

RatingsDirect®

Summary:

Newport News, Virginia; General Obligation

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Credit Profile

US\$83.72 mil GO bnds (City Of Newport News, Va) ser 2018 dtd 12/18/2018 due 02/01/2040

Long Term Rating AA+/Stable New

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

S&P Global Ratings assigned its 'AA+' long-term rating to Newport News, Va.'s series 2019A general improvement general obligation (GO) bonds. At the same time, S&P Global Ratings affirmed its 'AA+' rating on the city's GO debt outstanding. The outlook on all ratings is stable.

The series 2019A GO bonds are secured by the city's full faith, credit, and unlimited tax pledge for repayment. Officials plan to use proceeds to fund various capital projects.

The city has a history of conservative and accurate revenue and expense forecasting and of maintaining strong reserve levels, supported by strong and established financial policies and practices in addition to stable economic metrics. Shipbuilding, military, and defense-related activities in the city have been stable and remain important economic drivers. As a result, we expect Newport News' economy to continue expanding, which should provide continued good revenue growth.

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

- Adequate economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with slight operating surpluses in the general fund and at the total governmental fund level in fiscal 2018 after accounting for transfers in and out of the general fund as well as capital expenses funded with bond proceeds;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 18% of operating expenditures;
- Very strong liquidity, with total government available cash at 31.2% of total governmental fund expenditures and 3.5x governmental debt service, and access to external liquidity we consider strong;

- Strong debt and contingent liability profile, with debt service carrying charges at 9.0% of expenditures and net direct debt that is 81.1% of total governmental fund revenue, as well as low overall net debt at less than 3.0% of market value and rapid amortization, with more than 70.0% of debt scheduled to be retired in 10 years; and
- Very strong institutional framework score.

Adequate economy

We consider Newport News' economy adequate. The city, with an estimated population of 179,388, 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 82.4% of the national level and per capita market value of \$96,846. Overall, the city's market value grew by 1.7% in 2017 to \$17.4 billion in 2018. The city's unemployment rate was 4.7% in 2017.

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 for 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 is 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 (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 has plans to spend as much as \$1 billion on additional facility and technology upgrades. Expansion projects by other major employers in the city, including Jefferson Lab and Tech Center, as well as a number of redevelopment projects, continue to generate strong economic momentum in the city. Although we believe that some economic concentration exists with respect to federal and manufacturing sector employment, we understand that historically the impacts of federal sequestration and federal government cuts have had a relatively minor impact on Newport News' local economy. 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.

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 that 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 maintains a formalized debt management policy that states the debt burden will remain below 3.0% relative to taxable value, that at least 20% of the CIP will be cash funded, the ratio of debt service to general fund and school revenues will not exceed 9.5%, and that amortization of debt will equal at least 60% within 10 years. The city's reserve policy mandates that the unassigned fund balance equal at least 7.5% of

general fund revenues from the previous year, although in practice, the city has historically maintained unassigned reserves above 11.0% of expenditures.

Strong budgetary performance

Newport News' budgetary performance is strong in our opinion. The city had slight operating surpluses of 0.6% of expenditures in the general fund and of 1.0% across all governmental funds in fiscal 2018.

Our analysis accounts for annual transfers in and out of the general fund including annual reimbursements from the utility fund into the general fund, as well as capital expenditures funded with bond proceeds.

In fiscal 2018, Newport News generated a \$2.8 million surplus despite a \$5.0 million cash contribution to capital expenditures due primarily to general fund expenditures coming in \$9.1 million, or 2.0%, under conservative budget estimates. Total available reserves increased to \$82.8 million.

The fiscal 2019 budget of \$486.9 million was structurally balanced without an increase to the real property tax rate and without the appropriation of fund balance as a revenue source. Included in the budget are salary increases averaging about 2% as well as increased school and health insurance contributions. We understand that management expects to end fiscal 2019 with close-to-breakeven operations and without a material change to reserves.

The real property tax rate has remained \$1.22 per \$100 of assessed value since 2014. Real property taxes account for 58% of general fund revenues, followed by other taxes, which account for nearly one-fourth of revenues. Property tax revenue has averaged 2.3% annual growth since 2008.

Very strong budgetary flexibility

Newport News' budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 18% of operating expenditures, or \$82.8 million. Over the past three years, the total available fund balance has remained at a consistent level overall, totaling 17% of expenditures in 2017 and 18% in 2016.

In fiscal 2018, Newport News increased available general fund reserves by \$2.8 million. The \$82.8 million available fund balance consists of unassigned reserves (\$56.9 million) and assigned reserves (\$25.9 million). The city has a history of using a significant portion of general fund surpluses to fund capital projects in accordance with its debt policy that at least 20% of the CIP will be cash funded.

We understand that for fiscal 2019, management has no plans to significantly spend down reserves in its general fund and that the city should end each year with a similar reserve position.

Very strong liquidity

In our opinion, Newport News' liquidity is very strong, with total government available cash at 31.2% of total governmental fund expenditures and 3.5x governmental debt service in 2018. In our view, the city has strong access to external liquidity if necessary.

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

In July 2015, Newport News' Economic Development Authority (EDA) executed a fixed rate private placement in the amount of \$12.7 million that is backed by the city's moral obligation. This debt cannot be accelerated. In addition,

Newport News has no privately placed bank debt. As such, in our opinion, we believe that the city's exposure to contingent liabilities is minimal, given 100% of the city's direct debt is fixed rate, and the only exposure to privately placed debt is limited to a moral obligation pledge of the EDA's debt.

Strong debt and contingent liability profile

In our view, Newport News' debt and contingent liability profile is strong. Total governmental fund debt service is 9.0% of total governmental fund expenditures, and net direct debt is 81.1% of total governmental fund revenue. Overall net debt is low at 2.7% of market value, and approximately 70.6% of the direct debt is scheduled to be repaid within 10 years, which are in our view positive credit factors.

The city's five-year CIP totals \$423.3 million and is funded primarily through a combination of GO debt, revenue bonds, user fees, grant funds, and pay-as-you-go contributions. We understand that management expects to fund nearly half of its CIP with grants, and the other half with a combination of additional GO bonds and pay-as-you-go cash funding. Based on the five-year CIP, we estimate the city could issue an additional \$70 million of GO debt in the next two years as part of its capital funding program.

Newport News' combined required pension and actual other postemployment benefits (OPEB) contributions totaled 8.9% of total governmental fund expenditures in 2018. Of that amount, 7.4% represented required contributions to pension obligations, and 1.5% represented OPEB payments. The city made its full annual required pension contribution in 2018.

The city continues to contribute to the Newport News Employees' Retirement Fund (NNERF), as well as the Virginia Retirement System (VRS). Newport News also provides OPEB, for which it is accumulating funds in an irrevocable trust.

Reforms were made in 2010 and 2013 to help reduce the city's pension liability, including closing NNERF to new hires in 2010 as well as eliciting employee contributions from city employees. Since 2016, the city has funded 100% of the annual required contribution or actuarially determined contribution.

As of June 30, 2018, the NNERF plan was 71.3% funded, a funded ratio that has increased steadily in the past few years as part of management's plan outlined a number of years ago. The city's net pension liability totaled \$386.5 million assuming a 7.35% discount rate as of June 30, 2018.

Employees hired after 2010 participate in VRS. In fiscal 2018, the city's pension expense to VRS totaled \$1.9 million. Currently, the city maintains a net pension asset of \$7.9 million assuming a 7.0% discount rate at the end of fiscal 2018.

In addition, the city provides OPEB to eligible employees. The net OPEB liability totals \$82.2 million as of June 30, 2018.

Very strong institutional framework

The institutional framework score for Virginia municipalities is very strong.

Outlook

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

Upward scenario

If the city's economic indicators were to improve to levels more commensurate with that of higher rated peers, including increased income and wealth levels, while the city continued to maintain what we consider to be strong financial performance and very strong reserve levels, we could raise the rating.

Downward scenario

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

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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