Moody's Investors Service

New Issue: MOODY'S ASSIGNS Aaa ISSUER RATING TO CITY OF NEWPORT BEACH; Aa2 RATING ASSIGNED TO THE CITY'S COPS

Global Credit Research - 21 Oct 2010

APPROXIMATELY $122 MILLION IN DEBT AFFECTED INCLUDING CURRENT ISSUE

Newport Beach (City of) CA
Municipality
CA

Moody's Rating

ISSUE		RATING
2010A Civic Center Project/Central Library Refunding COPS		Aa2
Sale Amount	$25,200,000	
Expected Sale Date	11/16/10	
Rating Description	Certificates of Participation	
2010B Civic Center Project/Central Library Refunding COPS		Aa2
Sale Amount	$94,100,000	
Expected Sale Date	11/16/10	
Rating Description	Certificates of Participation	

Opinion

NEW YORK, Oct 21, 2010 -- Moody's Investors Service has assigned an Aaa Issuer Rating to the City of Newport Beach. We have also assigned an Aa2 rating to the city's 2010A and 2010B Certificates of Participation (COPs). The two notch rating distinction between the current COP rating and the city's Issuer Rating represents Moody's standard notching for essential purpose, fixed asset leases relative to a California issuer's general obligation or Issuer Rating. Broadly speaking the two notches reflect the risk of abatement (and the related lack of seismic insurance coverage) and the narrower, general fund security pledge for leases compared to the unlimited property tax pledge securing general obligation bonds.

RATINGS RATIONALE

The rating assignments are determined by the city's exceptionally strong socioeconomic profile, which includes very high wealth levels, an economy that has weathered the recession well compared to other cities, and sound prospects for continued economic stability. The city's healthy fiscal position features notably ample reserves and a standard debt profile. The lease provisions are mostly typical with the exception of not having a reserve for the COPs. However, this is only a minor weakness in light of the city's overall credit strengths and was also factored into the rating. The Issuer Rating signals our expectation that despite the pressured statewide economy, the city will continue to perform significantly better than other California and national cities with respect to its local economy and fiscal operations.

The COPs will be issued by the Newport Beach Public Facilities Financing Corporation, which will make debt service payments derived from lease payments received from the city. The city has covenanted to budget and appropriate lease payments for use and occupancy of the leased assets, which include several fire stations, a police station, and central library.

EXCEPTIONALLY STRONG COASTAL SOUTHERN CALIFORNIA ECONOMY

Newport Beach is a full service city of 87,000 people in Orange County located 45 miles south of the city of Los Angeles. The community is bounded to the west by coastline, which is a major draw for tourists and a significant contributor to the local economy. The city is approximately 90% built out and residential but has grown in recent years by annexing adjacent unincorporated areas.

A major strength of the city's credit profile is the substantial wealth of the community and local economy. City residents earn per capita incomes that are almost three times greater than the national median and are second only to the City of Beverly Hills among Moody's-rated Aaa California cities. The median home price in the city is $1.3 million, which is also among the highest in the nation. The Newport Beach economy has been impacted by the economic recession as indicated by an increase in unemployment. However, the level of joblessness is still just 6% and, though well above the ten-year average of 3.1%, it is still only half of the statewide mark. One factor helping to curb unemployment is the city's location, which provides residents with access to the diverse job centers of both greater Orange County and Los Angeles.

The city's local economy maintains a sound level of diversity among its taxpayers and employment base. The city's principal employers represent a wide range of industries including healthcare, professional services, technology and hospitality. The top ten taxpayers combine to contribute just 7.5% of the total $38.7 billion assessed valuation. This level of valuation results in an impressive assessed valuation per capita of $446,000. The assessed valuation continued to grow in both 2010 and 2011, albeit by very modest rates, at a time when many other tax bases around the state were diminished as a result of the recession.

The rise in unemployment and slowdown in assessed valuation clearly indicate that the city has not been immune to the effects of the recession. However, the rating incorporates our expectation that the city's economy and socioeconomic profile will continue to withstand the recession significantly more resiliently than other cities within the state and around the nation.

VERY HEALTHY FISCAL POSITION HIGHLIGHTED BY AMPLE RESERVES

The city has consistently maintained a very healthy fiscal position that has resulted in the accumulation of a considerable level of reserves and a strong cash position. The city's general fund balance has averaged 47.5% of total general fund revenues over the last six years including a very healthy 55.2% in 2010. These figures are consistent with the Aaa rating level within the state and well above the national median for the rating level. Including other unrestricted funds outside of the city's general fund, the total available reserves rise to 96% for fiscal 2010. The city's general fund cash position has also been consistently stout while averaging 46% since fiscal 2005. The city's fiscal 2010 general fund balance was preserved by mid-year budget cuts that reduced an $8 million budget gap. These reductions allowed the city to refrain from using reserves to address the budget and maintain structural balance.

For fiscal 2011, the city anticipates balanced operations that will enable the maintenance of a healthy reserve position. The city plans to transfer $31 million from the general fund to the facilities financing special revenue fund. Despite the transfer, the monies will remain available for use in the general fund on an unrestricted basis, which will keep the total available fund balance at an unusually high level. As it has for more than a decade, the city will also transfer approximately $20 million to its Tidelands fund in recognition of the costs associated with providing primarily public safety service to the beaches and marina. This subsidy has been level and consistent and is not expected to change in the foreseeable future.

The city's finances have remained robust through the economic downturn, in part, because the city has a below average reliance upon sales tax revenues, which have been particularly volatile during the recession. Sales tax revenues only comprise 14% of the city's total revenue base versus the 20% to 25% level more common in California cities. The city's sales tax base also benefitted from not having a single auto dealership close as opposed to other communities, which lost meaningful portions of sales tax revenues following a dealership loss. Though sales tax revenue did decline in both 2009 and 2010, the level of deterioration given the limited exposure to the revenue stream was not enough to significantly disrupt the city's fiscal operations. Here again the city benefits from the wealth of its citizenry who, despite the recession, retain well-above average purchasing power to help support sales tax revenue. So far for fiscal 2011, sales tax revenues are on pace to improve from the previous year with auto dealers, retail, and restaurants recognizing the biggest gains.

Property tax revenues are typically half of the city's revenues and have continued to grow slowly over the last two years reflecting the general weakness in the housing market. The city is a well-established community that did not undergo rapid growth resulting from high volumes of new housing starts as was the case in other portions of the state. As a result, the city is also not undergoing as severe a home price correction and property tax revenues have remained stable.

Moody's anticipates that the city will continue to effectively manage operations to retain its overall fiscal strength despite ongoing economic uncertainty that could pressure revenues and require swift expenditure adjustments.

SOUND DEBT POSITION WITH NO FIRM ADDITIONAL DEBT PLANS

The current issue will be the city's only general fund debt obligation and will result in manageable annual lease payments of approximately 5% of total general fund revenues. Following the sale, the city will have direct and overall debt levels 0.3% and 1.8% respectively, which is typical for a Moody's-rated city. The new money proceeds from the sale will be used to finance construction of the city's new civic center including city hall, civic center park, parking structure, and library expansion. The city will also refund its 1998 Library COPs and receive level annual debt service savings with no extension of the maturity schedule. The leased assets have a combined appraised value of $140 million as established by a third-party appraisal firm. Once construction is complete, the city expects to substitute the new civic center as the leased asset. The city will also budget debt service for the Build America Bonds portion of the debt on a gross basis inclusive of expected subsidies. The city has no additional borrowing plans.

MOSTLY STANDARD LEGAL STRUCTURE AND COVENANTS BUT NO RESERVE FUND FOR COPs

The legal provisions of the sale are largely standard with the exception of there being no reserve for the COPs. This weakness is sufficiently offset by the city's available reserves and move to transfer general fund resources to the facility financing fund to support the debt (though these funds are not solely restricted for the COPs). Other elements of the legal provisions are more typical and include two-years of rental interruption insurance, title, liability, property and casualty insurance. The lease purchase agreement also allows the city to substitute leased assets in the event that it loses use and occupancy of all or a portion of one of the current leased assets.

WHAT COULD CHANGE THE RATING -UP

N/A

WHAT COULD CHANGE THE RATING- DOWN

The rating could become pressured if the city's fiscal position materially deteriorates while the city's socioeconomic profile becomes significantly weaker.

KEY STATISTICS

Fiscal 2011 assessed valuation: $38.7 billion

Assessed valuation per capita: $446,000

Fiscal 2010 general fund balance (unaudited actual): 55.2%

Direct debt burden: 0.3%

Overall debt burden: 1.8%

The principal methodology used in rating Newport Beach Public Facilities Financing Corporation, CA was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations rating methodology published in October 2004. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found on Moody's website.

REGULATORY DISCLOSURES

Information sources used to prepare the credit rating are the following: parties involved in the ratings, parties not involved in the ratings, confidential and proprietary Moody's Investors Service's information, confidential and proprietary Moody's Analytics' information.

Moody's Investors Service considers the quality of information available on the credit satisfactory for the purposes of assigning a credit rating.

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