CREDIT OPINION
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Update

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City of San Diego, CA

Update - Moody's Affirms San Diego (CA)'s Aa2 Issuer Rating and A1 Lease Revenue Bond Rating; Outlook remains Stable

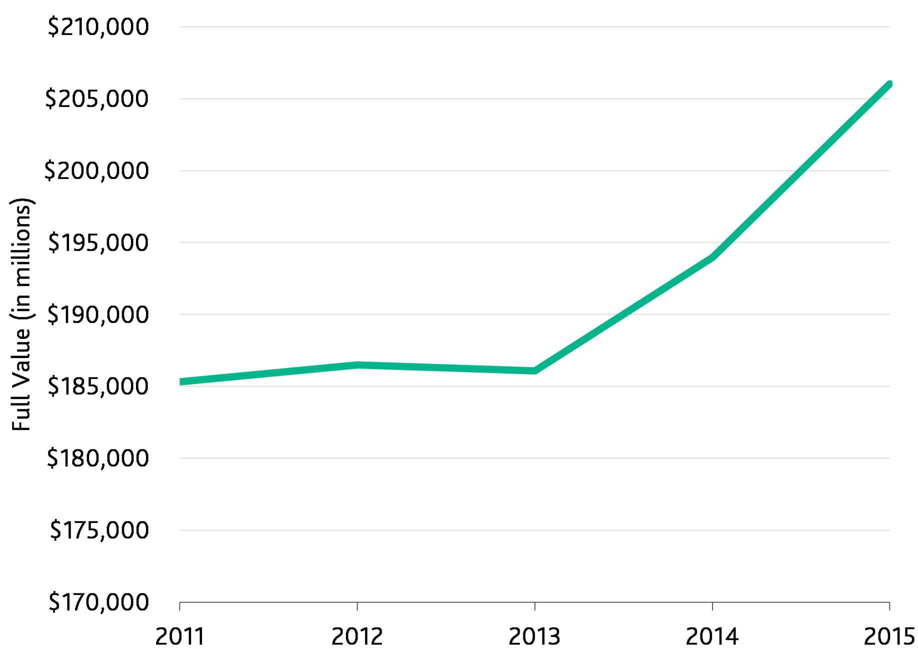
Summary Rating Rationale

Moody's Investors Service has affirmed the Aa2 issuer rating and A1 lease revenue bond ratings on the City of San Diego. The outlook on the ratings is stable. Moody's is currently evaluating comments we received on our proposed, methodological revisions to rating state and local government lease-backed obligations, the publication of the final, revised methodology could affect the city's lease-backed obligation ratings.

The Aa2 rating reflects the city's large and diverse economy which continues to demonstrate strong growth trends in key economic indicators, above average socio-economic indicators, a strong and improving financial position marked by growing reserves and policy targets. Additionally, factored in the Aa2 rating is a low debt burden and currently manageable pension and OPEB burdens, despite the uncertainty surrounding pension reform measures.

Strong Tax Base Growth Since 2014

Exhibit 1



Source: Moody's Investors Service

The issuer rating is equivalent to what the city's general obligation (GO) bond rating would be if it had any such debt. The difference between the city's issuer rating and its lease rating is based on the relative weakness of the pledge on the leases compared to the city's theoretical GO pledge as reflected by the issuer rating. The city's pledge to repay its lease debt is a contractual obligation, on parity with the city's other unsecured obligations. This promise is notably in contrast to the stronger, voter-approved GO pledge that provides a baseline for our estimate of the credit quality of lease pledges. Under California law, an issuer's GO pledge is an unlimited ad valorem property tax pledge. A California GO issuer must raise property taxes by whatever amount necessary to repay the obligation, irrespective of its general financial position.

Credit Strengths

- Large, diverse and dynamic local economy that continues to show strength in economic indicators
- Above average wealth and income levels for a large city
- Strong fiscal management with closely monitored budgets
- Continued positive financial performance increases reserve and liquidity position

Credit Challenges

- Exposure to economically sensitive revenue sources
- Significant portion of budget attributed to fixed costs
- Uncertainty surrounding pension reform savings as a result of Public Employment Relations Board order for city to rescind voter approved pension reform measure; city is currently appealing

Rating Outlook

The outlook on the ratings is stable. Moody's expects the city will continue to operate with strong fiscal discipline resulting in a stable financial position and reserves. We also expect continued improvement in the city and regional economy contributing to growth in the city's important revenue sources.

Factors that Could Lead to an Upgrade

- Significant growth in city reserve position
- Significant growth in overall wealth and income levels

Factors that Could Lead to a Downgrade

- Depletion of city reserve position or material challenges to the city's ability to generate structurally balanced budgets
- Significant and sustained contraction in the property tax base or overall economy

Key Indicators

Exhibit 1

Exhibit 2

San Diego (City of) CA	2011	2012	2013	2014	2015
Economy/Tax Base					
Total Full Value ($000)	$ 185,306,329	$ 186,504,557	$ 186,065,402	$ 193,971,148	$ 206,022,973
Full Value Per Capita	$ 141,252	$ 141,151	$ 140,296	$ 144,121	$ 150,595
Median Family Income (% of US Median)	120.5%	120.1%	120.1%	120.1%	120.1%
Finances					
Operating Revenue ($000)	$ 1,266,415	$ 1,253,633	$ 1,232,067	$ 1,371,603	$ 1,452,738
Fund Balance as a % of Revenues	12.8%	15.0%	16.1%	20.3%	17.1%
Cash Balance as a % of Revenues	20.0%	21.2%	22.4%	25.6%	26.5%
Debt/Pensions					
Net Direct Debt ($000)	$ 614,950	$ 563,660	$ 610,241	$ 615,888	$ 736,620
Net Direct Debt / Operating Revenues (x)	0.5x	0.4x	0.5x	0.4x	0.5x
Net Direct Debt / Full Value (%)	0.3%	0.3%	0.3%	0.3%	0.4%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	2.7x	2.9x	2.8x	2.8x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	1.8%	1.9%	2.0%	2.0%

Source: Moody's Investors Service

Detailed Rating Considerations

Economy and Tax Base: Large and Diverse Local Economy with Above Average Income and Wealth Levels for City of its Size

San Diego's economy is highly diverse with high technology manufacturing, international trade, and logistics playing roles in the expansion of the greater regional economy while the steadiness of long-entrenched military, higher education, and tourism sectors continues to provide a foundation for the city's large and strong economic base. The city population benefits from this dynamic and growing regional economy and has historically boasted above average wealth and income measures. The income estimates from 2013 where per capita income is 118% of the nation and median family income is 120% of the nation show continued gains over 109% and 106%, respectively, of the prior decade. Unemployment in San Diego continues to improve with the rate in November 2015 falling to its lowest levels over the past nine years and easily beating the respective state and national unemployment rates of 4.8% and 5.7% in the same time period.

Assessed value (AV) in 2016 reached an all time high of $218.4 billion posting a third consecutive year of strong AV growth. The tax base grew a healthy 6% in 2016, 6.2% in 2015, and 4.2% in 2014. The city's five-year average annual growth in AV was 3.3% in 2016. AV per capita is strong at $159,675 and comfortably exceeds the $109,557 US median for Aa2-rated cities and $133,454 for CA Aa2-rated cities. It is our expectation that strong tax base growth will continue given ongoing strength in the local economy, continued development in the city, and strong median housing sales prices. The median sales price of a home in San Diego is $485,000, close to the highest median sales price of $505,000 achieved in 2006.

Financial Operations and Reserves: Strong Financial Management and Robust Economic Performance Grow Revenues and Reserve Position

The city produced strong financial results in fiscal year 2015 generating a healthy $27.7 million surplus, or 2% of General Fund revenues. General Fund reserves grew to a healthy $377 million or 27.1% of revenues. The operating surplus was fueled by the conservative budgeting of expenditures and significant growth in the city's top revenue sources of property, sales, and transient occupancy taxes, as well as franchise fees. City reserves have grown steadily over the adequate 10% of revenues that were maintained six years ago, and now are more in-line with the 27% of General Fund revenues median for large US cities (General Fund revenues in excess of $750 million).

Fixed costs comprise a significant portion of the city's budget, with lease payments, pension and other post-employment benefit (OPEB) contributions making up 23.4% of expenditures in FY 2015. While these costs make up a significant portion of the city's budget and limit financial flexibility, it is of positive note that part of the increase is due to the city's aggressive approach to address its long-term pension and OPEB liabilities. The city's pension annually required contribution (ARC) had increased since the implementation of pension reform. However, the increase reflects the city's move to pay down the closed defined-benefit portion of the pension plan over a shorter 15-year amortization schedule.

The city's FY 2016 budget grew 7.5% over FY 2015 budgetary actuals and reflects growth in personnel for transportation, stormwater, parks and recreation, and police department full-time equivalents. The growth in the $1.29 billion General Fund budget is offset by a $6.2 million budgeted use of reserves. As of the city's first quarter report, revenues were outperforming budget and contributing to a slight surplus by year end. Management expects continued performance against these expectations growth in full-time expenditures.

LIQUIDITY

The city's liquidity position has improved and is healthy. Ending General Fund cash in fiscal year 2015 was $361 million or a 25.9% of General Fund revenues.

Debt and Pensions: Favorable Debt Position; Current Pension Burden Manageable, Impact of PERB Ruling to Overturn Pension Reforms Remains Unclear

The city's direct and overall debt ratios of 0.4% and 3.3%, respectively, are in line with other cities in the state, and compare to most large cities in the country. The city's $636.8 million of direct debt is composed of lease-supported obligations. The resulting lease burden of approximately $57.3 million represents a manageable 3.7% of 2015 Operating Funds expenditures. The city expects to issue approximately $270 million in lease obligation debt as needed between fiscal years 2017 and 2019 to continue to address ongoing infrastructure improvements. Of the city's outstanding lease-backed debt, Moody's rates approximately $272.4 million.

DEBT STRUCTURE

All of the city's outstanding debt is fixed rate.

DEBT-RELATED DERIVATIVES

The city has no debt-related derivatives.

PENSIONS AND OPEB

Pension-driven budgetary pressures for the city are significant, which prompted the city to take various steps to address the growing expenditure. In 2012 city voters approved Proposition B which sought to reform pensions, closing the city's defined benefit plan to employees hired after July 20, 2012 except police officers. The effect of pension reform including a negotiated 5 year pay freeze was a reduction of the city's unfunded pension liability by an estimated $194.9 million on a $2.2 billion liability. However, the status of these savings remains unclear given a December 2015 ruling by Public Employment Relations Board that ruled the city illegally placed Proposition B on the ballot without first conferring with labor groups. The city has appealed this ruling and is undertaking a study to determine the financial impact if its pension reform efforts are unwound. Moody's will continue to monitor these developments.

Moody's adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, is $3.74 billion or, compared to other California cities, an elevated 2.8 times operating revenues in FY 2015. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities.

The city's other post-employment benefits (OPEB) include retiree health care benefits to eligible retirees through a variety of defined benefit and defined contribution plans. The city has a unfunded OPEB obligation of $537.3 million, which is a very high 615.8% of covered payroll. The city's total retiree health contribution in FY 2015 was $57.8 million, which included a $31.5 million towards the defined benefit OPEB (or 75.5% of the defined benefit OPEB ARC). As of June 30, 2015 the city has $121.1 million in a California Employers Retiree Benefit Trust to pre-fund future defined benefit OPEB plan expenses.

Management and Governance: Moderate revenue-raising ability; strong financial management

The city's financial management is strong and effective and has produced consistently strong operating results. Financial reserve policies have been revisited and strengthened periodically, most recently in January of 2016 when the city council voted to increase its overall General Fund reserve to 16.7% of revenues, up from 14%. Additionally, the city council approved the creation of a separate Pension Payment Stabilization Reserve within the city reserve policy. The initial size and time frame to fund these increased reserves will be adopted later this year. The city's formal decision to establish a Pension Payment Stabilization Reserve sets it apart from its peers. The city's strong financial management will likely ensure stable reserves and operations going forward.

California cities have an institutional framework score of "A," or moderate. Revenue predictability is moderate, because the primary sources are property taxes and sales taxes. Property taxes are very predictable, given the state's constitutional formula, known as Proposition 13, while sales taxes are economically sensitive. Revenue-raising ability is moderate because increases almost always require voter approval. Expenditure reduction ability is moderate, because of collective bargaining and growing pension and OPEB pressures. Expenditure predictability is high, as police and fire typically make up 60% of discretionary spending in full-service cities.

Legal Security

The lease revenue bonds are secured by payments made by the Public Facilities Financing Authority of the City of San Diego, which are the derived from rental payments made by the city to the authority for the use and occupancy of leased property.

Use of Proceeds

Not Applicable

Obligor Profile

The City of San Diego is the second largest city in California and is the economic center of the region. The city is comprised of 342 square miles and its estimated population is 1.37 million. The city provides a full range of governmental services including police, fire, sanitation and health, construction and maintenance of streets and infrastructure, recreational activities and cultural events, and the maintenance and operation of water and sewer utilities. The city was incorporated in 1850 and has operated under a city charter since electoral adoption in 1922. The city is governed under a strong mayor form of government.

Methodology

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. An additional methodology used in the lease-backed rating was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in December 2011. Please see the Ratings Methodologies page on www.moodys.com for a copy of these methodologies.

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