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Newport Beach, California; Appropriations; General Obligation

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Credit Profile		
US$94.13 mil certs of part (BABs) ser B due 07/01/2040		
Long Term Rating	AA+/Stable	New
US$28.67 mil certs of part ser A due 07/01/2040		
Long Term Rating	AA+/Stable	New
ICR		
Long Term Rating	AAA/Stable	New

Rationale

Standard & Poor's Ratings Services assigned its 'AAA' issuer credit rating (ICR) to the City of Newport Beach, Calif. In addition, Standard & Poor's assigned its 'AA+' long-term rating to the city's series 2010A certificates of participation (COPs) and 2010B COPs. We understand that the series 2010B will be issued as federally taxable direct-pay Build America Bonds (BABs). The outlook on all ratings is stable.

The ICR reflects our opinion of the city's:

- Diverse economy located in Orange County;
- Extremely strong wealth levels with a market value per capita of $446,254;
- Track record of very strong general fund balances; and
- Good financial management practices and policies.

The COP ratings reflect our view of the city's:

- General creditworthiness;
- Covenant to budget and appropriate lease payments; and
- Appropriation risk associated with appropriation-backed obligations.

The COPs represent an interest in the city's base rental payments, which the city covenants to budget and appropriate. Payments on the COPs come from base rental payments made by the city, as lessee, to the Newport Beach Public Facilities Financing Corp., as lessor, for the use of the city's community center, senior center, two libraries, four fire stations, police station, and corporation yard. The leased assets are consistent with our seismic risk assessment during the life of the bonds. Under the lease agreement, the city covenants to annually budget and appropriate lease payments for the use of the leased properties. Base rental payments are subject to abatement for damage or destruction, which we believe is partially mitigated by the city's covenant to maintain business interruption insurance sufficient to cover rent for 24 months.

We understand that the city intends to designate the series 2010B bonds as BABs and elect to receive a direct federal subsidy equal to 35% of interest on the BABs. We also understand that the city will appropriate for 100% of the interest on the BABs.

We understand that there will not be a debt service reserve requirement for these bonds.

Management reports that it will use COP proceeds to refund roughly $4 million of the city's 1998 central library COPs and to fund a new civic center complex.

The City of Newport Beach is located 45 miles southwest of Los Angeles and 15 miles south of Long Beach in Orange County (AA-/Stable). The city's population in 2010 was roughly 86,738 and has grown steadily at an annualized rate of roughly 2% since 2000. The largest employment sectors in the city include professional services, health care, lodging/tourism, and government. Some of the city's largest employers include Hoag Memorial Hospital (4,001 employees), Conexant systems (1,650), Pacific Life Insurance Co. (1,513), and the city (940). As of August 2010, Newport Beach's unemployment rate (not seasonally adjusted) stood at 6.1%, lower than the state's rate of 12.4%. Income levels are very strong in our opinion, with median household effective buying income (EBI) at 190% and per capita EBI at 282% of the national average. Market value per capita, an indicator of wealth, is in our view extremely strong at $446,254. Based on data provided by the city, median all owner-occupied housing value stood at slightly over $1 million in fiscal 2009.

In our opinion, the city's assessed valuation (AV) has shown good growth, increasing by a 5% average annual rate over the past five years to $38.7 billion in fiscal 2011. Management does not expect AV to decline, because of the city's maturity and high home values. The tax base is diverse, in our view, with the top 10 taxpayers making up 7.5% of fiscal 2011 AV and the largest taxpayer at approximately 4.8%.

The city's general fund revenue sources are property taxes (47% of fiscal 2009 revenues), sales taxes (17%), transient occupancy tax (7.5%), and other taxes and revenues. The city has maintained what we consider to be very strong fund balances, and has been building reserves since fiscal 2001, reaching a peak unreserved fund balance of roughly 62% of operating expenditures in 2010 (unaudited). In fiscal 2009, the city's total revenues declined by roughly 5.4%, its sales tax by nearly 18%, its transient and occupancy tax (TOT) tax by 12%, and investment earnings by nearly 54%, reflecting the weaker economy. Still, the city ended fiscal 2009 with an operating surplus of roughly $551,825 (net of transfers, including $20.3 million to its tidelands fund, which is ongoing) and an unreserved fund balance at what we consider a still very strong level of 57.8% of operating expenditures. Management's unaudited fiscal 2010 results reflect an operating surplus of about $2.5 million and what we consider a very strong unreserved fund balance of roughly 62% of operating expenditures. For fiscal 2010, management estimates that sales tax revenues declined by 6.6% and TOT taxes grew 2.1% because of the completion of a new hotel. To offset the fiscal 2010 revenue decline, management implemented $5 million in cost reductions, including an early retirement incentive program (generating savings of $3 million annually), midyear reductions, contracting-out of services, and requiring employees to pick up additional shares of their pension costs. The city's fiscal 2011 budget shows an operating deficit of roughly $1.5 million. This reflects the city's conservative budgeting of revenues and public safety expenses. Management expects at least a balanced budget for fiscal 2011 and that reserves will remain flat or grow slightly. Management has identified roughly $8.2 million in additional savings for fiscal 2011, and has already implemented roughly $6 million in cost reductions.

We consider the city's financial practices to be "good" under our Financial Management Assessment (FMA) methodology. An FMA of "good" indicates our view that practices exist in most areas, although not all may be formalized or regularly monitored by governance officials.

Including this debt issuance, overall debt levels are what we consider high on a per capita basis at $8,131 and low as a percentage of market value at 1.8%. Roughly 82% of the city's debt is overlapping debt from school districts, the county, and water districts. Carrying charges are low, representing roughly 2% of government expenditures. City management does not plan on issuing new debt in the near term.

Financial Management Assessment: 'Good'

We consider the city's financial practices to be "good" under our FMA methodology. An FMA of "good" indicates our view that practices exist in most areas, although not all may be formalized or regularly monitored by governance officials. Highlights include multiyear financial forecasting, monthly finance committee meetings with quarterly updates to the budget, the maintenance of a rolling 30-year master capital improvement plan with funding sources identified, and the maintenance of a formal investment management policy that is reviewed annually and that requires the submission of quarterly investment reports to city council. The city also has a formal reserve policy of maintaining a contingency reserve of at least 12% of annual general fund operating expenditures and an operating reserve funded by operating surpluses with no set target. The city does not have a comprehensive debt management policy, but has a policy that debt service and capital contributions cannot exceed 5% of budget each year.

Pension Obligation and Other Post Employment Benefits (OPEB)

The city has a policy of 100% funding its annual required contribution to its public employees retirement fund (PERS) and has a pension rate stabilization fund of roughly $5 million to meet its policy. As of June 2008, the city's PERS unfunded accrued actuarial liability (UAAL) was roughly $93 million. Historically, the city has made the entire pension contribution of city safety employees on their behalf. Recently, management mandated that all of its safety employees contribute 3.5% of their base pay to offset the city's 9% contribution. Miscellaneous employees have contributed 3.4% to their pension costs since 2008. Due to the 24% investment loss experienced in fiscal 2009, PERS will implement a three-year phase in which it will increase the city's pension costs. To offset the expected additional contributions, management aims to have the remainder of its employees pick up additional shares of their pension costs and introduce a second tier of contribution rates for new miscellaneous employees. Management projects PERS costs to rise by roughly $2.9 million in fiscal 2013 and $5.9 million in fiscal 2014 if no adjustments are made. The city's total OPEB UAAL, consistent with Government Accounting Standards Board Statement 45, was roughly $43.8 million based on a 2009 estimated valuation. Management prefunds a portion of the liability associated with a previous plan over a 20-year amortization. The remaining portion of the OPEB liability is paid on a pay-as-you-go basis. The implied subsidy UAAL was roughly 50% as of June 2009.

Outlook

The stable outlook reflects our view that the city will maintain very strong fund balances and consistent financial operations in the event of revenue challenges and rising pension costs. Our assessment of the city's very strong tax base, wealthy income levels, and good financial management practices further support our view of the stability of the credit.

Related Criteria And Research

- USPF Criteria: GO Debt, Oct. 12, 2006
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007
- USPF Criteria: Financial Management Assessment, June 27, 2006