FITCH AFFIRMS NEWPORT BEACH, CA'S COPS AT 'AA+'; OUTLOOK STABLE

Fitch Ratings-New York-05 April 2017: Fitch Ratings has affirmed the following Newport Beach, CA (the city) ratings:

--$113.7 million outstanding certificates of participation (COPs) at 'AA+';
--Issuer Default Rating (IDR) at 'AAA'.

The Rating Outlook is Stable.

SECURITY
The certificates are secured by a standard lease-leaseback arrangement between the city and the Newport Beach Facilities Financing Corporation (the corporation). The city pays lease payments to the corporation for use and occupancy of various essential leased assets, subject to abatement. Insurance provisions are standard and the city covenants to budget and appropriate payments.

KEY RATING DRIVERS

The city's 'AAA' IDR reflects its notable financial flexibility and low liability levels. Consistent tax base performance enhances the city's strong revenue growth prospects, while moderate carrying costs underlie a well-controlled expenditure framework. Fitch expects that these factors, coupled with conservative financial management, would enable the city to maintain financial stability and solid reserves in a potential economic downturn. Ratings on the city's COPs are one notch lower at 'AA+', reflecting the slightly higher degree of optionality associated with lease payments subject to appropriation.

Economic Resource Base
Newport Beach, located in the coastal center of Orange County (IDR 'AA+'/Stable Outlook) benefits from its proximity to the substantial southern California economy. Major business sectors include tourism, health care, bio-technology, and computer software and hardware. The estimated 2015 population of 87,127 generally increases to well over 100,000 during the summer months.

Revenue Framework: 'aa' factor assessment
The city's participation in the regional economy and high affluence support a stable and diverse revenue framework highlighted by strong growth characteristics. The city's legal ability to raise revenues is constrained by state propositions that require voter approval for tax increases.

Expenditure Framework: 'aa' factor assessment
Fitch expects the natural pace of spending growth to generally track revenues over time. The city retains adequate expenditure flexibility given manageable carrying costs coupled with some degree of control over the workforce.

Long-Term Liability Burden: 'aaa' factor assessment
The extensive use of pay-as-you-go capital financing and planned pension overfunding to eliminate the outstanding liability support the city's low debt burden.

Operating Performance: 'aaa' factor assessment
The city reliably maintains reserves that are more than consistent with an 'aaa' assessment under Fitch's Analytical Sensitivity Tool (FAST) scenario analysis, which generates a low potential

decline of the city's revenues in a standard economic downturn based on historical results. Fitch believes the city maintains ample fiscal tools to address a future stress.

RATING SENSITIVITIES

Well-managed long-term liabilities: Anticipated overfunding of required pension payments to address the city's unfunded liability, limited near-term debt plans, and comprehensive multi-year planning support Fitch's expectations for a stable long-term liability burden. While not anticipated, deterioration in long-term liability metrics could pressure the rating.

CREDIT PROFILE

The local economy benefits from the city's mature, wealthy tax base and strong employment among regional financial and insurance firms, as well as retail shopping and tourism activity. The University of California, Irvine, is located adjacent to the city and has provided a catalyst for recent growth in the professional, technical, and scientific services.

Home values are among the highest in the country. Infill development and property appreciation contributed to positive assessed valuation (AV) performance over the past two decades, and spurred recent AV growth. Fitch anticipates continued positive taxable assessed value (TAV) trends in the intermediate term.

City unemployment is exceptionally low. Income metrics are more than double national and state averages. Population growth has moderated after a period of strong expansion, reflecting the built-out nature of the city.

Revenue Framework

The city benefits from diverse revenue sources, whereby stable property tax revenues can offset volatility in more economically sensitive revenue streams. In fiscal 2016, property taxes represented nearly half of total general fund revenues. Sales taxes, equal to slightly below one-fifth of revenues, capture retail activity of the city's wealthy residents and tourists, while transient occupancy taxes benefit from the city's success as a tourist destination.

The city's mature tax base, stable demographics, high personal incomes, and focus on economic development have contributed to strong historical general fund growth, above the levels of national GDP and inflation. Fitch expects the strong underlying fundamentals and on-going development will result in future revenue trends in line with past performance.

State law requires voter approval for tax increases, limiting the city's ability to control its revenues. In particular, property tax growth is constrained by an annual limit on TAV increases absent a change in ownership. Fees, charges for services, and fines can be raised only to recover the costs of providing related services. However, the city has demonstrated that it could generate significant annual general fund revenues by increasing its fee, charges for service, and fine amounts. Consequently, the city's revenue raising ability is judged to be satisfactory.

Expenditure Framework

The city provides a full range of municipal services with public safety accounting for just over half of the general fund budget. Public works accounts for about one-fifth of spending.

As with most local governments, spending growth will likely be near to slightly ahead of revenue trends in the absence of policy action as a result of moderate increases in the cost of services and population increases.

The city has adequate flexibility to adjust major expenditure items. Carrying costs associated with general government debt service, actuarially determined pension payments, and other post-emplyment benefit (OPEB) payments accounted for about 21% of the city's fiscal 2016 governmental spending. Pension payments equal a majority of the carrying costs.

The city benefits from a somewhat flexible labor environment with tight control over position growth. There is no prohibition against lay-offs and arbitration is non-binding.

Long-Term Liability Burden
Long-term liabilities place a low burden on the city, representing less than 10% of the resident personal income base. Overlapping debt constitutes the majority of this burden. The city engages in comprehensive long-term facilities and capital planning; it has limited debt issuance programmed during the next couple of years. Direct debt amortization is slow, with less than 30% of principal retiring within 10 years.

Qualified city employees are eligible to participate in the city's safety and miscellaneous employee pension plans. The California Public Employees Retirement System (CalPERS) administers these separate agent multiple-employer plans. State statute and local government resolutions establish the benefit provisions.

The unfunded pension liability constitutes just under one-third of the long-term liability. Recent city actions to mitigate the effect of escalating pension costs and eliminate the unfunded pension liability within 20 years include reducing benefit formulas for new hires and directing around half of a budget surplus towards reducing long-term liabilities, including pension obligations. In fiscal 2018, the city is considering increasing its annual pension payment by roughly $10 million above the $30 million or so actuarially determined contribution.

City employees hired after January 2006 as well as certain employees hired before that date participate in a defined contribution OPEB program. Once the city has contributed to the program, its only remaining funding obligation is the minimum mandated in the Public Employees' Medical and Hospital Care Act. Employees hired before that date had the option to retain post-employment health insurance under the city's health care plans. The liability is negligible as a percentage of personal income.

Operating Performance
The Fitch Analytical Sensitivity Tool (FAST) suggests that, at most, city revenues would decline only 1% given a 1% drop in national GDP. Fitch expects that the city would use a combination of its expenditure flexibility and robust reserves to offset recessionary revenue declines. Even after a moderate economic stress, the city's healthy fund balance would remain well-above both Fitch's 'aaa' assessment modeled reserve safety margin for municipalities with low revenue volatility and the city's contingency reserve equal to 25% of the general fund operating budget.

Conservative budgeting and sound financial policies have resulted in a trend of general fund operating surpluses and strong reserve levels. Extensive long-range plans include a 20-year fiscal projection combining master capital plans, major revenue and expenditure assumptions, CalPERS estimates, and equipment replacement plans. Stress tests ensure affordability under a range of economic conditions.

Fiscal 2016 concluded with collections and expenditures that were positive to the budget and improved from the prior year. After transfers out exceeding $28 million for construction projects and a newly established capital fund, the general fund showed an $8.1 million decline in fund balance, equal to 3.9% of spending. Reserves remained ample at 30.6% of spending ($64 million), inclusive of the city's contingency reserve.

The $199 million fiscal 2017 budget includes $5.6 million of proposed capital appropriations. The budget is balanced with the use of $2.5 million in reserves. City management anticipates generating an operating surplus consistent with levels achieved in past years. After increasing its contingency reserve, the city expects to utilize about half of the surplus to pay down unfunded pension liabilities and the remainder to fund capital projects.

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In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

Applicable Criteria
U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016)
https://www.fitchratings.com/site/re/879478