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FITCH RATES SAN DIEGO PUBLIC FACILITIES FINANCING AUTH (CALIFORNIA) $365MM 2009B SR WATER REVS 'AA-'

Fitch Ratings-Austin-03 June 2009: Fitch Ratings assigns a rating of 'AA-' to approximately $364.8 million San Diego Public Facilities Financing Authority water revenue bonds, series 2009B. The bonds are payable from net revenues of the city of San Diego's (the city) water system (the system), on parity with the system's outstanding senior lien obligations. Bond proceeds will be used to finance system improvements, refund a portion of the system's outstanding debt, fund a debt service reserve, and pay costs of issuance. The bonds are scheduled to sell via negotiation the week of June 15, 2009.

At this time, Fitch also affirms the ratings on the following outstanding debt secured by net system revenues:

San Diego Public Facilities Financing Authority
--$157.2 million water revenue bonds, refunding series 2009A (secured by a senior lien on water revenues) at 'AA-';
--$272.8 million subordinated water revenue bonds, series 2002 at 'A+'.

San Diego Facilities and Equipment Leasing Corporation
--$141.3 million certificates of undivided interest, series 1998 (secured by a senior lien on water revenues) at 'AA-'.

The Rating Outlook is Stable.

The 'AA-' rating reflects the system's historically favorable financial results and expectation of continued sound operations. The city has a broad and diverse service area, which allows them to raise rates to compensate for moderately high and rapidly growing debt levels, as well reduced sales. The system faces regulatory-driven capital needs over the intermediate-term, which will lead to rising leverage pressures. In addition, drought conditions within the state and region have necessitated increased conservation efforts, reducing sales over the immediate future. Recognizing these challenges, the city council passed a multi-year rate package in calendar 2007 that should preserve the system's financial flexibility.

Capital needs for fiscals 2009-2014 total $872 million on an inflated basis, with the majority of costs attributable either directly or indirectly to requirements under a regulatory consent order. Approximately 80% of funding sources are expected to be derived from debt issuances, which will increase the system's leverage ratios substantially through the CIP period. Currently, debt levels are relatively high, and planned borrowings are expected to result in leveraging that will be well above other comparably rated systems by fiscal 2014.

In addition to a rising fixed cost structure, the system faces near-term operational challenges as a result of drought conditions and certain legal constraints that have led the city's wholesale water provider, San Diego County Water Authority (CWA, revenue bonds rated 'AA' by Fitch), to seek reductions in customer consumption levels. Despite these challenges, it is expected that the system will maintain a favorable financial profile through at least the fiscal 2014 projection period. Historically, system financial results have produced increasing annual debt service (ADS) coverage, sound liquidity, and good cash flows. For fiscal 2008, ADS coverage on senior lien bonds was 4.3 times (x) and 2.2x for all debt. Liquidity for the year ended with over 215 days of cash and working capital, while free cash to depreciation was nearly 165%.

To account for the constrained water supply situation, the city has prepared three separate stress forecasts based on a sustained drop in available supplies of 10%, 15%, and 20% for fiscals 2010-2014. Under the more moderate 10% cut in supplies, senior lien and all-in ADS coverage is projected at no less than 2.4x and 1.6x, respectively, including the costs associated with rising debt levels. Under the most severe 20% supply reduction scenario, debt service coverage would be curtailed, but given the city purchases most of its water from CWA, operational costs would be partially offset. As a result, senior lien and all-in ADS coverage under this scenario would only fall to lows of 1.9x and 1.3x, respectively.

In light of the city's capital demands, as well as the need to recover pass-through costs from CWA, the city council passed a series of rate hikes in recent years. In total, rates were increased over 15% for fiscal 2009 and will increase an additional 6.5% in fiscals 2010 and 2011; no additional escalations are currently forecasted for fiscals 2012-2014. With the adjustment for fiscal 2009, the current average monthly residential bill has risen to a moderately high 1.2% of estimated median household income. While the current and projected level of customer charges is a credit concern given the diminished rate flexibility, user costs are not, nor are they expected to be, significantly higher than other major West Coast metropolitan providers through the projection period.

The system provides retail service to around 1.3 million people within the city and also provides limited wholesale service to certain customers in the outlying area. The city's diverse economy is driven by healthcare, military, tourism, and educational sectors. The city experienced broad economic growth throughout much of this decade, but like many areas across the country the collapse of the housing market and national recession have impacted job growth and led to rising foreclosure activity. Likewise unemployment is rising, with the city's most recent results for April 2009 at 9.1%, up from 4.9% year-over-year.

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