

Newport News, Virginia; General Obligation

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Credit Profile		
US\$61.57 mil GO bnds ser 2011 A B due 07/01/2031		
<i>Long Term Rating</i>	AA/Stable	New
Newport News		
<i>Long Term Rating</i>	AA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA' rating and stable outlook to Newport News, Va.'s series 2011A and 2011B general obligation (GO) general improvement refunding bonds and GO water refunding bonds, respectively, and affirmed its 'AA' rating, with a stable outlook, on the city's existing GO debt, issued by the city and Newport News Economic Development Authority.

The 'AA' rating reflects our view of the city's:

- Stable local economy with Newport News Shipyards serving as an anchor;
- Extremely strong property values; and
- Strong financial operations, supported by, what we consider, prudent financial management policies and practices.

We believe somewhat offsetting credit factors include the city's:

- Below-average income levels;
- Continued employment concentration in the shipbuilding sector; and
- Moderate overall debt position with a large, albeit what we consider manageable, capital improvement plan (CIP).

The city's GO pledge secures the series 2011 bonds. Officials plan to use series 2011A bond proceeds to finance various capital projects citywide, such as school improvements, public building repair and renovations, street and sewer rehabilitations, parks and recreation facilities, and emergency services upgrades. Officials plan to use the series 2011B bonds, totaling about \$22 million, to finance the refunding of certain series of bonds for present value debt service savings.

Newport News, with a population estimate of 186,414, participates in the Hampton Roads economy, which counts shipbuilding, manufacturing, and military as leading economic drivers. These industries have contributed to the area's economic stability during the downturn. Manufacturing accounts for 35% of total employment; while the economic downturn has hit this sector hard in other parts of the nation, long-term naval contracts have allowed the city to maintain below-average unemployment compared with the nation's rate. Unemployment averaged 7.8% in 2010, above the commonwealth's 6.9% rate but below the nation's 9.6% rate. Income levels are, in our opinion, a below-average 79% and 90% of commonwealth and national averages, respectively. In our view, however, the area's lower cost of living and federal government employment somewhat offset lower income levels.

The city's property tax base experienced growth through fiscal 2010. Market value is, in our opinion, an extremely

strong \$106,013 per capita. Property values, however, showed a slight contraction of 3.9% and 1.7% in fiscals 2011 and 2012, respectively. The city has maintained a constant property tax rate of \$1.10 per \$1,000 of assessed value (AV) since fiscal 2008. Real and personal property taxes are the city's primary general fund revenue source at 48% of total general fund revenue: Growth in personal property and machinery and tools taxes offset some of the reductions in the real property tax levy. Sales and other taxes (18%) and state aid (15%) round out the city's leading revenue sources.

In our opinion, Newport News' financial position has remained strong through business cycles. The city ended fiscals 2009 and 2010 with general fund surpluses of \$5.6 million and \$4.3 million, respectively, that increased total fund balance to \$103.7 million, or, what we consider, a very strong 29% of general fund expenditures. Of this amount, \$97.4 million (27% of expenditures) was unreserved and \$41.8 million (12%) was unreserved and undesignated. Management increased its formal reserve policy in fiscal 2011 to maintain a minimum of 7.5% as unreserved and undesignated fund balance. In addition, management's informal target is to maintain at least 10% in reserve, which it has adhered to since fiscal 2008.

The city's fiscal 2011 general fund budget of \$411 million is roughly 2% less than the fiscal 2010 general fund budget, and it incorporates a flat tax rate on a 3.9% reduction in property values. In the final month of the fiscal year, management expects a surplus of approximately \$2 million, which it plans to achieve through position vacancy savings since the city has already reduced its workforce by a reported 5% over the past several years. During the fiscal year, management created a special project reserve for working capital outside the general fund, consistent with its debt management policies; it funded the reserve with \$12 million and spent about \$4.2 million on land purchases and 911 equipment. The fiscal 2012 budget of \$415 million represents a 1% increase over the fiscal 2011 budget for increased pension, health care, and local contributions to the school district. It assumes a flat tax rate and reduced real property tax revenue, offset by increases in cigarette, personal property, and machinery and tools taxes.

In fiscal 2009, the city adopted a resolution that terminated the King William Reservoir project, for which it issued \$20 million in revenue bonds, due to the U.S. Army Corps of Engineers decision to suspend the federal permit. The council approved prepayment of the bonds; therefore, the public utility fund recognized a \$52.6 million extraordinary loss relative to total utility fund operating expenditures of \$56.9 million. Officials repaid the bonds through a combination of unused proceeds and utility fund reserves. We do not believe the extraordinary loss will have an effect on the city's general governmental obligations.

Standard & Poor's considers Newport News' financial management practices "strong" under its Financial Management Assessment methodology, indicating practices are strong, well embedded, and likely sustainable.

We consider the city's overall net debt burden a low-to-moderate 2.6% of market value, or \$2,766 per capita. Over the past several years, officials have taken several actions to reduce the city's debt burden to 3% of AV, including reducing the frequency of debt issues to every two years, putting a moratorium on moral obligation debt, and funding the five-year CIP with at least 20% pay-as-you-go capital. Debt service carrying charges are, in our view, a moderate 12% of expenditures; amortization is, what we consider, above average with officials planning to retire 73% of GO bonds over the next 10 years. The city's five-year CIP totals \$230.6 million; it is 65% GO bond funded with grants and working capital providing the remaining funding.

The city maintains a single-employer pension plan and contributes to the commonwealth system. The city's system was 57% funded as of June 30, 2010. In March 2010, officials adopted several pension reform measures, including

closing the system to new and rehires and adopting a plan to fund the annual required contribution in full within the next eight years. The city will contribute to the commonwealth system on behalf of any new hires. The city closed its other postemployment benefit (OPEB) trust fund to new hires in March 2010, and it contributes 3% of new hire salaries to future benefits. As of June 30, 2010, the city's total unfunded pension and OPEB liabilities were \$472 million and \$209 million, respectively. Fiscal 2010 contributions represented 6% of total governmental and enterprise expenditures while required contributions represented 8.9%.

Outlook

The stable outlook reflects Standard & Poor's opinion that Newport News will likely maintain, what Standard & Poor's considers, its strong financial position through balanced operations. The stability of the city's and region's employment anchors provide further rating stability. We believe the city will likely continue to maintain a moderate and manageable debt burden as it continues to fund its CIP. We do not expect to change the rating during the outlook's two-year parameter since we believe officials will likely maintain balanced operations through sound financial management practices.

Economy: Diversification Continues Around A Stable, Though Concentrated, Employment Anchor

Newport News is well positioned geographically for its role in the local economy and economic expansion in the future. The city 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 expanding Newport News-Williamsburg International Airport; it also serves as the eastern terminus of the CSX rail system.

Newport News Shipbuilding is the city's leading employer with more than 19,000 employees, equivalent to nearly 10% of the city's population. The industry serves as a stable economic anchor; while Newport News Shipbuilding's ownership structure has changed, its activity remains local: It is one of only two nuclear submarine builders in the nation. The shipyard announced a \$300 million expansion in 2010 that will employ an additional 1,000 workers to double its nuclear submarine production capacity pursuant to its naval contract. The shipyard also supports an apprentice school, which receives grant support from the commonwealth.

Defense and military are also major industries in the area. The city did not experience any dislocation under the 2005 Base Realignment & Closure program. Fort Eustis Military Reservation, in western Newport News, actually expanded; a number of troops relocated there after the closure of Fort Monroe in bordering Hampton.

Manufacturing remains a leading employment driver in the city, employing about 35% of the city's workforce. In addition to the shipyards, Canon, Liebherr Mining, and a number of federal government contractors are in the region. While the manufacturing base has shown, in our view, much more stability and resilience than other areas of the nation, unemployment has remained elevated during the economic downturn compared with the unemployment rates of the rest of the region and commonwealth. Unemployment, however, is still below the national rate.

The city's active industrial and economic development authorities continue to strengthen and diversify the local economy, promoting expansions by several local employers, including Canon, Newport News Shipbuilding, and AREVA. In addition, the authorities have expanded service at the Newport News-Williamsburg International Airport and have won the relocation of the Atlantic 10 Athletic Conference. The authorities have also focused

incentives on strengthening sections of the city, bringing in mixed-use developments that include housing and retail.

Related Criteria And Research

- USPF Criteria: GO Debt, Oct. 12, 2006
- USPF Criteria: Key General Obligation Ratio Credit Ranges – Analysis Vs. Reality, April 2, 2008
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007

Newport News, Virginia

Economic statistics	
Population	186,414
Median household EBI, % of U.S.	90.0
Per capita EBI, % of U.S.	89.0
Total market value per capita (\$)	96,820
Net direct debt (\$000s)	573,334
Net direct debt per capita (\$)	
Net direct debt, % of market value	3.2
Assessed value (\$000s)	18,048,533
Market value (\$000s)	18,048,533

EBI -- Effective buying income. Population and income -- Source: Claritas.

Financial statistics (fiscal year-end)	6/30/2010	6/30/2009	6/30/2008
General fund balance (\$000s)	103,673	99,358	93,714
General fund balance, % of general fund expenditures	28.8	27.0	26.0
Unreserved fund balance (\$000s)	97,366	94,164	87,704
Unreserved fund balance, % of general fund expenditures	27.0	25.6	24.3
Total general fund expenditures (\$000s)	360,583	367,808	360,276
Total general fund expenditures -- one-year change (%)	(2.0)	2.1	6.1
Total general fund revenues (\$000s)	407,618	409,151	401,770
Total general fund revenues -- one-year change (%)	(0.4)	1.8	3.6

Ratings Detail (As Of June 28, 2011)

Newport News GO bnds & GO rfdg bnds ser 2009		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Newport News Econ Dev Auth, Virginia		
Newport News, Virginia		
Newport News Econ Dev Auth (Newport News) econ dev rev		
<i>Long Term Rating</i>	AA/Stable	Affirmed

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