CITY OF SAN DIEGO
REPORT OF RATING CHANGES

PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO, CALIFORNIA (Base CUSIP: 797299)

$167,635,000 Lease Revenue Refunding Bonds, Series 2010A (Master Refunding Project)

$ 90,745,000 Lease Revenue Bonds, Series 2012A (Capital Improvement Projects) **and Series 2012B** (Fire and Life Safety Facilities Refunding)

$49,530,000 Lease Revenue Bonds and Lease Revenue Refunding Bonds, Series 2013A (Capital Improvement Projects and Old Town Light Rail Extension Refunding) **and Series 2013B** (Balboa Park/Mission Bay Park Refunding)

$107,290,000 Lease Revenue Bonds, Series 2015A (Capital Improvement Projects) **and Series 2015B** (Capital Improvement Projects);

$103,255,000 Lease Revenue Bonds and Lease Revenue Refunding Bonds, Series 2016 (Ballpark Refunding)

CONVENTION CENTER EXPANSION FINANCING AUTHORITY (Base CUSIP:79727L)

$140,440,000 Lease Revenue Refunding Bonds, Series 2012A (City of San Diego, California, as Lessee)

NOTICE IS HEREBY GIVEN that on February 17, 2017, Fitch Ratings, Inc. raised its rating on the City of San Diego's Lease Revenue Refunding Bonds (issued by either the Public Facilities Financing Authority or the Convention Center Expansion Financing Authority) to "AA-" from "A+". The City's Issuer Default Rating was also raised to "AA" from "AA-" The outlook on the rating was revised from "Positive" to "Stable".

This is not a recommendation to buy, sell or hold any City indebtedness. Generally, a rating agency bases its ratings on the information and materials furnished to it and on investigations, studies and assumptions of its own. There is no assurance that such ratings will continue for any given period or that such ratings will not be revised downward or withdrawn entirely provided, if in the view of such rating agency, circumstances warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price or marketability of the City's obligations identified above.

DATED: 2-23-17

CITY OF SAN DIEGO

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San Diego, California

Full Rating Report

Ratings

San Diego

Issuer Default Rating	AA

San Diego Public Facilities Financing Authority

Lease Revenue Bonds	AA–
Series 2010A (Master Refunding Project) Lease Revenue Bonds, Series 2012A (Capital Improvement Projects)	AA–
Lease Revenue Bonds, Series 2012B (Fire and Life Safety Facilities)	AA–
Lease Revenue Bonds, Series 2013A (Capital Improvement Projects and Old Town Light Rail Extension Refunding) and 2013B (Balboa Park/Mission Bay Park Refunding)	AA–
Lease Revenue Bonds, Series 2015A (Capital Improvement Project) and 2015B (Capital Improvement Projects)	AA–
Lease Revenue Bonds, Series 2016 (Ballpark Refunding)	AA–

Convention Center Expansion Financing Authority

Lease Revenue Bonds, Series 2012A	AA–

Rating Outlook

Stable[a]

[a]Revised from Positive on Feb. 17, 2017.

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Analytical Conclusion

The upgrade of San Diego's Issuer Default Rating (IDR) and lease revenue bond ratings results from application of Fitch Ratings' revised criteria for U.S. state and local governments, released on April 8, 2016, particularly with regard to the strength of the city's revenue framework and anticipated financial resiliency in a stress scenario.

The city's exceptionally strong gap-closing capacity and satisfactory reserves result from its strong general fund revenue performance, solid expenditure flexibility, healthy economy and tax base, conservative financial management policies, and strong financial planning and disclosure practices.

Key Rating Drivers

Economic Resource Base: San Diego is the second most populous city in California, with a gradually growing population of approximately 1.4 million. The city's diverse economy continues to benefit from job growth, residential and commercial construction, and a strong tourism sector. Approximately 2,300 new hotel rooms are under or pending construction. The city's unemployment rate (less than 4% in December 2016) is lower than the unemployment rates of San Diego County, the state and the nation.

Wealth and education characteristics are largely above average, and the tax base continues to grow strongly. The relatively minor taxable assessed valuation (TAV) decline during the recession (less than 3% between fiscal years 2010 and 2013) has been more than offset by the almost 18% TAV growth that occurred through fiscal 2017, reflecting a more buoyant property market and ongoing new construction.

Revenue Framework: 'aa' factor assessment. General fund revenues have performed well in excess of national GDP, and the major revenue streams are all projected to continue growing. However, this revenue strength is partially offset by the city's limited independent revenue-raising ability.

Expenditure Framework: 'aa' factor assessment. The city faces expenditure pressures above revenue growth, which could result in deficit spending through fiscal 2019. Subsequently, the city expects to return to balanced operations through fiscal 2022. Expenditure flexibility is solid, but the strong labor environment is somewhat of a constraint.

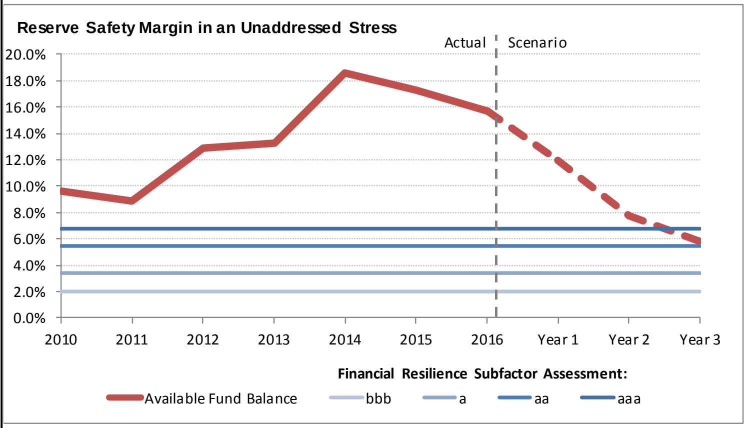
Long-Term Liability Burden: 'aa' factor assessment. Long-term liabilities are moderate relative to the city's resource base. Based on the city's limited debt issuance plans, average direct debt amortization rate and the expected growth in personal income, Fitch expects the long-term liability burden to remain moderate. However, Fitch notes that the city does not control debt issued by overlapping entities or pension system demographic assumption changes.

Operating Performance: 'aaa' factor assessment. The city's gap-closing capacity is exceptionally strong, supported by satisfactory reserves and strong financial management oversight and planning.

San Diego (CA)

Scenario Analysis

v. 1.10 2016/06/22



Analyst Interpretation of Scenario Results:

Given the city's historically low revenue volatility, solid budget flexibility, and satisfactory reserves, Fitch expects the city to retain exceptionally strong gap-closing capacity through the economic cycle. The city prioritizes the funding of various financial reserves. However, from fiscal 2018 onwards, pressure to fund larger actuarially determined pension contributions might result in slowing by four years the timetable to reach general fund reserve targets. This suggests a level of funding pressure on the general fund in the medium term. Despite a strong labor environment and litigation related to pension reform, the city was able to negotiate concessions with its labor groups both during and after the most recent recession.

Scenario Parameters:	Year 1	Year 2	Year 3
GDP Assumption (% Change)	(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)	2.0%	2.0%	2.0%
Revenue Output (% Change)	(1.4%)	1.5%	4.3%
Inherent Budget Flexibility	Midrange		

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2010	2011	2012	2013	2014	2015	2016	Year 1	Year 2	Year 3
Total Revenues	965,607	1,051,162	1,125,782	1,103,557	1,260,618	1,315,944	1,396,556	1,377,633	1,397,829	1,457,754
% Change in Revenues	-	8.9%	7.1%	(2.0%)	14.2%	4.4%	6.1%	(1.4%)	1.5%	4.3%
Total Expenditures	1,072,732	1,099,393	1,130,309	1,146,831	1,267,040	1,315,313	1,369,054	1,396,435	1,424,364	1,452,851
% Change in Expenditures	-	2.5%	2.8%	1.5%	10.5%	3.8%	4.1%	2.0%	2.0%	2.0%
Transfers In and Other Sources	146,339	160,857	91,289	108,179	77,757	79,971	48,216	47,563	48,260	50,329
Transfers Out and Other Uses	38,583	25,453	66,624	74,678	46,938	52,901	78,173	79,736	81,331	82,958
Net Transfers	107,756	135,404	24,665	33,501	30,819	27,070	(29,957)	(32,174)	(33,071)	(32,629)
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	631	87,173	20,138	(9,773)	24,397	27,701	(2,455)	(50,976)	(59,606)	(27,726)
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	0.1%	7.7%	1.7%	(0.8%)	1.9%	2.0%	(0.2%)	(3.5%)	(4.0%)	(1.8%)
Unrestricted/Unreserved Fund Balance (General Fund)	107,027	99,868	154,306	161,991	243,981	236,608	227,171	176,195	116,589	88,862
Other Available Funds (Analyst Input)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Analyst Input)	107,027	99,868	154,306	161,991	243,981	236,608	227,171	176,195	116,589	88,862
Combined Available Fund Bal. (% of Expend. and Transfers Out)	9.6%	8.9%	12.9%	13.3%	18.6%	17.3%	15.7%	11.9%	7.7%	5.8%

Reserve Safety Margins	Inherent Budget Flexibility				
	Minimal	Limited	Midrange	High	Superior
Reserve Safety Margin (aaa)	21.7%	10.8%	6.8%	4.1%	2.7%
Reserve Safety Margin (aa)	16.3%	8.1%	5.4%	3.4%	2.0%
Reserve Safety Margin (a)	10.8%	5.4%	3.4%	2.0%	2.0%
Reserve Safety Margin (bbb)	4.1%	2.7%	2.0%	2.0%	2.0%

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's downturn scenario assumes a -1.0% GDP decline in the first year, followed by 0.5% and 2.0% GDP growth in Years 2 and 3, respectively. Expenditures are assumed to grow at a 2.0% rate of inflation. Inherent budget flexibility is the analyst's assessment of the issuer's ability to deal with fiscal stress through tax and spending policy choices, and determines the multiples used to calculate the reserve safety margin. For further details, please see Fitch's US Tax-Supported Rating Criteria.

Rating History — IDR

Rating	Action	Outlook/ Watch	Date
AA	Upgraded	Stable	2/17/17
AA–	Affirmed	Positive	2/2/16
AA–	Assigned	Stable	4/13/12
AA–	Revised	Stable	4/30/10
A+	Upgraded	Stable	12/11/08
BBB+	Affirmed	Positive[a]	3/27/08
BBB+	Downgraded	Negative[a]	5/27/05
A	Downgraded	Negative[a]	2/16/05
AA	Affirmed	Negative[a]	9/23/04
AA	Downgraded	Negative	2/27/04
AAA	Upgraded	—	5/28/02
AA+	Assigned	—	4/3/98

[a]Rating Watch.

Rating History — Lease Revenue Bonds

Rating	Action	Outlook/ Watch	Date
AA–	Upgraded	Stable	2/17/17
A+	Affirmed	Positive	2/2/16
A+	Revised	Stable	4/30/10
A	Upgraded	Stable	12/11/08
BBB–	Affirmed	Positive[a]	3/27/08
BBB–	Downgraded	Negative[a]	5/27/05
A–	Downgraded	Negative[a]	2/16/05
AA–	Affirmed	Negative[a]	9/23/04
AA–	Downgraded	Negative	2/27/04
AA+	Assigned	—	5/28/02

[a]Rating Watch.

Related Research

San Diego Public Facilities Financing Authority, California (February 2016)

Related Criteria

U.S. Tax-Supported Rating Criteria (April 2016)

Rating Sensitivities

Maintenance of Financial Resilience: The ‘AA’ IDR is sensitive to shifts in fundamental credit characteristics, most notably Fitch’s expectations for the city’s ongoing strong financial flexibility throughout economic cycles. Successfully addressing the city’s capital and pension expenditure pressures could result in positive rating action.

Credit Profile

Revenue Framework

The city’s total general fund revenues have outperformed national GDP growth and inflation over the past 10 years, despite a less diverse revenue structure than most other large California cities. For example, San Diego does not levy a utility user tax or a trash collection fee, and has a relatively low business license tax rate. Such levies require voter approval, and Fitch believes that there would likely be considerable taxpayer and voter resistance to introducing or increasing such taxes. However, in November 2016, voters did approve a non-medical cannabis business tax of up to 15% on gross receipts.

Fitch expects that the city’s four primary general fund revenue sources (property, sales and transient occupancy taxes, and franchise fees) will continue to grow in the medium term, given projected ongoing economic strengthening and a healthy tourism sector.

As with all local governments in California, the city’s independent legal ability to raise revenue is constrained by various voter-approved initiatives (most notably Propositions 13 and 218).

Expenditure Framework

Personnel expenses represent 68% of the adopted fiscal 2017 general fund budget. Baseline personnel expenses will increase in the medium term, primarily due to higher actuarially determined contributions (ADC) for pensions and negotiated compensation and benefit increases in multiyear contracts. These include adjustments for specific positions experiencing recruitment and retention pressures. Overall, salary and benefit changes are projected to increase total general fund spending by 1% in fiscal 2018, 2% in fiscal 2019 and 3% annually during fiscal years 2020–2022. Non-personnel expenses will increase because of inflation.

Based on the city’s current spending profile and manageable population growth, Fitch expects future general fund expenditure growth to be in line with, to marginally above, general fund revenue growth.

Estimated governmental carrying costs for direct debt service and pension costs are sizable, and likely to remain so as new debt is issued and the city continues to seek to reduce its unfunded pension liabilities. While the city’s workforce framework does not include binding arbitration requirements or prohibitions against layoffs or furloughs, negotiations occur with strong labor associations that actively litigate against benefit reforms. Personnel cost increases are already locked in via multiyear contracts, and the city will continue to need to address recruitment and retention pressures, particularly for its sworn personnel. Nevertheless, the city has demonstrated its ability to negotiate personnel cost controls, by restraining pensionable pay increases and modifying OPEB entitlements. The city has also modified service provision levels where necessary.

Long-Term Liability Burden

Long-term liabilities are moderate relative to the city’s resource base. The city’s debt issuance plans are limited, and its direct debt amortization rate is average. Given expected growth in personal income, this suggests the long-term liability burden will remain moderate. However, the city's overall debt profile could be affected if additional debt is issued by San Diego County, which is expected to maintain a low debt profile, and/or by San Diego Unified School District, which retains $3 billion in unspent bonding authority.

The city's attempt to reform its pension system still awaits judicial appeal proceedings. In the event that pension reform has to be wholly or partially unwound in response to the litigation outcomes, the city's long-term liabilities would increase. However, there would be little near-term impact on the city's annual operating costs.

What will impact the city's annual operating costs is the San Diego City Employees' Retirement System board's adoption of new actuarial assumptions, most notably related to demographics and mortality. These will likely increase the unfunded actuarial accrued liability by approximately $444 million (to nearly $2.6 billion) and increase the fiscal 2018 ADC by over $42 million (16%). The city is wholly responsible for the ADC increases related to retirees, and 50% responsible for the ADC increases related to current employees.

To fund a portion of this increased pension ADC cost in fiscal 2018, the city will draw down on its pension payment stabilization reserve, created in 2016 to provide a funding source for ADC increases and investment underperformance. That reserve is currently fully funded at $21 million (8% of the last three years' average ADC). The city plans to incrementally replenish the reserve from available funds in future years, including cash freed up from pushing out the 16.7% general fund reserves goal by four years to fiscal 2025, and by redeploying cash in the workers' compensation reserve to fund other reserves. Effectively, the use of reserves is providing a stop-gap funding source for fiscal 2018, while the city adjusts its baseline spending in future years to accommodate the increased pension ADCs.

In contrast to pension system reform, the city successfully made OPEB modifications in the face of considerable labor opposition. An initiative to cap the city's annual OPEB contributions successfully withstood a legal challenge on the basis that OPEBs are an employment benefit rather than a vested contractual right and, therefore, can be modified. The city's unfunded actuarial accrued OPEB liability is approximately $538 million, or less than 1% of personal income.

Operating Performance

Given the city's historically low revenue volatility, solid budget flexibility and satisfactory reserves, Fitch expects the city to retain exceptionally strong gap-closing capacity through the economic cycle. For details, see Scenario Analysis, page 2.

The city ended fiscal 2015 with a strong unrestricted general fund balance of approximately $237 million, over 17% of spending, and then lowered it slightly in fiscal 2016 to $227 million, or almost 16% of spending, due to increased transfers out to other governmental funds. Nevertheless, in fiscal 2016, the city fully funded its reserve policy goal (14.5% of the most recent three-year average of annual audited general fund revenues on a budgetary basis). The city also ended fiscal 2016 with almost $107 million in other fund balances, which could be borrowed by the general fund in an emergency. Despite a small deficit in the midyear fiscal 2017 report, the city expects to end fiscal 2017 in balance due to departmental under-expenditures, and to meet that year's reserve policy goal of 14.75%.

The city's general fund reserves target increases to 15% in fiscal 2018. The city expects to balance its fiscal 2018 budget without drawing down on those reserves to cover that year's increased pension ADC. A key budget balancing tool will be 3.5% departmental spending reductions.

Infrastructure investment continues to be both a priority and a challenge. During fiscal years 2014–2016, the city invested approximately $432 million in general fund infrastructure improvements, of which bond proceeds funded approximately 30%. The city has also undertaken extensive capital planning. Its five-year capital infrastructure planning outlook identifies $4.3 billion in capital infrastructure needs in fiscal years 2018–2022, based on both existing ongoing capital improvement projects, as well as new projects to address regulatory requirements. The city has identified $3 billion in projected funding, leaving an estimated funding gap of $1.3 billion. This translates into a projected funding shortfall of between $210 million and $358 million per year. These estimates exclude proposed convention center expansion and stadium redevelopment projects.

A number of new capital funding sources have been identified. These include potential capital bonds and a new infrastructure fund commencing in fiscal 2018, to be funded by an estimated $72 million in unrestricted general fund revenues during fiscal years 2018–2022. A proposed ballot measure in fiscal 2018 or 2019 to increase transient occupancy tax could provide a funding source for additional street repair and convention center expansion plans, as well as homeless services.

There will be continued infrastructure investment challenges in the longer term. For example, capital costs related to storm water permit compliance and flood risk management are currently estimated at almost $1.5 billion between fiscal years 2022 and 2035.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.