CITY OF SAN DIEGO
REPORT OF RATING CHANGES

PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO, CALIFORNIA (Base CUSIP: 79730A)

$161,930,000 Senior Sewer Revenue Refunding Bonds, Series 2010A (Payable Solely from Installment Payments Secured by Wastewater System Net Revenues)

$634,940,000 Senior Sewer Revenue Refunding Bonds, Series 2009B (Payable Solely from Installment Payments Secured by Wastewater System Net Revenues)

$453,775,000 Senior Sewer Revenue Bonds, Series 2009A (Payable Solely from Installment Payments Secured by Wastewater System Net Revenues)

NOTICE IS HEREBY GIVEN that on September 12, 2013, Standard & Poor's Rating Services (S&P) raised its long-term rating on the City of San Diego's Senior Sewer Revenue Bonds to "AA-" from "A+". The outlook on the rating is stable.

This is not a recommendation to buy, sell or hold any City indebtedness. Generally, a rating agency bases its ratings on the information and materials furnished to it and on investigations, studies and assumptions of its own. There is no assurance that such ratings will continue for any given period or that such ratings will not be revised downward or withdrawn entirely provided, if in the view of such rating agency, circumstances warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price or marketability of the City's obligations identified above.

DATED: September 18, 2013

CITY OF SAN DIEGO

By: ______________________

Greg Bych
Interim Chief Financial Officer

Distribution: Electronic Municipal Market Access (EMMA)
The Bank of New York Mellon Trust Company, N.A.

Summary:

San Diego Public Facilities Financing Authority, California San Diego; Water/Sewer

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Long Term Rating	AA-/Stable	Upgraded
San Diego Pub Facs Fincg Auth (San Diego) senior swr rev rfg bnds (San Diego) ser 2010A dtd 04/29/2010 due 05/15/2024-2029		
Long Term Rating	AA-/Stable	Upgraded
San Diego Pub Facs Fincg Auth (San Diego) sr swr rev bnds ser 2009A		
Long Term Rating	AA-/Stable	Upgraded

Rationale

Standard & Poor's Ratings Services raised its long-term rating to 'AA-' from 'A+' on San Diego, Calif.'s senior sewer revenue bonds, issued by the San Diego Public Facilities Financing Authority. The outlook is stable.

The raised rating is based on our view of the wastewater system's history of maintaining strong debt service coverage (DSC) and a strong liquidity position. We believe financials may come under pressure in the future if the city is required to enhance treatment to a secondary level at its largest treatment plant. This requirement would lead to substantial capital costs. Also, during the next two years, the current lack of planned rate increases could lead to lower coverage if expenses rise. Despite these potential challenges, in our view the system's current financial position and large, stable customer base provide it financial flexibility commensurate with the 'AA-' rating.

More specifically, the rating is based on our view of the system's:

- Large and diverse local customer base of 1.3 million, plus a regional wholesale treatment base of another 1.2 million in the San Diego area;
- Strong senior-lien DSC of 1.85x and total DSC of 1.74x in 2012; and
- Strong liquidity position of 812 days of operating expenses on hand as of June 30, 2012.

These strengths are partly offset, in our opinion, by the system's:

- Lack of rate increases since 2010, with the city projecting flat revenues, increasing expenses, and lower DSC through 2015;
- Past consent decree related to collection system rehabilitation, though management expects to fulfill the requirements in 2013; and
- Potentially very large future capital needs if the city is required to implement secondary treatment at its largest

treatment facility under future discharge permits.

The bonds are secured by installment payments, which are backed by net revenues of the city's wastewater system. The bonds also have a reserve, funded at the lesser of 10% of proceeds, 125% of average annual debt service, and maximum annual debt service. A rate covenant requires the city to generate system net revenues that provide at least 1.20x DSC. Rate stabilization fund withdrawals can be included in this calculation. As of June 30, 2012, the city had $1.12 billion in senior-lien debt outstanding and $57.3 million in subordinate-lien state loans.

San Diego (population: 1.32 million) anchors the large and diverse San Diego County economy. The regional economy consists of various high-tech clusters, including biotech and telecommunications, combined with concentration in the tourism, military, and defense industries. Its economic base is also anchored by higher education and major scientific research institutions, including the University of California-San Diego, San Diego State University, Scripps Research Institute, the Salk Institute for Biological Studies, and the San Diego Supercomputer Center. The U.S. Navy and the U.S. Marine Corps also have a significant presence in the region. We consider the city's median household effective buying income to be strong, at 113% of the national average in 2012.

The city's wastewater system includes a local collection system (the Municipal Sub-System) and a regional treatment system (the Metropolitan Sub-System). The collection system provides sewage collection to customers within San Diego. The regional treatment system provides treatment and disposal services within the city and on a wholesale basis to 15 nearby cities and districts. The participating agencies are the cities of Chula Vista, Coronado, Del Mar, El Cajon, Imperial Beach, La Mesa, National City, and Poway; the East Otay Sewer Maintenance District; the Lakeside/Alpine Sanitation District; Lemon Grove Sanitation District; the Otay Water District; the Padre Dam Municipal Water District; the Spring Valley Sanitation District; and the Winter Gardens Sewer Maintenance District. Under the disposal agreement, each participating agency pays San Diego its proportionate operating and capital costs associated with the system, based on wastewater flows and strength. Each participating agency maintains its own collection system. In fiscal 2012, wholesale sewer service charges represented about 19.3% of total operating revenue.

The regional treatment system includes three treatment plants, two ocean outfalls, a biosolids handling center, four pump stations, force mains, and gravity flow interceptors. The system's principal treatment facility is the 240 million gallon per day (mgd) Point Loma Plant. The plant provides advanced primary treatment before discharge through an ocean outfall. The city has received a waiver from the U.S. Environmental Protection Agency (EPA) allowing it to avoid secondary treatment through 2015, when its current discharge permit expires. If the city is required to enhance treatment under future permits, the capital costs will likely be substantial. The system's two smaller plants are the 30 mgd North City Water Reclamation Plant and the 15 mgd South Bay Water Reclamation Plant. Both can treat wastewater to a tertiary level for recycling.

Wastewater charges are included on the same bill as water and stormwater. The city can shut off water for prolonged delinquencies. A residential customer pays a base rate plus a flow rate based on winter water use. A residential customer with 1,000 cubic feet of water use would pay about $51 per month. Rates were last raised in 2010 when the city completed four consecutive years of 7% to 9% increases. The city has commissioned a cost-of-service study outlining ongoing costs and capital needs over the next two years. Under the latest draft, no rate increases are planned for 2014 or 2015. In our view, rate increases will likely be needed in the future to maintain stable financial metrics, particularly if the city is required to implement secondary treatment at the Point Loma plant.

The system's financial performance has been strong during the last three years. In fiscal 2012, operating revenues totaled $370.3 million, up 3.5% over fiscal 2011. Operating expenses including operating transfers were up 1.7% in fiscal 2012, totaling $202.1 million. Net revenues including net operating income and nonoperating revenue totaled $189.3 million in fiscal 2012, providing senior-lien DSC of 1.85x and total DSC of 1.74x, as calculated by Standard & Poor's. This is up from 1.78x and 1.68x, respectively, in fiscal 2011. Under the draft cost-of-service study, senior lien and total DSC are projected to fall to 1.47x and 1.39x, respectively, in 2015 due to no rate increases and increasing operating expenses. Although these coverage levels are lower, we still view them as good.

The system has maintained a strong liquidity position, in our view. As of June 30, 2012 -- the latest audited figures -- unrestricted cash and investments totaled $433 million, representing about 812 days of operating expenses on hand. This is up from 771 days as of June 30, 2011. Under the cost-of-service study, the system is projected to maintain a strong balance through fiscal 2015.

According to the cost-of-service study, the city is planning $119 million in capital projects in fiscal 2014 and $105 million in 2015. The plan is largely focused on main replacements, with additional funding planned for treatment plant improvements. The city has been rehabilitating pipeline under a court-approved consent decree executed with the EPA in 2007. We understand that the city is in compliance with the consent decree and expects to fulfill the requirements this year. Longer term, the system could have substantial new capital needs if the city is required to enhance treatment at the Point Loma plant under a future discharge permit.

Outlook

The stable outlook reflects our anticipation that the system will maintain at least good DSC levels and a strong liquidity position. If the city is required to implement major capital improvements and does not adjust rates to maintain stable financial metrics, we could lower the rating. Given the uncertainty of future large capital expenses, we do not anticipate raising the rating during the next two years.

Related Criteria And Research

- USPF Criteria Key Water And Sewer Utility Credit Ratio Ranges, Sept. 15, 2008
- USPF Criteria Standard & Poor's Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.