STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

RatingsDirect®

# Summary:

# San Diego, California; Appropriations; General Obligation

**Primary Credit Analyst:**
Misty L Newland, San Francisco (1) 415-371-5073; misty.newland@standardandpoors.com

**Secondary Contact:**
Lisa R Schroeer, Charlottesville (1) 434-220-0892; lisa.schroeer@standardandpoors.com

## Table Of Contents

## Summary:

# San Diego, California; Appropriations; General Obligation

| Credit Profile | | |
|---|---|---|
| US$60.57 mil lse rev bnds (Capital Improvement Projects) ser 2015A due 10/15/2044 | | |
| *Long Term Rating* | AA-/Stable | New |
| US$48.435 mil lse rev bnds (Capital Improvement Projects) ser 2015B due 10/15/2033 | | |
| *Long Term Rating* | AA-/Stable | New |
| San Diego ICR due 04/30/2040 | | |
| *Long Term Rating* | AA/Stable | Affirmed |

## Rationale

Standard & Poor's Ratings Services assigned its 'AA-' rating to San Diego, Calif.'s lease revenue bonds, series 2015A and 2015B. We also affirmed our 'AA' issuer credit rating (ICR) on the city and our 'AA-' long-term rating and underlying rating (SPUR) on various authorities' lease revenue bonds, issued for San Diego. The outlook on all ratings is stable.

The city's lease revenue bonds are secured by lease payments made by San Diego, as lessee, to various authorities as lessor, for the use and possession of the leased assets. The ratings on the authorities' lease revenue bonds reflect our view of the city's general credit characteristics and its covenant to budget and appropriate annual lease payments for various properties' use. Payments are triple net, without right of set-offs, and the city is responsible for maintenance, taxes, and utilities. Payments may be abated in the event of damage to, or the destruction of, the leased assets. To mitigate abatement risk in such a case, the city has covenanted to maintain rental-interruption insurance coverage equal to 24 months of maximum annual debt service. We understand proceeds from the series 2015A and 2015B bonds will be used to fund capital improvement projects. We understand that litigation challenging the validity of the bonds is currently pending in the California Court of Appeals. In the opinion of the city's bond counsel, the California Supreme Court, acting reasonably and properly briefed on the issues, would not conclude that the 2015 bond approvals are invalid based on such allegations.

The ratings reflect our assessment of the following factors for the city:

- Very strong economy, which benefits from participation in the broad and diverse metropolitan statistical area (MSA);
- Strong budgetary flexibility, with available general fund reserves equal to 14% of general fund expenditures for fiscal 2014;
- Adequate budgetary performance;
- Very strong liquidity providing very strong cash levels to cover both debt service and expenditures;
- Very strong management with strong financial policies; and
- Very weak debt and contingent liabilities profile

### Very strong economy

We consider the city's economy to be very strong, with projected per capita effective buying income at 119% of the U.S. and per capita market value of $153,108. Assessed valuation (AV) reached $206.1 billion for fiscal 2015, an increase of 6%. The city informed us that AV grew 4.2% for fiscal 2014. The city, with a population of 1.3 million, participates in the San Diego-Carlsbad, Calif. MSA, which we consider broad and diverse. The county's unemployment rate for calendar year 2013 was 7.6%. The city's unemployment rate for that year was lower, at 6.6% and has continued to improve, with a monthly rate of 5.5% for January 2015 (preliminary, not seasonally adjusted), according to the Bureau of Labor Statistics.

### Strong budgetary flexibility

In our opinion, the city's budgetary flexibility is strong, with available general fund reserves equal to 14% of adjusted general fund expenditures for audited fiscal 2014. Available general fund reserves include the combined unassigned and assigned balance and the restricted balance for the city's policy-required emergency reserve. We understand that, as of its midyear budget report, the city is projecting about a 15% general fund reserve for fiscal 2015.

### Adequate budgetary performance

The city's budgetary performance factor is adequate, in our view. The fiscal 2014 general fund and total governmental funds net adjusted results include a deficit of 2.6% (after transfers) and a surplus of 4.2% (before transfers), respectively. We have excluded general fund items we view as one-time in nature, including $22.85 million of capital lease proceeds, $21.1 million extraordinary loss, and $34.9 million of former redevelopment property tax revenue redistribution. The city's fiscal 2015 midyear budget monitoring report shows major general fund revenues are outperforming the adopted budget, and results are balanced if including $13.9 million of fund balance, but show a deficit of $8.9 million (equal to 0.7% of expenditures) if excluding the $13.9 million of fund balance.

### Very strong liquidity

Supporting the city's finances is liquidity we consider very strong, with total primary government cash and investments equal to 122% of total governmental funds expenditures and 19.4x total governmental funds debt service. Due to the frequency of debt issuances and diverse types of debt, we believe the city has exceptional access to external liquidity.

### Very strong management conditions

We view the city's management conditions as very strong with strong financial practices. Strengths include strong oversight of budget-to-actual results during the year. The city also maintains a five-year financial forecast and capital improvement plan and a policy of maintaining a general fund emergency reserve of 8% and a stability reserve of 6%, for a total reserve minimum of 14%. The reserve is calculated as a percentage of the most recent three-year average of general fund operating revenues. The emergency reserve is held in the restricted general fund balance, while the stability reserve is held within the assigned and unassigned general fund balance.

### Very weak debt and contingent liabilities profile

In our opinion, the city's debt and contingent liabilities profile is very weak, due to retiree benefit obligations that we view as large. The city contributes the annual required contribution (ARC) to the San Diego City Employees' Retirement System. The combined pension ARC and other postemployment benefit pay-as you-go payment for fiscal 2014 was 18.6% of total governmental fund expenditures. According to management, the actuarial liability was 74% funded as of June 30, 2014. In 2012, voters approved Proposition B, which replaced defined benefit pension plans for new city hires (except police officers) with a 401(k)-style plan and freeze pensionable pay for five years. However, we understand this is currently subject to legal challenge.

The total governmental fund debt service as a percentage of total governmental fund expenditures is 6.3%, and net direct debt (including tax increment bonds) as a percentage of total governmental fund revenue is 86%. We anticipate that a planned debt issuance within the next two years will have a minimal impact on the net direct debt ratio. The city plans to issue $270 million for public infrastructure improvements over three years starting in fiscal 2017.

### Strong institutional framework

We consider the institutional framework score for California cities with $500,000 or more in federal awards expended a year, and two or more federal programs strong based on the legislative and functional environment under which these local governments operate, including a framework that encourages transparency by requiring these local governments to perform annual financial statement audits of their entire operations. See institutional framework score for California.

## Outlook

The stable outlook reflects our view of the city's very strong economy and strong budgetary flexibility, which is supported by very strong management conditions. We could consider raising the rating if budgetary performance improves to a level we consider strong, coupled with no deterioration in other factors. Although not expected, we could lower the ratings if budgetary performance and flexibility weaken.

## Related Criteria And Research

### Related Criteria

- USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007

### Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Institutional Framework Overview: California Local Governments

| Ratings Detail (As Of March 24, 2015) | | |
|---|---|---|
| San Diego lse rev rfdg bnds (Balboa Park & Mission Bay Pk Rfdg) | | |
| *Long Term Rating* | AA-/Stable | Affirmed |
| San Diego lse rev & rfdg bnds (Capital Improvement Project & Old Town Light Rail Rfdg) ser 2013A due 10/15/2042 | | |
| *Long Term Rating* | AA-/Stable | Affirmed |
| San Diego lse (Cap Imp Proj & Old Town Light Rail Rfdg) | | |
| *Unenhanced Rating* | AA-(SPUR)/Stable | Affirmed |
| **San Diego Convtn Ctr Expansion Fing Auth, California** | | |
| San Diego, California | | |
| San Diego Convtn Ctr Expansion Fing Auth (San Diego) lse rev rfdg bnds | | |
| *Long Term Rating* | AA-/Stable | Affirmed |

| Ratings Detail (As Of March 24, 2015) (cont.) | | |
|---|---|---|
| **San Diego Pub Facs Fincg Auth, California** | | |
| San Diego, California | | |
| San Diego Pub Facs Fincg Auth (San Diego) lse rev bnds (Cap Imp Proj) | | |
| *Long Term Rating* | AA-/Stable | Affirmed |
| San Diego Pub Facs Fincg Auth (San Diego) lse rev rfdg bnds ser 2007A | | |
| *Long Term Rating* | AA-/Stable | Affirmed |
| San Diego Pub Facs Fincg Auth (San Diego) lse rev rfdg bnds (Fire & Life Saftey Facs Rfdg) | | |
| *Long Term Rating* | AA-/Stable | Affirmed |
| San Diego Pub Facs Fincg Auth (San Diego) lse rev rfdg bnds (San Diego) (Master Rfdg Proj) ser 2010A due 03/01/2040 | | |
| *Long Term Rating* | AA-/Stable | Affirmed |

Many issues are enhanced by bond insurance.

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.