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Ratings

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Summary:

Successor Agency to the San Diego Redevelopment Agency, California; Tax Increment

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Summary:

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Credit Profile		
US$177.945 mil tax alloc rfdg bnds ser 2017B dtd 01/26/2017 due 09/01/2040		
Long Term Rating	AA/Stable	New
US$57.93 mil tax alloc rfdg bnds ser 2017A dtd 01/26/2017 due 09/01/2040		
Long Term Rating	AA/Stable	New
Successor Agy to the San Diego Redev Agy tax alloc rfdg bnds		
Long Term Rating	AA/Stable	Upgraded

Rationale

S&P Global Ratings raised its rating to 'AA' from 'AA-' on the Successor Agency (SA) to the San Diego Redevelopment Agency (RDA), Calif.'s tax allocation refunding bonds (TARBs), series 2016. At the same time, S&P Global Ratings assigned its 'AA' rating to the SA's TARBs, series 2017. The outlook is stable.

The upgrade reflects our view of the increase in coverage resulting from recent assessed value (AV) growth and refunding savings, as well as the strong recovery of AV across the combined project areas.

The rating on the TARBs reflects our view of the agency's:

- Very strong 2017 coverage of maximum annual debt service (MADS);
- Large and diverse tax base spanning multiple project areas over 10,000 acres throughout the city of San Diego, with a combined valuation in excess of $26 billion;
- Moderately low volatility ratio of 0.17 across all project areas; and
- Limited ability to issue additional debt pursuant to the 2016 indenture.

Partially offsetting these strengths, in our view, are consistently large historical taxpayer appeals, although we note that both the value in dispute and the rate of successful appeals have declined in recent years.

The series 2017 TARBs will refund the following series of outstanding tax allocation bonds of the former RDA:

- Series 2006A and B (Centre City),
- Public Facilities Financing Authority series 2007 A and B (Southcrest, Central Imperial, and Mount Hope),
- Series 2008A (Centre City),
- Series 2009A (North Park),
- 2010 series A and B (City Heights),
- 2010 series A (Crossroads,)
- 2010 series A (Naval Training Center),
- 2010 series A and B (San Ysidro), and
- Housing set-aside 2010 series A.

The series 2017 TARBs will be issued on parity with the agency's series 2016 TARBs and secured by a lien on money available from time to time in the agency's redevelopment property tax trust fund (RPTTF), after payment of senior pass-throughs and debt service on senior obligations issued for individual project areas. A debt service reserve funded in cash or investment-grade surety at the lowest of MADS, 10% of principal, or 125% of average annual debt service further protects the bonds.

Upon closing of the series 2017 TARBs, the ratings on the above bonds will be subject to discontinuance. The RDA's series 1999A, 2003B, and 2001A bonds, each secured by a prior lien on revenues generated by the Centre City project area, will remain outstanding. In addition to the senior Centre City bonds, the agency has two other agreements with a prior lien on tax increment generated solely by the Grantville and Naval Training Center project areas, respectively. Each senior obligation is secured by tax increment revenues derived from the specific project area for which it was issued, but not by RPTTF revenues or tax increment derived from the agency's other project areas.

We calculate that 2017 pledged revenue, after accounting for projected discounts due to open pending appeals, provides 3.72x coverage of senior and parity MADS. Our calculation is based on a tax rate of 1% and excludes 20% housing set-aside pledged revenue generated by the Grantville project area (approximately 0.6% of pledged revenue from all project areas combined), which has a senior developer agreement with an indeterminate payment schedule due in an amount not to exceed $9.8 million. Coverage for fiscal 2017 is also calculated assuming a loss of $7.5 million (roughly 3% of gross tax increment revenue) to account for open pending appeals. In fiscal 2018, assuming no further growth and the resolution of open pending appeals based on historical success rates, we expect coverage to exceed 4x MADS.

The Naval Training Center project area also has a senior developer agreement, under which the agency is obligated to reimburse the developer for certain yet-to-be-completed improvements within the project area. We understand that the agency has subordinated to debt service payments due to the developer for future improvements, and we consider amounts due from tax increment for completed improvements, which total $800,000 due within the next two years, to be minimal.

The combined project areas lost just 5.5% of total AV between fiscal years 2009 and 2012, when many areas of the state and the nation saw much steeper recessionary declines. Since 2013, combined AV has grown by a cumulative 24% to $26.9 billion in 2017. The Centre City Expansion, Marina, Gaslamp, and Columbia project areas, which were merged in 1992, make up 58% of combined project AV.

The agency reports that the combined project areas currently have $6.5 billion in value under appeal, with an estimated value reduction of $757 million, or 2.8% of total AV in fiscal 2017. While appeals activity within the project areas has historically been large, the number and size of appeals as well as their success rate have declined since 2011.

The combined project areas represent a mix of residential (43.6%) and commercial (47.1%) property, and the aggregate top 10 taxpayers are moderately diverse, in our view, accounting for 13% of total AV. The leading taxpayer, a large hotel in the Marina project area, accounts for 3% of AV; however, we believe the risk of delinquent tax payments is mitigated by the fact that vacancy rates at the hotel, a major attraction for tourists and conference goers in the city's popular waterfront area, are consistently low. At the current combined volatility ratio of 0.17 and coverage of

3.72x, we calculate that the project areas could withstand the loss of 61% of AV before coverage on the bonds fell below 1x. Given the size and dispersion of the project areas across the city of San Diego, we believe such a decline is substantially less likely than it would be for a smaller, contiguous project area.

San Diego, the second-largest city in California by population, is a major economic center whose base has historically been the tourism, military, and aerospace/defense sectors, with growing biotech and telecommunications clusters. Its economy 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. Median household effective buying income in the city is 115% of the national level, which we consider good.

Postdissolution debt administration

The city is serving as SA to the former RDA after Assembly Bill (AB) x126 and its trailer legislation AB1484 dissolved these agencies. The SA has received its finding of completion from the state Department of Finance (DOF), and completed an asset transfer review by the State Controller's Office with no significant findings. The SA currently has two lawsuits outstanding to dispute the DOF's determination on the disposition of certain assets and obligations postdissolution. We currently do not believe that the disputes pose a significant threat to the agency's RPTTF distribution, given that the agency has complied under protest with the DOF's direction to transfer disputed cash to the SA.

ABx126 and AB1484 require SA and oversight officials to adhere to deadlines for requesting debt service payment amounts and subordinating pass-through payments when necessary. Since the law limits the SA revenue to payment on enforceable obligations, and since it requires more proactive management than under the predissolution flow of funds, we believe an SA's debt management practices after dissolution become more important to credit quality.

We understand the SA has complied with 2016 indenture provisions requiring it to request in each semiannual recognized obligation payment schedule period an amount sufficient fund full annual debt service payments on all outstanding bonds. Should the agency receive insufficient RPTTF in its Jan. 2 distribution to cover all its debt service for the year, its senior indentures require it to deposit with the trustees from the first available revenue received each year from applicable project areas an amount sufficient to cover all payments due under senior indentures for the bond year, and to apply any remaining available revenues toward annual debt service on the bonds, with any shortfall to be cured as soon as possible from the next semiannual RPTTF distribution. Based on available RPTTF funds reported in the county auditor semiannual distribution estimate reports, we anticipate that the SA will have sufficient available revenues in the RPTTF to cover full annual debt service on all (senior and parity) bonds from the January distribution.

Under the 2016 indenture, the SA may issue additional senior or parity bonds only to refund existing senior or parity debt as permitted by section 34177.5 of the Dissolution Act. We do not expect that any such issuance would dilute debt service coverage.

Outlook

The stable outlook reflects our anticipation of continued strong debt service coverage supported by a robust and growing tax base that is not concentrated by geography or ownership.

Upside scenario

We could raise the rating on the bonds should continued growth in the combined project areas contribute to increased coverage levels and lower volatility such that the agency's credit characteristics are no longer commensurate with those of similarly rated peers.

Downside scenario

We could lower the rating should AV experience significant and sustained declines, causing coverage on the bonds to decrease to levels we no longer view as consistent with peers'.

Related Research

- Revisiting The Dissolution Of California Redevelopment Agencies, June 11, 2013
- Following A Decade Of Change, The Tax Increment Sector Shows Improving Credit Quality, March 28, 2016

Ratings Detail (As Of January 9, 2017)		
Successor Agy to the San Diego Redev Agy tax alloc rfdg bnds (federally taxable)		
Long Term Rating	AA/Stable	Upgraded