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Summary:

# Newport News, Virginia; Appropriations; General Obligation

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## Summary:

# Newport News, Virginia; Appropriations; General Obligation

| Credit Profile | | |
|---|---|---|
| US$53.6 mil General Imp and rfdg GO bnds ser 2015 due 07/15/2035 | | |
| *Long Term Rating* | AA+/Stable | New |
| Newport News Sch Brd certs of part | | |
| *Long Term Rating* | AA/Stable | Affirmed |
| **Newport News GO** | | |
| *Long Term Rating* | AA+/Stable | Affirmed |
| **Newport News Econ Dev Auth, Virginia** | | |
| Newport News, Virginia | | |
| **Newport News Econ Dev Auth (Newport News)** | | |
| *Long Term Rating* | AA+/Stable | Affirmed |

## Rationale

Standard & Poor's Ratings Services assigned its 'AA+' long-term rating to Newport News, Va.'s series 2015 general improvement and refunding general obligation (GO) bonds. At the same time, Standard & Poor's affirmed its 'AA+' rating on the city's GO debt outstanding as well as its 'AA' rating on the city's appropriation-backed obligations. The outlook on all ratings is stable.

The series 2015 GO bonds are secured by the city's full faith, credit, and unlimited tax pledge for repayment. Officials plan to use proceeds to provide approximately $48.9 million in new money to fund its capital improvement plan, and about $4.7 million to refund bonds outstanding for purposes of interest rate savings over the life of the bonds.

The 'AA+' long-term GO rating reflects our view of the following credit strengths:

- Strong economy centered in Hampton Roads with a significant defense presence and with access to a broad and diverse metropolitan statistical area (MSA);
- Adequate budgetary performance, with an operating surplus in the general fund in fiscal 2015 as well as a history of budgeting for significant pay-go capital expenditures;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2015 of 28% of operating expenditures including funds set aside for future capital projects that are ultimately available for operating expenses following council approval;
- Very strong liquidity, with total government available cash at 31.0% of total governmental fund expenditures and 3.0x governmental debt service, and access to external liquidity we consider strong;
- Very strong management, with "strong" financial policies and practices under our financial management assessment (FMA) methodology;

- Strong debt and contingent liability position, with debt service carrying charges at 10.5% of expenditures and net direct debt that is 88.3% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of market value and rapid amortization, with nearly 70% of debt scheduled to be retired in 10 years; and
- Very strong institutional framework score.

## Strong economy

We consider Newport News' economy strong. The city, with an estimated population of 183,012, is located in the Virginia Beach-Norfolk-Newport News MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 90.4% of the national level and per capita market value of $89,170. Overall, the city's market value grew by 0.7% over the past year to $16.3 billion in 2015. The city's unemployment rate was 6.2% in 2014 and we understand that it stood at 4.8% as of September 2015.

Newport News participates in the Hampton Roads economy, which counts defense, shipbuilding, and manufacturing as leading economic drivers. The city is well-positioned geographically for its role in the local economy and economic expansion in the future. Newport News is in southeast Virginia, on the southwestern portion of the Virginia peninsula, bordered by the James River. It is easily accessible at the interstates 64 and 664 interchange and home to the Newport News-Williamsburg International Airport; it also serves as the eastern terminus of the CSX Rail system. In addition, significant transportation improvements, including the expansion of Interstate 64 should continue to provide significant benefits to the local economy.

Huntington Ingalls Industries Inc. (or Newport News Shipbuilding) and the Joint Base Langley-Eustis are major economic drivers in the region. Joint-Base Langley Eustis has invested more than $400 million in the past decade and expects to spend an additional $220 million on new projects through 2020. We understand that historically the impacts of federal sequestration and federal government cuts have had a relatively minor impact on the city's local economy and that the shipyards continue to work on recently awarded government contracts. Although we believe that economic concentration exists with respect to federal and manufacturing sector employment, in our view, the city did not experience employment loss to the same extent as other regions during the economic downturn. In addition, the local economy continues to diversify into other forms of manufacturing with Liebherr Construction Equipment Co. (mining) and Canon Virginia Inc. (robotic manufacturing and camera repair) as major local employers, as well as into health care through Riverside Health System.

## Adequate budgetary performance

Newport News' budgetary performance is adequate in our opinion. The city had surplus operating results in the general fund of 2.6% of expenditures after accounting for the transfer of excess surplus to the capital projects fund above the city's pay-as-you-go policy level, but a deficit result across all governmental funds of 3.6% in fiscal 2015 after accounting for capital expenditures funded with bond proceeds. General fund operating results of the city have been stable over the last three years and the city has a history of both budgeting for pay-as-you-go capital expenditures as well as using excess surplus reserves for capital expenditures.

In fiscal 2015, Newport News conservatively budgeted the use of $3.5 million of reserves for one-time purposes but in actuality ended the year increasing fund balance by about $3.2 million, despite transferring $16.1 million from the general fund to its capital projects fund to help fund capital projects on a pay-as-you-go basis. The city originally budgeted for the transfer of about $8.0 million from the general fund to the capital projects fund for pay—as-you-go

capital expenditures, but ended up transferring $16.1 million given its strong performance during the year. Newport News's tax rate of $1.22 per $100 of assessed value is unchanged.

The fiscal 2016 budget of $464.2 million represents a 3.7% increase from the adopted fiscal 2015 budget and is structurally balanced without an increase to the real property tax rate. Included in the budget is the planned use of $4.0 million of previous years' surpluses for one-time capital expenditures, which is consistent with the city's historical practice of using excess reserves for one-time purposes. We understand that management expects reserves to remain at least at current levels and that it will continue to work toward building available reserves such that unassigned reserves in addition to reserves held in the general capital improvement fund and debt service fund equal 20% of expenditures; these reserves equaled 18.6% of expenditures at the end of fiscal 2015.

### Very strong budgetary flexibility

Newport News' budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2015 of 28% of operating expenditures, or $119.3 million. The available fund balance includes $88.8 million (20.6% of expenditures) in the general fund and $30.5 million (7.1% of expenditures) that is outside the general fund, but legally available for operations.

In fiscal 2015, Newport News increased the total general fund balance by $3.2 million. The available fund balance of $88.8 million consists of unassigned reserves ($49.7 million) and assigned reserves ($39.1 million). The city has a history of transferring surpluses to its cash capital and special projects reserves for future project funding. As such, it maintains additional available reserves outside of the general fund in its capital improvement fund, which it has built up through general fund transfers and does not include bond proceeds. In total, the capital improvement fund had $30.5 million of reserves at the end of fiscal 2015 that could be used for operations following council approval.

We understand that there are no plans to significantly spend down reserves either in the general fund or in the capital improvement fund according to the 2016 budget.

### Very strong liquidity

In our opinion, Newport News' liquidity is very strong, with total government available cash at 31.0% of total governmental fund expenditures and 3.0x governmental debt service in 2015. In our view, the city has strong access to external liquidity if necessary.

We believe that the city's exposure to contingent liabilities is minimal, given that 100% of its direct debt is fixed rate, and the only exposure to variable-rate debt and swap terminations relates to $16.7 million of Economic Development Authority debt backed by the city's moral obligation pledge.

Newport News' investments are primarily in the local government investment pool, as well as bank deposits.

### Very strong management

We view the city's management as very strong, with "strong" financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Newport News has a long-standing record of being fiscally conservative with well-adhered-to management policies and practices. The city maintains a detailed five-year financial forecast, which it updates annually. In addition, it

maintains a five-year capital improvement plan (CIP) that is updated annually and identifies sources of funding. Budget-to-actual reports are reviewed monthly by management and quarterly reports are reviewed by council and published on the city's website. Newport News' reserve policy mandates that the unassigned fund balance equal at least 7.5% of general fund revenues from the previous year.

### Strong debt and contingent liability profile

In our view, Newport News' debt and contingent liability profile is strong. Total governmental fund debt service is 10.5% of total governmental fund expenditures, and net direct debt is 88.3% of total governmental fund revenue. Overall net debt is low at 2.9% of market value, and nearly 70% of the direct debt is scheduled to be repaid within 10 years, which in our view are positive credit factors.

The city's five-year CIP totals $337.1 million and is funded primarily through GO debt (43% of CIP) and grant funds (42%). Additional debt plans in the next two years include an estimated $56 million in GO debt to fund the city's long-term capital improvement plan.

Newport News' combined required pension and actual other postemployment benefits (OPEB) contributions totaled 9.6% of total governmental fund expenditures in 2015. Of that amount, 7.7% represented required contributions to pension obligations, and 1.8% represented OPEB payments. The city made 98% of its annual required pension contribution in 2015.

The city continues to contribute to the Newport News Employees' Retirement Fund (NNERF), as well as the Virginia Retirement System. Newport News also provides OPEB, for which it is accumulating funds in an irrevocable trust. The city's combined 2015 pension annual required contribution (ARC) and OPEB contribution represented 9.6% of expenditures in fiscal 2015. As of June 30, 2015, the NNERF plan was 67% funded, a funded ratio that has increased steadily in the past few years per management's plan outlined six years ago to achieve full funding of the pension ARC by fiscal 2017 and increase the funded ratio. Management indicates it will reach full funding of the ARC in fiscal 2016, a year earlier than originally outlined in the plan. Newport News has also closed the plan to new hires and also elicited employee contributions that helped reduce the annual pension expense.

### Very strong institutional framework

The institutional framework score for Virginia cities and towns with a population greater than 3,200 or with a school division is very strong.

## Outlook

The stable outlook reflects our view of Newport News' very strong fiscal management, which we believe has contributed to its strong reserve and liquidity position. We believe that the city's budgetary performance and debt profile will remain stable given the city's adherence to historical practices of adopting structurally balanced budgets as well as its plans for fully funding its pension ARC in fiscal 2016. For these reasons, we do not expect to change the rating within the two-year outlook horizon.

### Upward scenario

Precluding a higher rating at this point are what we consider below-average income levels, which in our view, can be partially attributed to the lingering economic concentration in the defense sector. If the city's economic indicators were to improve, however, including increased income and wealth levels, we could raise the rating.

### Downward scenario

While not foreseen, if Newport News' reserve and liquidity position deteriorated substantially, we could lower the rating.

## Related Criteria And Research

### Related Criteria

- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007
- USPF Criteria: Debt Statement Analysis, Aug. 22, 2006
- USPF Criteria: Financial Management Assessment, June 27, 2006

### Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Institutional Framework Overview: Virginia Local Governments

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