FITCH AFFIRMS NEWPORT BEACH, CA'S COPS AT 'AA+'; OUTLOOK STABLE

Fitch Ratings-New York-01 August 2014: Fitch Ratings has affirmed the following Newport Beach, California (the city) ratings:

--$122.2 million outstanding certificates of participation (COPs) at 'AA+';
--Implied unlimited tax general obligation at 'AAA'.

The Rating Outlook is Stable.

SECURITY

The certificates are secured by a standard lease-leaseback arrangement between the city and the Newport Beach Public Facilities Financing Corporation (the corporation). The city pays lease payments to the corporation for use and occupancy of various essential leased assets, subject to abatement. Insurance provisions are standard and the city covenants to budget and appropriate payments.

KEY RATING DRIVERS

ABOVE-AVERAGE ECONOMY: Economic characteristics have remained strong, demonstrated by low unemployment, very high wealth levels, stable housing market, and resilient overall tax base. Fitch believes modest in-fill development and the rebounding real estate market may drive tax base growth over the next several years.

STRONG FINANCIAL PROFILE: Prudent financial management has resulted in a history of positive operations, augmenting the city's very high reserves, despite large planned general fund investment in capital projects. Management has successfully implemented expenditure savings, including major labor concessions and the use of contracted services.

LOW DEBT, CARRYING COSTS: The city's total debt burden is low and likely to remain so given limited near-term capital needs. Amortization is average and the city has reduced retiree health care costs, though pension contributions are expected to rise. Carrying costs, including debt service and retiree benefit contributions, remain affordable.

SOUND LEASE STRUCTURE: The 'AA+' COP rating reflects a solid legal structure which includes essential leased assets, standard insurance provisions and a city covenant to budget and appropriate gross lease payments without consideration of the Build America Bonds subsidy, offset in part by the lack of a debt service reserve fund.

RATING SENSITIVITIES

The rating is sensitive to shifts in fundamental credit characteristics including the city's strong financial management practices. The Stable Outlook reflects Fitch's expectation that such shifts are unlikely.

CREDIT PROFILE

Newport Beach serves a 2013 population of about 87,000 along the Orange County coast.

DIVERSE AND AFFLUENT LOCAL ECONOMY

The economy benefits from the city's mature, wealthy tax base and strong employment among financial and insurance firms, as well as retail shopping and tourism activity. Home values are among the highest in the country and, according to Zillow, currently match their 2007 peak. Overall assessed valuation (AV) has been stable despite the economic downturn, with growth in the each of the last five years. City AV increased a strong 5.2% for fiscal 2014 reflecting continued development activity and residential value stabilization, though future growth is expected to taper off as AV returns to the historical trend.

Local unemployment remains exceptionally low, at 3.0%, less than half the state (7.1%) and national (6.1%) averages. Per capita income levels are nearly three times national, state and regional averages. The city's population showed strong growth over the last decade, moderating in recent years. Population is expected to remain steady as the area is built out, dampening prospects for new development and population growth.

SUPERIOR FINANCIAL MANAGEMENT

The city's robust resource base helps support its consistently strong financial position. Financial operations produced net surpluses (after transfers) in five of the last six fiscal years, bolstering the city's strong fund balances. The city achieved a surplus of $1.3 million (after transfers) in fiscal 2013, due to conservative budgeting practices and the successful negotiation of labor concessions. The surplus increased total general fund balance to $81.1 million, or a high 48% of general fund spending, of which $68.8 million (41% of spending) was unrestricted.

Financial operations continue to benefit from stable and growing property tax revenues (48% of fiscal 2013 revenues), and rebounding sales tax revenues (12%), which have performed better than budgeted, approximating pre-recessionary levels in fiscal 2013. Total revenues have grown for the last three consecutive years following their fiscal 2010 trough. Management prudently implemented expenditure reductions to mitigate recessionary declines, augmenting operating performance in the improved revenue environment.

Expenditure controls to date have been moderate, including early retirement incentive plans, increased employee contributions to pension plans, contracting services, and freezing vacant positions. Conservative general fund projections for fiscal 2014 indicate a small use of $2.5 million from fund balance driven by approximately $20 million in spending on capital investments. The adopted fiscal 2015 budget conservatively projects modest revenue growth and challenges management to meet overall expenditure growth of 6.7% over the adopted budget fiscal 2014 budget. The city's ability to manage costs will remain important to the maintenance of long-term structural balance. Management expects future savings through increased contracting out and employee attrition.

Financial management policies are robust and continue to improve to meet the city's financial needs. They include a contingency reserve equal to 25% of the general fund operating budget, up from 15% at the time of Fitch's last review. The city has also implemented a new debt policy, effective this year. The policy addresses specific purposes, forms, and levels of debt, as well as the procedure the city will take in the event of future borrowing.

MANAGEABLE DEBT AND CARRYING COSTS

Per capita debt is high at $9,437, though low at 1.9% of market value, reflecting the city's affluent tax base. The city's near-term debt plans are limited, with planned capital investment funded by general revenues and capital reserves.

The city's other post-employment benefit (OPEB) plan is partially pre-funded and contributions are affordable. The city participates in the California Public Employees Retirement System (CalPERS), with plans for both general and safety personnel. The total annual required contribution (ARC) for both plans was $18.1 million in fiscal 2013 and the funding levels of the general and safety plans are estimated to be 73% and 66%, respectively, based on the 7% investment rate of return used by Fitch. Total annual carrying costs, including debt service, pension ARC and OPEB contributions constitute a low 13.9% of governmental fund spending in fiscal 2013.

Contact:

Primary Analyst
George M. Stimola
Analyst
+1-212-908-0770
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Secondary Analyst
Andrew Ward
Director
+1-415-732-5617

Committee Chairperson
Arlene Bohner
Senior Director
+1-212-908-0554

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available at 'www.fitchratings.com'.

In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial Associates.

Applicable Criteria and Related Research:
--'Tax-Supported Rating Criteria' (Aug. 14, 2012);
--'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

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Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. Local Government Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314