FITCH RATES SAN DIEGO, CA 2010-11 TRANS 'F1+'

Fitch Ratings-San Francisco-07 June 2010: Fitch Ratings assigns an 'F1+' rating to the following San Diego (CA) tax and revenue anticipation notes (TRANs):

--$166.9 million 2010-11 notes, series A-C.

In addition, Fitch affirms the following:

--$4.3 million in outstanding San Diego general obligation (GO) bonds, series 1991 at 'AA-';
--$8.2 million San Diego certificates of participation (1993 Balboa Park/Mission Bay Park), series 2003 at 'A+';
--$167.6 million San Diego Public Facilities Financing Authority lease revenue bonds, series 2002B and 2007A at 'A+'.
--$168.4 million San Diego Public Facilities Financing Authority lease revenue refunding bonds, series 2010A (Master Refunding Project) at 'A+'.
--$11.4 million San Diego Metropolitan Transit Development Board lease revenue refunding bonds, series 2003 at 'A+'.
--$162.5 million Convention Center Expansion Financing Authority lease revenue bonds, series 1998A at 'A+'.

The notes are expected to sell via negotiation during the week of June 21, 2010.

RATING RATIONALE:

--Fitch's highest short-term rating reflects the sound repayment structure, strong coverage of note repayment set-asides, and substantial available and borrowable funds, which largely offset any risk of significant taxation revenue adjustments.
--The city benefits from above-average socio-economic characteristics, a diverse economy, diverse revenue streams, and its desirable location as a place to live and work, or visit.
--While the city's largest employers are in the traditionally stable military, education, government, and health care sectors, the city's unemployment rate has risen significantly during the economic downturn.
--Simultaneously, the city's key general fund revenue sources have declined, and are projected to stabilize at their current much lower levels through fiscal 2011.
--Nevertheless, the city continues to demonstrate its commitment to conservative financial management policies, multiyear budget planning, midyear budget modifications, and general fund balance and reserves preservation.
--Absent revenue increases to offset rising pension payment costs, the city is delaying progress towards achieving its reserve level policy goals. However, the city is balancing its fiscal 2011 budget without eroding its reserves below fiscal 2010 levels.
--The debt burden is low to moderate, with below-average amortization.

KEY RATING DRIVERS:

--Continued maintenance of general fund structural balance within the context of pressured general fund revenues.
--Continued progress towards achieving policy target reserve levels, and reduction of existing unfunded pension and OPEB liabilities.

SECURITY:

The notes are payable from unrestricted revenues attributable to fiscal 2011.

CREDIT SUMMARY:

The city expects to set aside the $51.5 million needed to repay principal and interest on the 2010-11 notes, series A beginning Jan. 1, 2011 in advance of those notes' Jan. 31, 2011 final maturity. Similarly, the $47 million principal and interest set-aside for the series B notes will occur beginning April 1, 2011 in advance of the April 29, 2011 final maturity, and the $71.7 million principal and interest set-aside for the series C notes will occur beginning May 1, 2011 in advance of the May 31, 2011 final maturity. Based on May 28, 2010 fund balances, the city expects to have approximately $621 million available for short-term interfund borrowing. Even without such borrowable resources, note coverage is high under Fitch's stress scenarios, which include significant declines across all revenue sources and assume the city does not take any expenditure actions in response.

San Diego is the second largest city in California, with a population of approximately 1.3 million. While the city has diverse employment and tax revenue bases and above-average socio-economic characteristics, some of the city's largest operating revenues are declining due to decreased taxable property values (a negative 0.6% in fiscal 2010, with no growth projected in fiscal 2011), softened tourist business and retail sales activity, and contraction in most employment sectors, resulting in a high unemployment rate of 10.4% in April 2010.

The city ended fiscal 2009 with an $80.5 million unreserved general fund balance which represents 7.1% of spending. This was in line with the city's fiscal 2008 results and provides good flexibility. Despite significant expenditure reductions throughout fiscal 2010 to respond to marked declines in nearly all of the city's general fund revenues (except franchise fees), the city still has an $7.8 million budget deficit to close due to further unexpected declines in general fund revenues. However, the city will not need to draw down on its reserves to do so because of planned expenditure and transfer reductions.

The city has already closed a $179.1 million budget gap for fiscal 2011 with a combination of ongoing and one-time budget adjustments, including $24.6 million in fiscal 2010 savings set aside for fiscal 2011. However, a January 2010 annual actuarial valuation of the pension system indicated that the general fund would need to contribute $9.8 million more than budgeted to the annually required pension contribution in fiscal 2011. The pension system's unfunded liability has increased significantly due to market losses ($2.1 billion, up from $1.3 billion the year prior). That increased pension contribution, combined with lower than expected tax revenues in the first half of fiscal 2010 lowering the revenue baseline for fiscal 2011, resulted in a further $28.2 million budget gap in fiscal 2011 which will be closed by a mix of expenditure reductions.

The city's five-year outlook forecasts operating deficits for fiscal years 2012-2015 even after assuming no personnel cost increases, which Fitch believes is unlikely. While the city has a record of solving such deficits without adversely affecting its general fund balances and reserves, the options available to it will diminish over time absent significant revenue increases.

The city states that maintenance of required reserves at fiscal 2010 levels is a priority, but due to general fund revenue declines has postponed by one year increasing reserves levels in fiscal 2011 as had been previously planned.

The direct debt burden is low at $411 per capita, or 0.3% of market value. Taking debt issued by overlapping entities into account, overall net debt is a more moderate $3,496 per capita, or 2.6% of market value. Debt amortization is below average at 42% in 10 years. Debt levels are expected to remain affordable despite anticipated future debt issuances. The notes are designed to finance the city's cashflow and working capital needs, including the fiscal 2011 pension obligation payment which is made up front.

Applicable criteria available on Fitch's website at 'www.fitchratings.com':
'Tax-Supported Rating Criteria,' dated Dec. 21, 2009.
'U.S. Local Government Tax-Supported Rating Criteria', dated Dec. 21, 2009.

For Appropriation Debt:
The unlimited taxing power of most local government general obligation pledges is the broadest

security a U.S. local government can provide to the repayment of its long-term borrowing, and therefore is the best indicator of its overall credit quality. Some debt repayment requires annual legislative appropriation, and this lesser long-term commitment to repayment is reflected in a lower rating than that of the general obligation rating, usually by one to two notches. The average local government general obligation rating is 'AA' with approximately 85% rated at or above 'AA-' and 1% rated 'BBB+' or below. The relatively high ratings reflect local governments' inherent strengths: the authority to levy property taxes, nonpayment of which can result in property foreclosures; additional taxing power that can include sales, utility, and income taxes; and essentiality of and lack of competition for services provided by local governments. Those with low investment-grade or below-investment-grade ratings generally have a combination of a limited or highly volatile economic base, high levels of long-term liabilities including debt and post-employment benefits, and/or unusually limited financial flexibility.

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