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Ratings

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Summary:

San Diego Community Facilities District No. 2 (Santaluz) Improvement Area No. 1, California; Special Assessments

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San Diego Comnty Facs Dist No. 2 (Santaluz) Imp Area No. 1 spl tax rfdg bnds		
Long Term Rating	BBB+/Stable	Affirmed

Rationale

S&P Global Ratings affirmed its 'BBB+' rating on San Diego Community Facilities District (CFD) No. 2 (Santaluz) Improvement Area No. 1, Calif.'s series 2011A special tax refunding bonds. The outlook is stable.

The rating reflects our view of:

- The adequate, 18.6 to 1 combined direct and overlapping value-to-lien (VTL) ratio; and
- A S&P Global calculated 13% of the levy from properties with an overall VTL ratio below 10 to 1.

Those credit weaknesses are offset in part by our view of:

- The mostly built-out and primarily residential nature of the district in San Diego;
- Good assessed value (AV) growth for three consecutive years, leading to improved VTL ratios; and
- A closed parity lien except for refunding purposes.

The bonds are secured by special taxes collected from real property in the district, net of administrative expenses. Special tax rates vary across parcels and are based on square footage. Debt service coverage (DSC) is based on the Mello-Roos law limitation of the district's ability to increase the annual levy by 10% on residences above the amount that would have been levied as a result of delinquencies or defaults. The bonds are protected by a fully funded debt service reserve (DSR), which is required to be equal to the least of maximum annual debt service (MADS), 125% of average annual debt service, or 10% of the original par amount. The district agrees not to issue any additional parity debt except for refunding purposes.

San Diego CFD No. 2 is 20 miles northeast of downtown San Diego and encompasses 2,546 gross acres. It is primarily residential and levied a special tax on 1,000 parcels in fiscal 2015 with 87.6% of the special tax levy from completed parcels; six parcels remain undeveloped.

The district's direct and overlapping, or overall, VTL ratio is about 18.6 to 1 in fiscal 2016, reflecting what we consider to be a somewhat large amount of direct and overlapping debt. The direct VTL ratio in fiscal 2016 is 31.2 to 1. In fiscal 2016, district AV increased 5.4% to about $1.32 billion, marking the third consecutive year of rising AV after the recession. Although the district's special tax is on a per-property basis and not dependent on AV, we view AV as an indicator of the tax base performance.

In our view, given the primarily residential composition of the district, the tax base is diverse, with the top 10 taxpayers responsible for 5.9% of the special taxes. The leading taxpayer, a golf course, constitutes only 2.7% of the fiscal 2016 special tax levy.

While the maximum levy would provide DSC of about 1.57x for the bonds, the district is practically limited to raise the levy by 10% as a result of delinquencies. In 2015, it levied roughly 61% of the maximum tax for fiscal 2016 to cover debt service on the bonds, which resulted in 0.96x coverage. For the remaining portion needed for debt service, the district used some extra cash on hand from a surplus fund as a credit to taxpayers in the district. The district intends to use the surplus account for next several years, which should continue to provide some minor relief to taxpayers. The effective tax rate is about 1.44% in fiscal 2016.

At 1.1x coverage, we calculate that the district could withstand either a permanent tax delinquency equivalent to the amount generated by its top 10 largest special taxpayers (representing approximately 5.9% of the estimated 2016-2017 maximum tax), a permanent delinquency of special taxpayers with overall VTL ratios of less than 5 to 1 (representing about 6.2% of the estimated 2016-2017 maximum tax), or 14.4% delinquencies annually till the DSR is exhausted. The fiscal year-end 2015 delinquency rate was very low, in our view, at 0.3%. We understand the district has historically set the actual levy based on historical delinquency rates, estimated administrative fees, and debt service.

Median household effective buying income for San Diego is strong, in our view, at 115% of the national level. As of February 2016, the city and San Diego County unemployment rate stood at 4.4% and 4.7%, respectively, which was lower than the state and national averages.

Outlook

The stable outlook reflects our view of the district's primarily residential and virtually built-out status. It also reflects our view of the district's low delinquency rates and consecutive years of AV growth, leading to greater overall VTL ratios. We do not anticipate changing the rating in the two-year outlook horizon.

Upside scenario

We could raise the rating if properties with an overall VTL ratio below 10 to 1 show improvement and if AV grows significantly enough to increase the district's overall VTL to levels above those of similarly rated peers.

Downside scenario

Should delinquency rates in the district increase considerably and the tax base deteriorate, we could consider lowering the rating.

Related Criteria And Research

Related Criteria

- USPF Criteria: Special-Purpose Districts, June 14, 2007
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings public website at www.standardandpoors.com. Use the Ratings search box located in the left column.