

# RatingsDirect®

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## Summary:

# Newport News, Virginia; Water/Sewer

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## Summary:

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### Credit Profile

US\$28.43 mil wtr rev bnds ser 2017 due 07/01/2037

*Long Term Rating* AAA/Stable New

Newport News wtr rev rfdg bnds ser 2016 due 07/15/2036

*Long Term Rating* AAA/Stable Affirmed

#### **Newport News wtr**

*Unenhanced Rating* AAA(SPUR)/Stable Affirmed

Many issues are enhanced by bond insurance.

## Rationale

S&P Global Ratings assigned its 'AAA' long-term rating to Newport News, Va.'s water revenue new issue bonds, series 2017 and has affirmed its 'AAA' long-term rating on the city's parity revenue bonds outstanding. The outlook is stable.

The rating reflects our opinion of the combination of a very strong enterprise risk profile and an extremely strong financial risk profile.

Factors that we believe support the extremely strong enterprise risk profile include:

- The robust service area economy that includes Newport News and four neighboring cities and counties in the Virginia tidewater region;
- A history and projection of annual rate adjustments with the city, adjusting rates to increase the fixed revenue component and decrease reliance on volumetric collections to better align with future revenue needs; and
- An operational management assessment we deem as strong with ample water supply.

Factors we believe support the extremely strong financial risk profile include:

- Stable financial performance that we believe will continue, because Newport News has ample supply and relationships with the neighboring municipalities that the department serves;
- Ample liquidity and reserve levels that we expect will remain high with the recent city council adoption of formal financial policies; and
- Strong financial management, which includes a detailed capital improvement program (CIP) that identifies funding sources, and well-delineated policies.

Bond proceeds will be used for capital needs in accordance with the city's long-term capital plan. The Newport News Waterworks Department has no direct purchase or other nontraditional financing obligations. We view the bond provisions as standard. A rate covenant and additional bonds test provide for a minimum 1.2x coverage of annual debt service on senior-lien debt, and a minimum 1.0x coverage including subordinate and other general obligation (GO)-related supported debt. We understand that the series 2017 bonds will not have a debt service reserve account. In our opinion, the utility's strong operations and cash on hand are sufficient to support debt service coverage (DSC)

without a debt service reserve fund.

The water system serves and provides treated water to five areas; it is not a water wholesaler, but instead sells water directly. The water system serves a population of approximately 407,000 people in southeast Virginia. The system's main service area economy is Newport News, which accounts for 45% of the population; the remaining four areas are the City of Hampton (33%), York County (17%), James City County (2%), and the City of Poquoson (3%). The Hampton Roads Sanitation District services all sewage treatment for this area. Newport News, with a population of about 180,000, participates in the Hampton Roads economy, which counts defense, shipbuilding, and manufacturing as leading economic drivers. Huntington Ingalls Industries Inc. (or Newport News Shipbuilding), and the Joint Base Langley-Eustis are major economic drivers in the region. Income levels for the service area are strong, in our view, with median household effective buying income (MHEBI) levels at 105% of the national level. The city's unemployment rate was 5% in February 2017.

We characterize the customer base as stable, primarily residential, and diverse. The total number of water customers increased an annual average of less than 1% in the past five years. Management expects growth to increase similarly in the future. We consider the customer base to be diverse, with the leading 10 customers accounting for less than 20% of total water sales. Anheuser Busch Inc.'s bottling facility continues to be the largest customer by both consumption and revenue, at about 5% for each. We believe that the system's operational capacity is adequate to meet long-term demand, and Newport News expects supply to be adequate through 2050. The two water treatment plants and the one reverse osmosis facility have a combined total capacity of 91 million gallons per day (mgd), compared with average daily demand of about 36 mgd in 2016.

In our opinion, the system has maintained strong financial performance in the past three years, which we expect to continue. The all-in DSC, including the subordinate and GO bonds, has increased to a strong 1.8x in fiscal 2016 from a still-good 1.2x in fiscal 2013. The GO bonds are not double-barrel and so are not technically funded by the water department, but within the overall city budget. The city's general fund does receive annual transfers from the water fund, and management expects these transfers (ranging from \$9.5 million to \$10 million) to continue, and so we have included these as expenses in our DSC calculations. Based on budgetary projections for fiscal 2017, we expect all-in DSC to remain around 2x. Regardless of security type, 78% of all the debt (not including this refunding) will be repaid within 10 years, a rate we consider rapid.

The current average residential monthly water bill for 6,000 gallons is \$40.56, which we consider affordable relative to the service area's wealth levels (at 1.1% of MHEBI). Management projects demand to increase about 1% a year and have included 2% annual rate increases in the forecast through 2021. We believe this to be reasonable considering recent past experience. The system has maintained a strong liquidity position in the past five years, which we expect to continue. It had \$48.3 million of unrestricted cash based on audited fiscal 2016 results, equivalent to 304 days' cash in hand. This represents a 9% increase from the prior year, at roughly \$44.2 million in 2015. Management has recently adopted a number of liquidity and reserve policies, as well as a pledge to develop a plan to replenish any tapped reserves within a three-year period.

We believe Newport News has a manageable CIP. The system plans to incur about \$82.2 million in capital expenses from 2018-2022. The city updates the water system's five-year capital plan annually. The CIP assumes about \$38.5

million and \$7.6 million in revenue bonds in fiscal years 2018 and 2019, respectively. The city has adopted a formal policy to fund at least 25% of the capital plan with cash, and in the current plan expects pay-as-you-go to account for 44% of the funding.

We rate the bonds higher than our issuer credit rating on the U.S. (AA+/Stable/A-1+) because the system has a predominantly locally derived revenue base from local service charges, derived through an autonomous rate-setting process. This, coupled with operating expense flexibility, limits exposure to federal revenues.

## **Outlook**

The stable outlook reflects our expectation of continued strong fiscal performance, with strong all-in DSC ratios and liquidity as Newport News continues to address the utility's capital needs.

### **Downside scenario**

Assuming the city will continue to adjust rates as needed to maintain coverage and liquidity levels, we do not expect any downward rating pressure over our two-year horizon. However, the planned additional revenue debt, should coverage materially erode, could create downward rating pressure.

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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com). All ratings affected by this rating action can be found on the S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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