

RatingsDirect®

Summary:

Newport News, Virginia; General Obligation

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US\$17.035 mil GO bnds ser 2021C due 02/01/2033

Long Term Rating

AA+/Stable

New

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating, and stable outlook, to the City of Newport News, Va.'s general obligation (GO) refunding bonds, series 2021C in the amount of \$17.0 million, which are being issued as a private placement.

The bonds are secured by the city's full faith, credit, and unlimited tax pledge for repayment. Officials plan to use series 2021C bond proceeds to refund a portion of the city's series 2012C GO bond proceeds outstanding.

Credit overview

Newport News has a history of conservative and accurate revenue and expense forecasting and of maintaining strong reserve levels, supported by established formalized 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. We understand these industries have remained resilient through the recent economic recession and the COVID-19 pandemic, and that the city continues to expand, resulting in good revenue growth. Furthermore, management has been proactive in cutting costs as a result of the pandemic to insure maintenance of its very strong financial position. As a result, we believe the city is very well-situated to preserve its strong finances and reserves.

Nevertheless, we believe that the next 12 months could present a challenging operating and funding environment for local governments. Headwinds include the possibility of reduced economically sensitive revenues and challenges associated with the pandemic as well as recovery from a national recession. We believe Newport News will continue to make budget adjustment as needed to maintain operational balance and keep its strong reserve position. For more information on S&P Global Economics' outlook, see our report "Economic Outlook U.S. Q2 2021: Let The Good Times Roll," published March 24, 2021, on RatingsDirect.)

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

- Strong 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;
- Adequate budgetary performance, with a slight operating surplus in the general fund and an operating surplus at the total governmental fund level in fiscal 2020, while reflecting some continued risk associated with the pandemic on near-term economic activity and financial operations;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2020 of 20% of operating expenditures;

- Very strong liquidity, with total government available cash at 44.9% of total governmental fund expenditures and 4.7x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability profile, with debt service carrying charges at 9.5% of expenditures and net direct debt that is 79.4% 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 two-thirds of debt scheduled to be retired in 10 years; and
- Very strong institutional framework score.

Environmental, social, and governance (ESG) factors

We consider Newport News' social risks, including the health and safety risks arising from the COVID-19 pandemic that could temporarily impact the city's economy and financial profile, to be in line with those of the sector. In addition, we evaluated the city's governance factors relative to Newport News' economy, financial measures, management, and debt and long-term liability profile, and view these factors as being consistent with those of the sector.

We believe the city's environmental risks are above average relative to those of peers given the city's location proximate to the coast, which in our view makes Newport News more susceptible to natural weather-related disasters and various climate risks, including sea level rise. However, city management indicates that sea level rise is not expected to have a significant impact on Newport News given that it sits on a ridge on the Peninsula, with elevations of at least 10-20 feet along much of the 3-mile shore line. Furthermore, according to management, the low-lying portions of the city generally have low-to-mid densities. We understand the city has incorporated these risks into its zoning regulations as well as its capital program.

Stable Outlook

Downward scenario

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

Upward scenario

If the city's economic metrics, including in particular income and wealth indicators, were to improve to levels more commensurate with those of higher-rated peers, while Newport News continued to maintain what we consider strong financial performance and very strong reserve levels, we could raise the rating, assuming environmental risks continue to be effectively mitigated by city management through planning and policies.

Credit Opinion

Strong economy

We consider Newport News' economy strong. The city, with an estimated population of 179,940, is 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 81.2% of the national level and per capita market value of \$103,994. Overall, the city's market value rose by 3.6% in 2019 to \$18.7 billion in 2020. The city unemployment rate was 3.5% in 2019.

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 via multiple interchanges off interstates 64 and 664 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 Joint Base Langley-Eustis remain 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 construction) and Canon Virginia Inc. (robotic manufacturing and camera repair) as major local employers, as well as into health care through Riverside Health System.

City unemployment has historically been either in line with or below the state and national averages, reflecting strong economic characteristics. Following the onset of the pandemic, the unemployment rate increased to 14.0% in April 2020. However, since then, the rate has steadily trended lower and stood at just 6.3% as of November 2020, which was below state and national levels.

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.

Adequate budgetary performance

Newport News' budgetary performance is adequate in our opinion. The city had slight surplus operating results in the general fund of 0.7% of expenditures, and surplus results across all governmental funds of 3.2% in fiscal 2020 after

accounting for data adjustments. General fund operating results of the city have been stable over the last three years, with a result of 2.4% in 2019 and a result of 0.6% in 2018.

Our assessment accounts for risks to budget performance related to the pandemic in fiscal years 2021 and 2022 even though year-to-date impacts have been modest and well managed by city officials in our opinion. In addition, 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 2020, Newport News generated a \$3.2 million surplus due to conservative budgeting, strong revenue growth, and a limited impact on both revenues and expenses from the pandemic. Specifically, general fund revenues came in \$3.9 million above budget, while general fund expenses came in \$1.1 million below budget also due in part to management's proactive cost-containment measures implemented as soon as the pandemic began, including a hiring freeze, and reduced travel and discretionary spending. As a result, the city made a year-end cash capital contribution of \$9.0 million and an additional contribution to debt service of \$1.9 million while increasing available reserves.

The fiscal 2021 budget of \$515.1 million, a 3.5% increase relative to the previous year's revised budget, was structurally balanced without an increase to the real property tax rate and without the appropriation of the fund balance as a revenue source. Included in the budget is a projected 3.9% increase in assessed value (AV), which is the driver behind a \$12.7 million increase to general property taxes. Management indicates the city continues to maintain a hiring freeze on all new positions until the economic outlook becomes more favorable. In addition, the city has received \$31.2 million in coronavirus relief funds (federal Coronavirus Aid Relief and Economic Security Act funding), which has offset any pandemic-related expenses. The budget includes salary increases averaging about 2.5% as well as increased school and health insurance contributions and full funding of retirement costs. We understand that management expects to end fiscal 2021 without a material change to reserves.

The real property tax rate has remained \$1.22 per \$100 of AV since 2014. Real property taxes account for nearly 60% of general fund revenues, followed by other taxes, which account for nearly one-fourth of revenues. Property tax revenue has averaged 3.2% annual growth since 2013.

Very strong budgetary flexibility

Newport News' budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2020 of 20% of operating expenditures, or \$97.3 million. The total available fund balance has remained at a consistent level overall, totaling more than 18.0% in each of the past three years.

In fiscal 2020, Newport News increased available general fund reserves by \$3.2 million. The \$97.3 million available fund balance consists of unassigned reserves (\$70.6 million) and assigned reserves (\$26.7 million). In addition, the city maintains an additional \$3.3 million of unrestricted reserves in the debt service fund balance providing additional flexibility. 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 2021, 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 44.9% of total governmental fund expenditures and 4.7x governmental debt service in 2020. In our view, the city has strong access to external liquidity if necessary.

The city's 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. We believe the city's exposure to contingent liabilities is minimal, given that 100% of Newport News' direct debt is fixed rate, and that in addition to this privately placed GO issuance, 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 9.5% of total governmental fund expenditures, and net direct debt is 79.4% of total governmental fund revenue. Overall net debt is low at 2.5% of market value, and approximately 66.9% 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 \$513.9 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.

Pension and other postemployment benefits

We do not view the city's pension and other postemployment benefits (OPEB) liabilities as an immediate credit pressure. Required contributions currently make up a moderate portion of total governmental expenditures. If required contributions materially increase in the next few fiscal years, which we do not expect, we don't believe fiscal stability would be greatly affected, in part due to Newport News' sizable reserves.

As of June 30, 2020, the city participates in:

- The Newport News Employees' Retirement Fund (NNERF): 70.3% funded, with a proportionate net pension liability of \$404.2 million, using a discount rate of 7.35%;
- The Virginia Retirement System: 117.7% funded, with a proportionate net pension asset of \$7.6 million, using a discount rate of 6.75%;
- A Line of Duty single-employer plan that provides benefits to eligible family members of eligible employees and volunteers killed in the line of duty: 26.4% funded, with a net OPEB liability of \$7.3 million, using a discount rate of 3.5%; and
- The Newport News OPEB plan: A single-employer, defined-benefit plan administered by the city that provides health benefits for retired employees and spouses; as of July 1, 2020, it is 29.1% funded, with a net OPEB liability of about \$84.8 million, using a discount rate of 7.35%.

Pension contributions are actuarially determined, and the city has historically funded its annual required costs in full. Newport News' combined required pension and actual OPEB contributions totaled 8.9% of total governmental fund expenditures in 2020. Of that amount, 7.5% represented required contributions to pension obligations, and 1.4% represented OPEB payments. The city made its full annual required pension contribution in 2020.

Actuarial assumptions for Newport News include discount rates of 7.35%, which we view as a bit aggressive, representing market risk and resulting in contribution volatility if the plan fails to meet assumed investment targets. However, contributions did exceed our static funding metric and we do not expect plan contributions to materially change over the next couple of years.

Reforms were made to the city's pension plan in 2010 and 2013 to help reduce Newport News' 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 actuarially determined contribution.

Very strong institutional framework

The institutional framework score for Virginia municipalities is very strong.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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