturity, base of very wealthy residents, and strong shopping, festival, and tourism draw. The city’s stable tax base is supported by home values that are among the highest in the U.S., despite recent price declines, and assessed valuation (AV) growth has remained positive through the recession, although recent growth has been subdued. Unemployment is low, and income levels are extremely high.

Considerations for Taxable/Build America Bonds Investors

This sector credit profile is provided as background for investors new to the municipal market.

Local Government Appropriation-Backed Bonds
The unlimited taxing power of most local government general obligation pledges is the broadest security a U.S. local government can provide to the repayment of its long-term borrowing and, therefore, is the best indicator of its overall credit quality. Some debt repayment requires annual legislative appropriation, and this lesser long-term commitment to repayment is reflected in a lower rating than that of the general obligation rating, usually by one to two notches.

The average local government general obligation rating is ‘AA’, with approximately 85% rated at or above ‘AA–’ and 1% rated ‘BBB+’ or below. The relatively high ratings reflect local governments’ inherent strengths: the authority to levy property taxes, nonpayment of which can result in property foreclosures; additional taxing power that can include sales, utility, and income taxes; and essentiality of and lack of competition for services provided by local governments. Those with low investment-grade or below-investment-grade ratings generally have a combination of a limited or highly volatile economic base, high levels of long-term liabilities, including debt and post-employment benefits, and/or unusually limited financial flexibility. For additional information on these ratings, see “U.S. Local Government Tax-Supported Rating Criteria,” dated Oct. 8, 2010, available on Fitch’s Web site at www.fitchratings.com.

Rating History — COPs

Rating	Action	Outlook/ Watch	Date
AA+	Assigned	Stable	10/19/10

Rating History — Implied GO

Rating	Action	Outlook/ Watch	Date
AAA	Assigned	Stable	10/19/10

The city's financial profile is strong. The last three audited fiscal years and estimated actual results for fiscal 2010 all produced surplus general fund operations, resulting in the maintenance of high general fund balance levels. Financial management practices are impressive, and management has taken steps to deal with both its OPEB liability and pension costs that are likely to increase.

Debt

Proceeds from this issuance will predominantly fund the construction of a new civic center, which will include a city hall building, a 450-space parking structure, a library expansion, and a park. A small portion of proceeds will refund outstanding COPs. The COPs are secured by a standard lease-leaseback arrangement between the city and the Newport Beach Public Financing Corporation for use of various essential assets, subject to abatement. Upon completion, the city may substitute the civic center for the current leased assets. The city covenants to budget and appropriate lease payments, and insurance provisions are standard, including 24-month rental interruption insurance. However, there is no debt service reserve fund.

Debt Statistics

($000)

This Issue	122,800
Outstanding Debt	6,806
Refunding Portion	(3,990)
Total Direct Debt	**125,616**
Overlapping Debt	586,966
Total Overall Debt	**712,582**
Debt Ratios	
Direct Debt per Capita ($)[a]	1,448
As % of Assessed Value[b]	0.3
Overall Debt per Capita ($)[a]	8,215
As % of Assessed Value[b]	1.8

[a]Population: 86,738 (2007 estimate).
[b]Assessed value: $38,707,165,000 (fiscal 2011). Note: Numbers may not add due to rounding.

The city's debt profile is strong. Although net debt per capita is high at about $8,200, net debt as a percentage of assessed value is a low 1.8%, reflective of the strength of the property tax base. Capital needs are limited, but amortization is slow, with just 11% and 25% of debt maturing within five and 10 years, respectively, due to a level debt service structure. The city's OPEB plan is partially pre-funded, and costs are manageable. Management is exploring ways to deal with likely rising pension costs, including two-tiered systems, and has already had some success in negotiating increased employee contributions. The city prudently established a pension rate stabilization fund with a balance of $5 million. Pension costs are estimated to rise by approximately $10 million–$12 million annually over the next five to seven years without further action by management.

Management sensibly developed a 30-year general lifecycle replacement plan for its capital facilities. Its financing sources include capital reserves, developer fees, and general fund contributions of up to 5% of general fund expenditures.

Finances

The city's financial position is notably strong. Financial operations have produced surpluses in each of the past four fiscal years, some of them sizable, resulting in large and growing fund balances. Fiscal 2010 operations are estimated to have produced a $2.5 million general fund surplus, raising the total and unreserved general fund balances to $82 million (56.2% of expenditures and transfers out) and $76.6 million (52.4%), respectively. The city could also transfer up to $38.5 million to its general fund from workers compensation and vehicle replacement funds, if necessary, raising the city's total unreserved financial cushion to yet higher levels.

General Fund Financial Summary

($000, Audited Fiscal Years Ended June 30)

	2007	2008	2009	2010[a]
Property Taxes	63,003	67,389	70,127	72,000
Sales Tax	21,088	21,855	17,926	16,742
Sales Tax in Lieu	7,348	8,018	7,503	4,540
Transient Occupancy Tax	12,059	12,752	11,171	11,401
Other Taxes	8,309	8,289	8,487	7,976
Intergovernmental	3,812	3,083	2,597	2,690
Licenses and Permits	3,109	4,994	4,396	2,607
Charges for Services	14,369	14,935	14,374	16,028
Fines and Forfeitures	3,706	3,958	3,711	3,840
Investment Income	3,176	3,655	1,697	1,415
Net Change in Value of Investments	(546)	508	1,097	—
Property Income	6,471	6,604	6,553	6,080
Donations	1,324	1,202	261	145
Other	1,967	1,459	235	1,608
Total Revenue	**149,195**	**158,702**	**150,134**	**147,072**
General Government	13,624	14,426	15,478	15,027
Public Safety	50,425	53,650	57,286	56,051
Public Works	24,403	25,454	26,221	25,553
Community Development	7,223	7,770	8,302	8,070
Community Services	11,749	12,639	13,282	13,091
Capital Outlay	10,369	10,456	5,910	6,811
Debt Service	2,000	1,643	1,571	—
Total Expenditures	**119,793**	**126,037**	**128,050**	**124,603**
Operating Income/(Deficit)	**29,402**	**32,664**	**22,084**	**22,469**
Transfers In	1,027	5,521	690	1,519
Transfers Out	(20,103)	(29,040)	(22,222)	(21,513)
Proceeds from Long-Term Debt	5,000	—	—	—
Net Income/(Deficit)	**15,326**	**9,146**	**552**	**2,476**
Total Fund Balance	69,913	79,059	79,611	82,087
As % of Expenditures and Transfers Out	50.0	51.0	53.0	56.2
Unreserved Fund Balance	62,426	72,252	73,704	76,593
As % of Expenditures and Transfers Out	44.6	46.6	49.0	52.4

[a]Fiscal 2010 results are estimated.

Financial operations have benefited so far from stable and growing property tax revenues (49% of fiscal 2010 estimated revenues). However, sales tax revenues (12%) have been hit significantly by the economic downturn, falling 18% in fiscal 2009, with an estimated 7% decline in fiscal 2010. Management has prudently implemented expenditure reductions to mitigate falling sales tax revenues. Fiscal 2011 budgeted reductions amount to $18 million, of which $8.6 million is in operational reductions. These include early retirement incentive plan savings, increased employee contributions to pension plans, contracting out jobs, and salary freezes. The city is budgeting for a modest operational deficit in fiscal 2011; however, the city historically has outperformed its budgets. A transfer out of $31.5 million for a new capital reserve fund in fiscal 2011 will lower the total general fund balance to still strong levels, or approximately 24.4% of expenditures. There are no plans to use the transferred cash, and it could be transferred back to the general fund, if necessary.

Financial management policies are impressive. They include a contingency reserve equal to 12% of the general fund operating budget, operational reserves, a stabilization reserve funded by operating surpluses, and a 15-step fiscal sustainability plan adopted by the City Council this year. Although the operational reserve is designed to be used in times of financial hardship, the council has decided not to use it in this economic downturn.

Economy

The city's economy is very strong. Compared with the prior year, the city's unemployment rose by a small 0.1% to 6.1% in August 2010 and is less than one-half the state and regional averages. The largest local employers include Hoag Memorial Hospital (4,001 employees) and Conexant (1,650), a semiconductor manufacturing firm. Other major local employers include Pacific Life, US Bank, and PIMCO. The city's income profile is extremely strong, with per capita income levels about three times higher than those of the region, state, and nation. Population growth has been very low for years and is expected to remain so given that most of the area is built-out. However, limited opportunities for new development exist in infill development and a small amount of vacant space that could be developed.

AV benefits from a very strong housing market. Home prices are among the highest in the country, although median home prices fell from about $1.8 million in 2007 to $1.3 million in 2009. Despite price declines, AV rose 1.8% in fiscal 2010 and 0.2% in fiscal 2011. The property tax base is somewhat concentrated in the top payer, The Irvine Company, which makes up 4.8% of AV and is a major regional real estate investment company with multiple holdings within the city. AV stability is supported by a mature housing stock, ongoing infill development, and enhancements to existing homes.