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## San Diego Water Revenue Bond Ratings Affirmed

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NEW YORK (Standard & Poor's) Dec. 12, 2008--Standard & Poor's Ratings Services affirmed its 'AA-' underlying rating (SPUR), and stable outlook, on San Diego, Calif.'s senior-lien water revenue bonds, and its 'A+' SPUR, and stable outlook, on the city's subordinate-lien water revenue bonds. We also assigned a 'AA-' SPUR and stable outlook to the \$62.985 million series 2009A water revenue refunding bonds.

The ratings reflect our view of the city's following credit strengths:

- Good historical and projected debt service coverage, even after excluding one-time capacity charge revenue;
- Strong cash reserves bolstered by targeted cash reserve policies;
- Council-approved system rate increases through fiscal 2011; and
- A diverse service area economy and customer base.

We believe offsetting credit concerns include the system's:

- Significant capital improvement plan (CIP) driven by regulatory concerns in the next five years and additional long-term capital and rate pressures related to water supply needs;
- Required annual approvals by city council for customer water charge increases related to passed-through water purchase costs, which are also subject to Proposition 218 requirements; and
- Legal provisions that allow net system revenue calculations to include transfers from the rate stabilization fund and secondary purchase funds.

A senior-lien pledge of installment payments payable from the net

revenues of the city's water system secures the series 2009A water revenue refunding bonds and series 1998 certificates of undivided interest. A subordinate-lien pledge secures the series 2002 bonds. Series 2009A bond proceeds will be used to pay off \$57 million in note principal at the end of January 2009; the city council has authorized the issuance of the long-term series 2009A bonds at a market interest rate of up to 10%.

After issuing the 2009A refunding bonds, the water system will have about \$750 million of revenue bonds, state revolving fund loans, and private placement notes outstanding secured by senior and subordinate liens of the system's net revenue. The system has no variable rate debt outstanding. Coverage of senior debt service on the senior-lien debt by net system revenue in fiscal 2007 was a strong 3.6x, in our opinion. Total combined senior and subordinate debt service, was also what we consider strong at 1.8x. Based on fiscal 2008 unaudited results, system officials estimate net system income--including operating receipts, capacity charges, and interest earning revenue--provided what we consider strong senior and combined debt service coverage of approximately 3.0x and 1.5x, respectively. Fiscal 2008 unaudited results reflect a 38% decline in one-time capacity charges due to slowing residential construction. Excluding all capacity charges, estimated senior and combined debt service coverage in fiscal 2008 drops to 2.6x and what we view as a good 1.3x, respectively. Coverage of fixed water purchase charges and combined debt service, excluding capacity charges, totaled an adequate 1.15x in fiscal 2008, in our opinion, based on unaudited results.

Fiscal 2009 projections include a 6.5% rate increase approved by council and an 8.4% rate increase, effective Jan. 1, 2009, to offset rising water purchase costs and a one-year pilot project to study the viability of increasing potable water sources through reuse and reservoir augmentation. Together with the sewer rates, overall residential rates are somewhat above-average for a regional system, at about \$96 per 7,500 gallons per month, but what we believe is a still-manageable 2.5% of the city's 2007 median household effective buying income.

"The stable outlook reflects our expectation that pre-approved rate increases should help to maintain good debt service ratios in the next several years, despite the city's implementation of a large capital improvement program associated with regulatory requirements," said credit analyst Sussan Corson.

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