STANDARD & POOR'S RATINGS SERVICES

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San Diego Public Facilities Financing Authority San Diego; Appropriations; General Obligation

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Credit Profile		
US$40.03 mil lse rev & rfdg bnds (Capital Improvement Project & Old Town Light Rail Rfdg) ser 2013A due 10/15/2042		
Long Term Rating	A+/Stable	New
US$6.005 mil lse rev rfdg bnds (Balboa Park & Mission Bay Pk Rfdg) ser 2013B due 10/15/2042		
Long Term Rating	A+/Stable	New

Rationale

Standard & Poor's Ratings Services assigned its 'A+' long-term rating and stable outlook to San Diego Public Facilities Financing Authority, Calif.'s series 2013A (capital improvement projects and old town light rail extension refunding) and 2013B (Balboa Park/Mission Bay Park Refunding) lease revenue refunding bonds secured by rental payments from the City of San Diego.

In addition, Standard & Poor's affirmed its 'AA-' issuer credit rating on San Diego and its 'A+' long-term rating on various authorities' lease revenue bonds and certificates of participation (COPs), issued for San Diego. The outlook on all ratings is stable.

The city's COPs represent an interest in, and the lease revenue bonds are secured by, lease payments by San Diego, as lessee, to various authorities as lessor, for the use and possession of the leased assets. The rating on the authorities' lease revenue bonds and COPs reflects our view of the city's general credit characteristics and its covenant to budget and appropriate annual lease payments for various properties' use.

The ratings reflect what we view as San Diego's:

- Strong financial management practices, including the practice of multi-year forecasting and proactive budget adjustments, which have historically allowed management to identify future fiscal imbalances in time to develop and implement solutions;
- Strong general fund reserve position that the city projects will continue to exceed targeted levels in fiscal years 2013 and 2014, particularly after the recent stabilization of general fund revenue; and
- Strong long-term economic fundamentals, including the city's role as the anchor and center for the majority of employment in the county, despite some dependence on tourism and the military.

These credit strengths are partially tempered, in our view, by San Diego's:

- Limited revenue-raising flexibility;
- Additional capital costs related to the city's deferred capital program as well as new stormwater system regulations; and
- Significant pension liabilities that we believe continue to represent a large share of the city's general fund budget.

The San Diego Public Facilities Financing Authority's series 2013A lease revenue bonds and 2013B lease revenue refunding bonds are secured by lease payments by San Diego, as sub-lessee, to the authority, as sub-lessor, under a master and amended facility lease agreement for the use of various city-owned properties. Under separate site lease agreements, the city and the San Diego Metropolitan Transit System will lease the property to the San Diego Public Facilities Financing Authority. The facility lease agreement allows for abatement of lease payments for damage and destruction of the property but requires the city to procure use and occupancy insurance sufficient to cover 24 months of base rental payments. We understand San Diego intends to use the series 2013A lease revenue bond proceeds for capital improvements related to its deferred capital program and to refund the San Diego and Metropolitan Transit Development Board Authority's series 2003 lease revenue refunding bonds. We understand the series 2013B lease revenue refunding bond proceeds will be used to refund the city's series 2003 COPs.

None of the series 2013 bonds includes a debt service reserve fund; however, lease payment dates of April 15 and Oct. 15, which occur more than three months after the city's fiscal year-end, mitigate late budget risk, in our view.

San Diego (estimated population: 1.32 million) is a primary employment center in San Diego County, representing about half of the county's total employment. The economy consists of various high-tech clusters, including biotech and telecommunications, combined with a reliance on tourism, and the 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 Corp. have a significant presence in the region and directly and indirectly contribute more than $30 billion to the San Diego County economy. We believe that, historically, the military presence in the region has stabilized the regional economy, although there is a potential that federal budget reductions related to sequestration could slightly dampen regional economic growth. We consider the city's median household effective buying income strong at 113% of the national average in 2012, despite the military presence. San Diego's total assessed valuation has remained fairly stable in the past couple of years, fluctuating between about $167 billion and $168 billion, and corresponds to what we view as extremely strong market value per capita of $126,300. Unemployment for the city was 8.0% in February 2013, which remains below the state level of 9.6%, based on seasonally unadjusted data by the Bureau of Labor Statistics.

Based on San Diego's May 2013 year-end budget monitoring report, the city expects to end fiscal 2013 with revenue exceeding expenditures by $2.7 million, due primarily to higher year-over-year sales tax and hotel tax receipts and higher property tax revenue than originally budgeted because of the dissolution of redevelopment agencies (RDAs) in California. City officials estimate the fiscal 2013 year-end combined general fund unassigned balance and emergency reserve will increase to $170 million, or 14.5% of general fund expenditures and transfers, which we consider strong. We understand San Diego has designated $28 million of the projected available fiscal 2013 balance as contingency if agreements between the city's former RDA and the city to support a portion of general fund debt payments with property tax increment are invalidated. Including this contingent balance, the proposed fiscal 2014 general fund budget projects an ending available balance of $156 million, or about 13% of the proposed budget. The fiscal 2014 proposed budget assumes about 2% growth in revenue compared with fiscal 2013 year-end estimates in addition to higher year-over-year pension contribution costs and debt service costs that had previously been supported with property tax increment revenue. We understand the city is in the process of negotiating multi-year agreements with its unions that include multi-year compensation increases, although officials expect increases to non-salary compensation could result in lower estimated annual pension contributions.

We consider San Diego's management practices "strong" under Standard & Poor's Financial Management Assessment (FMA) methodology. An FMA of strong indicates practices are strong, well embedded, and likely sustainable.

In our view, overall net debt is a moderate $4,129 per capita and 3.3% of market value, including pro forma debt. Annual debt service carrying charges represented what we consider a low 7.5% of governmental expenditures, less capital outlay, in fiscal 2012. We consider existing principal amortization slightly below average, with about 48% of principal retired in 10 years and 86% in 20 years. City officials plan to issue between $80 million and $90 million of appropriation debt annually to address about $700 million of estimated deferred capital project needs and restore streets, buildings, and storm drains to good condition. San Diego also expects to issue additional debt for a future convention center expansion, which officials expect would be secured primarily by a combination of new hotel special tax and general fund revenue. We understand a recent adoption of the city's five-year stormwater permit requires additional capital investment related to water quality compliance. The city's preliminary estimated costs related to the stormwater regulations range between a very significant $1.5 billion and $2.7 billion over the next 20 years, although these estimates could change. The city is considering its options for funding this large potential liability, although it could include raising stormwater fees. San Diego has no variable-rate debt outstanding.

The city has contributed the annual required contribution (ARC) to the San Diego City Employees' Retirement System (SDCERS) for its employee retirement benefits in the past several years, including $232 million in fiscal years 2012 and 2013. Due in part to actuarial changes related to a recent voter-approved charter amendment that reformed the city's pension benefits and created a defined contribution pension plan for new hires, the fiscal 2014 estimated pension ARC rises to $275 million. Effective April 2012, the city negotiated reforms to its other postemployment benefits (OPEB) with eligible employees that elected certain benefit options, including a defined contribution plan, to fund retiree medical benefits. Based on these changes, the fiscal 2012 actuarial analysis reflects a significant $682 million decline in the city's unfunded OPEB actuarial liability from $1.1 billion at fiscal year-end 2011. Similarly, the fiscal 2012 total OPEB ARC for the defined benefit plan was only $49 million compared with $120 million in fiscal 2011. The actuarial analysis also incorporates an OPEB trust fund that had a balance of about $104 million at fiscal year-end 2012. We calculate that the city's combined pension ARC and OPEB contributions in fiscal 2012, including contributions to the OPEB defined benefit and defined contribution plans, represented about 15% of total governmental expenditures, which we consider moderate. However, the fiscal 2012 general fund share of the combined pension and OPEB contribution represented a high 19% of general fund expenditures.

Outlook

The stable outlook reflects our view of management's history of proactive budget adjustments, practice of long-term financial and capital forecasting, and recent economic improvement. We don't expect to raise the rating in the next two years due to currently high fixed charges in San Diego's general fund related primarily to the pension ARC, potential capital pressures related to the city's deferred capital, and new stormwater system regulatory requirements, as well as city income levels that are just over the national average due, in part, to the region's military presence. We expect San Diego will continue its practice of regular budget monitoring and midyear budget adjustments to offset additional potential costs and to maintain strong reserve levels, should fixed capital and pension costs pressure general fund flexibility or if the city fails to maintain reserve levels that we consider strong and in line with its minimum targets in the next two years, we could lower the rating.

Financial Management Assessment: 'Strong'

We consider San Diego's management practices "strong" under Standard & Poor's financial management assessment (FMA) methodology. An FMA of strong indicates our view that practices are strong, well-embedded, and likely sustainable. The city council generally performs formal budget amendments in the midyear and year-end reviews; in addition, the comptroller publicly posts and presents monthly reports on actual general fund performance to the city council's budget and finance committee. San Diego annually prepares a long-term financial outlook, which projects general fund operations, revenue and expenditure trends, and future budgetary gaps for the next five years; the outlook also includes forecasts for additional debt service costs associated with future anticipated debt issuance related to its deferred maintenance capital plan. While the city has historically prioritized and identified long-term capital needs for its utility funds, it has just recently estimated annual bonding requirements and pay-as-you-go funding for its general fund deferred maintenance needs in the next five years. The city reviews its formal investment policy annually and presents monthly reports on investment holdings and average yield to the city council. San Diego has a formal debt management policy that includes maximum debt burden thresholds for general obligation and lease revenue debt, as well as minimum coverage level targets for revenue bonds. The city has exceeded its reserve policy targets, which include a combined emergency, unallocated, and appropriated reserve equal to 8% of general fund revenue; the emergency reserve, to be used as a contingency for natural disasters or unforeseen catastrophic events, requires a minimum 5% of general fund revenue and requires a two-thirds council vote to access the reserve.

Redevelopment Agency Dissolution

Following the passage of Assembly Bill (AB) 1X 26 and AB 1484, laws related to the dissolution of RDAs in the state, San Diego is acting as successor agency (SA) to its RDA for both the nonhousing and housing functions.

The dissolution law invalidated certain loans and reimbursement agreements between a city and its former RDA that didn't meet specified criteria. San Diego and its former RDA had previously entered into reimbursement agreements to support certain city general fund-backed debt with tax increment revenue, which the state department of finance has declared invalid. The city continues to dispute this determination, but its fiscal 2014 general fund budget now incorporates annual debt service expenditures on appropriation-backed debt related to the Petco Park baseball stadium and for the convention center expansion that were previously supported by tax increment revenue. The dissolution law also provides for the additional distribution of property tax revenues to the underlying taxing entities, including the city, after the payment of former RDA obligations. The fiscal 2014 budgeted revenue includes an estimated $8 million in total recurring and nonrecurring property tax revenue related to the RDA dissolution, although city officials estimate only $2.6 million of this amount is San Diego's share of annual recurring property tax. Other potential costs to the general fund relate primarily to affordable housing obligations and administrative costs. The city also expects to make a $2 million loan to the SA to meet the balance of uncommitted housing funds of the former RDA the state claims are available for remittance to the county under the dissolution law. The SA has completed its nonhousing due diligence review but awaits the state department of finance's review. In addition, while a pending state controller review could require the reversal of previous nonhousing asset transfers the former RDA made to San Diego, city officials report that these assets are held apart from the city's general fund and general assets and, as such, even if reversals of transfers are required, won't affect San Diego's available general fund balance.

Retirement Benefits

San Diego contributes to SDCERS, a defined benefit pension plan. The plan's unfunded actuarial accrued liability (UAAL) was almost $2.4 billion as of June 30, 2012, with a 68.6% funded ratio. In addition, we understand some city employees participate in defined contribution pension plans, including a supplemental pension savings plan to which the city contributed a total of $19 million in fiscal 2012. San Diego's total pension ARC was almost $233 million in fiscal 2013, but increases to $275 million in fiscal 2014 due to changes in the actuarial assumptions in fiscal 2012. The city estimates its general fund portion of the pension ARC in fiscal 2013 will remain at about $181 million, or a still large, in our view, 15.6% of general fund expenditures.

The voters passed Proposition B in June 2012, which amended San Diego's charter to provide a defined contribution plan to new nonsworn police employees as opposed to a defined benefit plan, which is in place for existing employees. The measure also imposed certain restrictions on the council's ability to negotiate salary increases, which was subsequently challenged in court. The city expects continued pending legal action is likely to delay the implementation of some or all of its charter amendments. In the meantime, the actuarial pension report assumes the validity of the reform measure as well as certain assumptions on amortization of the liability and future base salary increases, which contribute to a higher pension ARC in the short-term, although city officials expect the amendments, if validated, could result in long-term future savings in San Diego's required pension contributions.

San Diego provides OPEB for many of its employees. The fiscal 2012 actuarial report on its OPEB liability incorporated a higher discount rate as well as negotiated recent reforms to the OPEB with existing employees, which significantly lowered the UAAL and ARC compared with fiscal 2011. The city has funded its OPEB obligation on a pay-as-you-go basis as well as through some prefunding into a retirement benefits trust. San Diego's new estimated OPEB ARC for the defined benefit plan in fiscal 2013 is $35 million, which is lower than the city's $36 million pay-as-you-go amount. Including city contributions to the OPEB trust and defined contribution plan, the city estimates it will contribute about $58 million in fiscal 2013. Altogether, we calculate fiscal 2014 estimated general fund pension and OPEB contributions, as well as other retirement-related benefits costs the city estimated in its multi-year forecast (including a supplemental pension plan and employee contribution offsets), represent a very high, in our view, 27% of the fiscal 2014 general fund budgeted expenditures.

Related Criteria And Research

- USPF Criteria: Key General Obligation Ratio Credit Ranges – Analysis Vs. Reality, April 2, 2008
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007
- USPF Criteria: GO Debt, Oct. 12, 2006

- USPF Criteria: Financial Management Assessment, June 27, 2006

Ratings Detail (As Of June 6, 2013)		
San Diego ICR due 04/30/2040		
Long Term Rating	AA-/Stable	Affirmed
San Diego 2003 certs of part (1993 Balboa Park/Mission Bay Pk Rfdg)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
San Diego Convtn Ctr Expansion Fing Auth, California		
San Diego, California		
San Diego Convtn Ctr Expansion Fing Auth (San Diego) lse rev rfdg bnds		
Long Term Rating	A+/Stable	Affirmed
San Diego Mtdb Auth, California		
San Diego, California		
San Diego Mtdb Auth (San Diego) 2003 lse rev rfdg bnds (San Diego Old Twn Lt Rail Transit Extension Rfdg)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
San Diego Pub Facs Fincg Auth, California		
San Diego, California		
San Diego Pub Facs Fincg Auth (San Diego) lse rev bnds (Cap Imp Proj)		
Long Term Rating	A+/Stable	Affirmed
San Diego Pub Facs Fincg Auth (San Diego) lse rev rfdg bnds ser 2007A		
Long Term Rating	A+/Stable	Affirmed
San Diego Pub Facs Fincg Auth (San Diego) lse rev rfdg bnds (Fire & Life Saftey Facs Rfdg)		
Long Term Rating	A+/Stable	Affirmed
San Diego Pub Facs Fincg Auth (San Diego) lse rev rfdg bnds (San Diego) (Master Rfdg Proj) ser 2010A due 03/01/2040		
Long Term Rating	A+/Stable	Affirmed

Many issues are enhanced by bond insurance.