Tax Supported
New Issue

San Diego, California

Ratings

New Issue	
2009-10 Tax and Revenue Anticipation Notes, Series A–C	F1+
Outstanding Debt	
San Diego	
General Obligation Bonds	A+
Certificates of Participation (1993 Balboa Park/Mission Bay Park), Series 2003	A
San Diego Public Facilities Financing Authority	
Lease Revenue Bonds, Series 2002B	A
Lease Revenue Bonds, Series 2007A	A
San Diego Metropolitan Transit Development Board	
Lease Revenue Refunding Bonds, Series 2003	A
Convention Center Expansion Financing Authority	
Lease Revenue Bonds, Series 1998A	A

Rating Outlook

Stable

Analysts

Alan Gibson
+1 415 732-7577
alan.gibson@fitchratings.com

Robert Sakai
+1 415 732-5628
robert.sakai@fitchratings.com

New Issue Details

Sale Information: Estimated $132,000,000 2009-10 Tax and Revenue Anticipation Notes, Series A–C, the week of June 22 via negotiation.
Security: Payable from unrestricted revenues, including taxes, income, revenue, cash receipts, and other moneys attributable solely to fiscal 2010.
Purpose: Fund city's general fund cash flow purposes, including the fiscal 2010 annually required pension fund contribution.
Final Maturity: June 30, 2010. Not subject to redemption prior to maturity.

Rating Rationale

- The city of San Diego benefits from above-average socioeconomic 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 healthcare sectors, the city's unemployment rate has risen sharply over the past year.
- Simultaneously, the city's key general fund revenue sources have declined markedly and are projected to remain under pressure through fiscal 2010, and taxable assessed valuation (TAV) is projected to decline by at least 1.5%.
- The debt burden is low to moderate, with average amortization.
- The city is demonstrating its commitment to conservative financial management policies, multiyear budget planning, midyear budget modifications, general fund balance preservation, increased general fund reserves, and reduced unfunded pension and OPEB liabilities.
- However, reduction of the city's unfunded pension and OPEB liabilities will require further concessions from labor, which has already accepted significant remuneration reductions.
- As the city's general fund continues to be pressured by significant personnel costs, deterioration in the funded status of pension and retiree health plans, state funding pressures, and unmet infrastructure and maintenance needs, there will be fewer available budget options to ensure ongoing structural balance.
- While baseline coverage levels for the 2009-10 TRANs, series A–C are thin without use of borrowable funds, this is partly the result of aggressive set-asides to be completed by April 2010. The underlying budgetary assumptions are conservative.

Key Rating Drivers

- Continued maintenance of general fund structural balance within the context of declining revenues.
- Achievement of policy target reserve levels, elimination of existing unfunded pension and OPEB liabilities, and reduction of future pension and OPEB liabilities.

Credit Summary

The 'F1+' short-term rating reflects the notes' aggressive set-asides, which will be completed by April 2010. While fiscally prudent, these accelerated set-asides create thin baseline coverage levels, which are offset by an estimated $68.7 million in available borrowable funds and extensive alternate liquidity through interfund borrowing.

The 'A+' long-term rating encompasses both the city's strengths and upcoming challenges. San Diego benefits from above-average socio-economic characteristics, a diverse economy, a diverse range of revenue streams, and its desirable location as a place to live and work or visit. However, while the city's largest employers are in the traditionally stable military, education, government, and healthcare sectors, the city's unemployment rate has risen sharply over the past year. Simultaneously, the city's key general fund revenue sources have declined markedly and are projected to remain pressured during fiscal 2010, and TAV is projected to decline in fiscal 2010 as well.

The city is demonstrating its commitment to conservative financial management policies, multiyear budget planning, midyear budget modifications, general fund balance preservation, augmented general fund reserves, and reduced unfunded pension and other post-employment benefit (OPEB) liabilities. However, reduction of the city's unfunded pension and OPEB liabilities will require further concessions from the labor unions, which have already absorbed significant remuneration reductions. As the city's general fund continues to be pressured by significant personnel costs, deterioration in the funded status of pension and retiree health plans, state funding pressures, and approximately $900 million in unmet general fund infrastructure and maintenance needs, there will be fewer available budget options to ensure ongoing structural balance.

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 socioeconomic characteristics, some of the city's largest operating revenues are declining due to decreased property values (a projected negative 1.5% in fiscal 2010), the softened tourist business and retail sales activity, coupled with a high unemployment rate of 9.1% in April 2009.

The city ended fiscal 2008 with a $78.9 million unreserved general fund balance, which represented 7.2% of spending. While this represented a decline from the peak $96.2 million unreserved general fund balance in fiscal 2007 (9.7% of spending), it remained higher than any other previous year. Significant revenue slowdowns during fiscal 2009 resulted in major budget revisions during the course of the year. The city, having reduced general fund expenditures at a greater rate than revenue declines, projects to end the year with a general fund net income of $1.4 million. Revenues are projected to continue declining in fiscal 2010, and an initial structural gap of $63 million had to be closed by labor concessions, reserve funds, new fees, and adjusted existing-fee levels. The budget solutions did not have to include service cuts over and above the ones already made in fiscal 2009. The state could negatively impact the city by a further $36 million if it decides to suspend Proposition 1A in fiscal 2010. Preliminary estimates from the city's independent budget analyst indicate a $100 million deficit in fiscal 2011. A significant cost pressure contributing to these deficits is the city's increasing pension and OPEB annually required contributions (ARC), particularly because of the decline in the value of retirement system investments.

Debt

2009-10 TRANs

The city has issued TRANs every year since the mid-1960s (except for fiscal 1979) to meet its cash flow requirements. The TRANs issued in fiscal years 2005–2008 were privately placed. The 2009-10 TRANs represent the city general fund's re-entry into the public capital markets. 2009-10 TRANs proceeds will be used for general fund cash flow purposes, including payment of the city's fiscal 2010 pension ARC on or around July 1, 2009, which will save an estimated $4.7 million when compared to paying the ARC incrementally throughout the year.

The 2009-10 TRANs will be fixed rate and issued in three series, each with its own principal and interest maturity date (Dec. 31, 2009 for series A; Jan. 29, 2010 for series B; and April 30, 2010 for series C). This forces the city to pay down each TRANs series on receipt of tranches of property taxes. Based on the city's fiscal 2010 cash flow projections, by June 30, 2010 the city will have an ending general fund balance of

Related Research

- *Fitch Upgrades $228MM San Diego, California Tax-supported Debt; Assigns $153MM Initial Rating, Dec. 12, 2008*
- *Fitch Upgrades San Diego, California GOs to 'A+'; Lease Revenues to 'A' and Water Revenues to 'AA-', Dec. 11, 2008*

Rating History — TRANs

Rating	Action	Outlook/ Watch	Date
F1+	Assigned	—	6/8/09

Rating History — Lease Revenue Bonds and COPs

Rating	Action	Outlook/ Watch	Date
A	Affirmed	Stable	6/8/09
A	Upgraded	Stable	12/11/08
BBB–	Affirmed	Positive	3/27/08
BBB–	Downgraded	Negative	5/27/05
A–	Downgraded	Negative	2/16/05
AA–	Affirmed	Negative	9/23/04
AA–	Downgraded	Negative	2/27/04
AA+	Assigned	—	5/14/03

Rating History — GO Bonds

Rating	Action	Outlook/ Watch	Date
A+	Affirmed	Stable	6/8/09
A+	Upgraded	Stable	12/11/08
BBB+	Affirmed	Positive	3/27/08
BBB+	Downgraded	Negative	5/27/05
A	Downgraded	Negative	2/16/05
AA	Affirmed	Negative	9/23/04
AA	Downgraded	Negative	2/27/04
AAA	Upgraded	—	5/28/02
AA+	Assigned	—	4/3/98

$88.2 million. Even after taking into account possible state action that reduces the city's property tax revenues by 8%, the city estimates that it would have an ending general fund balance of $52.2 million.

Debt Statistics

($000)

General Obligation Bonds	6,315
Certificates of Participation	23,390
Lease Revenue Bonds	513,900
Direct Debt	**543,605**
Overlapping Debt	3,912,544
Total Overall Debt	**4,456,149**
Debt Ratios	
Direct Debt per Capita ($)[a]	407
As % of Market Value[b]	0.3
Overall Debt per Capita ($)[a]	3,333
As % of Market Value[b]	2.7

[a]Population: 1,336,865 (2008 estimate).
[b]Market Value: $165,801,639,000 (fiscal 2009).
Note: Numbers may not add due to rounding.

The notes are a valid lien and charge against, and are payable from, first-pledged general fund moneys received by the city. However, in the event that additional moneys are required to meet the notes' debt service obligations, there are $68.7 million of other fund balances that would be made available. Further, alternate liquidity could be provided by interfund borrowing. The city charter permits advance of moneys in the city treasury as a temporary loan to any tax-supported fund, so long as the loan is repaid with the first property taxes received and does not exceed the current property taxes receivable. The city estimates that as of June 1, 2009, the total moneys available for payment of principal and interest on the 2009-10 TRANs, including the pledged moneys, will be in excess of $1.145 billion (8.6x coverage). As of June 30, 2008, the combined city cash and investments pool was approximately $2 billion.

As shown in the table on page 5, base debt service coverage is thin due to the aggressive set-asides, which will be completed by April 2010. However, debt service coverage rises to moderate levels when borrowable resources are considered. Coverage with borrowable resources remains above 1.00x for all but the most draconian of stress tests.

While the city covenants to not issue any parity notes, it does reserve the right to issue subordinate notes secured by a junior lien against the same pledge. The city does not presently expect to issue any such subordinated notes in fiscal 2010.

Outstanding debt

As shown in the table above, the direct debt burden is low at $407 per capita, or 0.3% of market valuation (MV). Taking debt issued by overlapping entities into account, overall net debt is $3,333 per capita, or 2.7% of MV. Debt amortization is average at 56% retiring in 10 years. The city currently intends to issue approximately $108 million in general fund supported obligations to fund capital projects in fiscal years 2011 and 2013. Debt levels are expected to remain affordable.

Finances

Reserves

In November 2008, the city council set goals for combined general fund reserves of: 6.5% by June 30, 2009 (currently at $71.5 million of the $74.0 million goal); 7.0% by June 30, 2010 ($80.2 million, which the city expects to reach); 7.5% by June 30, 2011; and 8.0% by June 30, 2012. The city council is also planning to fund the public liability fund reserve at a full 15% of the value of outstanding claims for fiscal 2010 ($17.1 million) and the worker's compensation fund reserve at a full 22% of the value of outstanding claims ($34.3 million). The city council plans to increase the worker's compensation fund reserve to 50% of outstanding claims by fiscal 2014.

General Fund Income Statement

($000, Audited Fiscal Years Ended June 30)

	2003	2004	2005	2006	2007	2008
Property Taxes	184,641	201,133	223,500	322,087	361,062	384,273
Sales Taxes	129,262	137,360	143,596	155,989	233,385	235,579
Transient Occupancy Tax	0	59,530	63,910	72,126	80,703	83,730
Other Local Taxes	109,241	64,977	73,456	72,102	74,069	71,594
Charges for Current Services	97,365	98,956	105,293	91,514	85,026	87,263
Licenses, Permits, Fines, Forfeitures, Penalties	48,028	55,531	60,316	64,259	71,821	64,898
Federal, State, and Other Agencies	92,061	78,259	81,459	16,349	21,710	18,322
Revenue from Use of Money and Property	30,539	27,758	33,015	35,872	42,157	44,577
Other	2,587	2,870	2,778	2,864	2,730	3,297
Total Revenues	**693,724**	**726,374**	**787,323**	**833,162**	**972,663**	**993,533**
Public Safety and Homeland Security	399,756	421,584	478,299	509,264	517,522	562,975
General Government	138,017	134,865	164,892	183,143	189,203	225,570
Sanitation, Health, Transportation	56,884	59,330	62,472	64,752	98,907	115,157
Parks, Recreation, and Libraries	93,982	97,380	106,274	108,153	112,967	119,125
Neighborhood Services	29,196	25,997	25,137	19,702	18,339	18,563
Debt Service	4,626	7,760	4,192	5,920	9,123	-
Other	0	0	0	0	0	7,924
Total Expenditures	**722,461**	**746,916**	**841,266**	**890,934**	**946,061**	**1,049,314**
Operating Income/(Deficit)	**(28,737)**	**(20,542)**	**(53,943)**	**(57,772)**	**26,602**	**(55,781)**
Transfers from Proprietary Funds	5,480	2,941	7,039	2,989	4,181	5,896
Transfers from Other Funds	39,028	37,994	58,913	71,672	86,980	94,562
Proceeds from Capital Leases	0	3,634	3,258	5,374	0	0
Total Transfers In	**44,508**	**44,569**	**69,210**	**80,035**	**91,161**	**100,458**
Other Sources	8,152	0	20	522	35	0
Transfers to Proprietary Funds	(7,080)	(13,707)	(1,185)	(246)	(1,373)	(5,358)
Transfers to Other Funds	(19,011)	(15,665)	(14,276)	(21,946)	(46,018)	(46,470)
Total Transfers Out	**(26,091)**	**(29,372)**	**(15,461)**	**(22,192)**	**(47,391)**	**(51,828)**
Net Income/(Loss) from Joint Venture	0	(485)	0	0	0	(116)
Net Transfers, Other Sources, and Other Uses	**26,569**	**14,712**	**53,769**	**58,365**	**43,805**	**48,514**
Net Income/(Deficit)	**(2,168)**	**(5,830)**	**(174)**	**593**	**70,407**	**(7,267)**
Total Fund Balance	67,052	61,222	61,048	61,641	132,048	124,781
As % of Expenditures, Transfers Out, and Other Uses	9.0	7.9	7.1	6.8	13.3	11.3
Unreserved Fund Balance	1,677	42,672	43,547	40,353	96,190	78,938
As % of Expenditures, Transfers Out, and Other Uses	0.2	5.5	5.1	4.4	9.7	7.2
Unreserved, Undesignated Fund Balance	—	41,339	41,593	39,884	95,031	75,339
As % of Expenditures, Transfers Out, and Other Uses	0.0	5.3	4.9	4.4	9.6	6.8

Note: Numbers may not add due to rounding.

Fiscal 2009

During the course of the year, the fiscal 2009 revised budget was reduced by $36.6 million, to $1.156 billion from $1.193 billion. This was necessitated by property tax, sales tax, transient occupancy tax, franchise fee, and interest revenue declines, and expenditure increases for booking fees and property tax administrative fees paid to the county. The budget reduction was achieved by eliminating some services and 147 full-time equivalent (FTE) general fund positions. (The city has eliminated a total of 875 FTE positions in fiscal years 2007–2009.) These represent ongoing savings.

The midyear budget update identified further revenue shortfalls (negative $8.7 million) that are more than offset by projected further expenditure savings ($10.5 million, primarily due to vacancies); therefore, no further budget adjustments were required. The May 2009 budget-monitoring report identified a further revenue shortfall (negative $8.4 million) offset by further expenditure savings ($8.1 million due to conservative spending). The mayor has recommended fiscal 2009 general fund budget reductions of $2.6 million. The city's projected net year-end projection of general fund revenues over expenditures is $1.4 million.

Projected Debt Service Coverage Levels and Stress Scenarios

($000)

	2009					2010					
	July and Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	March	April	May	June
General Fund Beginning Balance	85,848	7,746	(10,247)	(52,740)	(68,227)	(66)	651	10,197	17,511	26,317	61,614
Receipts	102,068	57,925	58,655	61,889	149,078	153,068	71,733	68,715	136,313	165,279	111,679
TRAN Proceeds	132,000	0	0	0	0	0	0	0	0	0	0
Total Receipts	**234,068**	**57,925**	**58,655**	**61,889**	**149,078**	**153,068**	**71,733**	**68,715**	**136,313**	**165,279**	**111,679**
Disbursements	(312,170)	(75,918)	(101,148)	(77,376)	(61,199)	(93,157)	(62,187)	(61,401)	(74,720)	(129,982)	(85,096)
TRAN Set-Asides	0	0	0	0	(19,718)	(59,194)	0	0	(52,787)	0	0
Total Disbursements	**(312,170)**	**(75,918)**	**(101,148)**	**(77,376)**	**(80,917)**	**(152,351)**	**(62,187)**	**(61,401)**	**(127,507)**	**(129,982)**	**(85,096)**
Month-End Cash Balance	7,746	(10,247)	(52,740)	(68,227)	(66)	651	10,197	17,511	26,317	61,614	88,197
TRANS Set-Aside Coverage (x)	—	—	—	—	1.00	1.01	—	—	1.50	—	—
Coverage with Borrowables (x)	—	—	—	—	4.48	2.17	—	—	2.80	—	—
Stress Scenarios											
Adjustment SS1[a]	49,848	(28,254)	(46,247)	(88,740)	(104,227)	(36,066)	(35,349)	(25,803)	(18,489)	(9,683)	25,614
Ending Balance SS1	(28,254)	(46,247)	(88,740)	(104,227)	(36,066)	(35,349)	(25,803)	(18,489)	(9,683)	25,614	52,197
TRANS Set-Aside Coverage (x)	—	—	—	—	(0.83)	0.40	—	—	0.82	—	—
Coverage with Borrowables	—	—	—	—	2.65	1.56	—	—	2.12	—	—
Adjustment SS2[b]	49,848	(31,994)	(52,315)	(96,874)	(114,478)	(48,620)	(49,502)	(41,689)	(36,293)	(29,081)	4,279
Ending Balance SS2	(31,994)	(52,315)	(96,874)	(114,478)	(48,620)	(49,502)	(41,689)	(36,293)	(29,081)	4,279	28,157
TRANS Set-Aside Coverage (x)	—	—	—	—	(1.47)	0.16	—	—	0.45	—	—
Coverage with Borrowables	—	—	—	—	2.02	1.32	—	—	1.75	—	—
Adjustment SS3[c]	49,848	(33,407)	(54,296)	(99,722)	(118,303)	(57,596)	(64,533)	(58,573)	(54,695)	(52,705)	(25,672)
Ending Balance SS3	(33,407)	(54,296)	(99,722)	(118,303)	(57,596)	(64,533)	(58,573)	(54,695)	(52,705)	(25,672)	(4,673)
TRANS Set-Aside Coverage (x)	—	—	—	—	(1.92)	(0.09)	—	—	0.00	—	—
Coverage with Borrowables	—	—	—	—	1.56	1.07	—	—	1.30	—	—
Adjustment SS4[d]	49,848	(38,560)	(62,346)	(110,704)	(132,380)	(79,127)	(93,717)	(91,344)	(90,901)	(95,727)	(76,958)
Ending Balance SS4	(38,560)	(62,346)	(110,704)	(132,380)	(79,127)	(93,717)	(91,344)	(90,901)	(95,727)	(76,958)	(61,543)
TRANS Set-Aside Coverage (x)	—	—	—	—	(3.01)	(0.58)	—	—	(0.81)	—	—
Coverage with Borrowables	—	—	—	—	0.47	0.58	—	—	0.49	—	—

[a]Stress Scenario 1 assumes state suspension of Proposition 1A and that the state of California borrows $36 million on July 1, 2009. [b]Stress Scenario 2 assumes SS1 variables, plus a 10% reduction to sales, safety sales, and transient occupancy taxes. [c]Stress Scenario 3 assumes SS1 variables, plus a 5% decline in overall revenues. [d]Stress Scenario 4 assumes SS1 variables, plus a 10% decline in overall revenues. Note: Numbers may not add due to rounding.

Fiscal 2010

At $1.129 billion, the general fund revised fiscal 2010 budget is $27.4 million less than the fiscal 2009 revised budget, assuming ongoing revenue declines from property and property transfer taxes, sales tax, transient occupancy tax, licenses, permits, fines, forfeitures, penalties, rent and concession payments, and funding from other agencies, with small offsetting increases in franchise fees and charges for current services. An initial $63.1 million general fund structural gap was solved through: 6% labor concessions, attrition, and vacancies; a transfer from an internal transient occupancy tax stabilization reserve; a transfer from the library systems improvement fund; and revised and new fees. The budget solutions do not include further service cuts.

The state's potential suspension of Proposition 1A could have a $36 million impact on the city's fiscal 2010 general fund budget. The city is currently developing a plan on how to deal with a $36 million budget gap through short-term borrowing, revenue increases, and/or expenditure reductions.

Economy

The city covers 342 square miles of San Diego County, Southern California, and has a population of approximately 1.3 million. It is the second largest city in California and the eighth largest in the U.S. Despite the city's above-average socioeconomic characteristics in terms of personal and median household income and buying power, the outlook for the local economy remains negative, with material weakness expected through 2010. The primary downside risks to city revenues are the continued decline of property values, tourism, and taxable retail sales, and high unemployment rates. The number of visitors has been steadily declining since 2006. While hotel room inventory has continued to increase, average occupancy and daily rates have both decreased. While the number of conventions is not expected to decline in fiscal 2010, average occupancy rates are expected to remain low, placing further downward pressure on average daily rates. Projections indicate that visitor levels experienced in 2008 are not likely to be regained until 2012.

Beginning in 2008, the city's unemployment rate was higher than the national average for the first time, primarily due to job losses in the construction, finance, manufacturing, and retail sectors. Between April 2008 and April 2009, the unemployment rate increased sharply to 9.1%. While the civilian labor force continues to grow (reflecting the city's steady population growth), employment opportunities have declined 2.7% over the past year.

The city benefits from low taxpayer concentration. In 2009, the top 10 taxpayers accounted for only 4.7% of TAV. After significant TAV run-up, the county assessor is projecting a 1.5% decline for the city in fiscal 2010 (compared to negative 2.5% for the county as a whole). However, the city is budgeting for negative 3.3% because its actual results tend to be 1.5%–2% lower that the county's projections. Median house values have declined 44.7% since the November 2005 peak to $275,000 in March 2009. However, as house prices have declined, house sales increased 34.2% between January and March 2009 as investors sought to buy properties at low prices. The value of new residential unit construction declined from $1.3 billion in fiscal 2005 (6,605 new units) to $0.7 billion in fiscal 2008 (1,678 new units), with a further 60% decline in the first three quarters of fiscal 2009. The downtown commercial real estate vacancy rate was 15.1% in March 2009 and recovery in office space demand is not predicted until the end of 2011. Commercial loan defaults are expected to increase over the next 18–24 months. Stabilizing factors include changes in ownership, new construction coming on-line, and Proposition 13 inflation adjustments for all properties with pre-2003 values.

A new pension plan for new hires transfers more of the investment risk to general employees and reduces the city's future liability. As of June 30, 2008, the pension fund had an unfunded actuarial accrued liability (UAAL) of $1.3 billion and the OPEB fund had a UAAL of $1.2 billion. Since then, both funds have experienced sizable investment losses, which will significantly impact the city's ARC from fiscal 2011 onwards. While the city is currently overfunding its pension ARC, it has yet to determine how to fully fund its OPEB ARC.