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# Fitch Rates Public Facilities Financing Auth of San Diego, CA Water Revs 'AA-'; Outlook Stable

Ratings Endorsement Policy

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Fitch Ratings-Austin-23 March 2012: Fitch Ratings assigns an 'AA-' rating to the following Public Facilities Financing Authority of the City of San Diego, California (the authority) bonds issued on behalf of the City of San Diego, California (the city):

--Approximately $186 million subordinated water revenue bonds, refunding series 2012A.

The bonds are scheduled to price the week of April 2 via negotiation. Proceeds will be used to refund certain maturities of the authority's series 2002 bonds for interest savings without extension and pay costs of issuance.

At this time, Fitch also affirms the following ratings on the authority's outstanding bonds:

--$594 million in outstanding senior lien revenue bonds at 'AA';
--$228 million in outstanding subordinate water revenue bonds, series 2002 (pre-refunding) at 'AA-'.

The Rating Outlook is Stable.

SECURITY

The bonds are secured by subordinated installment payments made by the city to the San Diego Facilities and Equipment Leasing Corporation (the corporation). The corporation has assigned its rights to receive the installment payments to the authority and the authority has likewise assigned its right to such installment payments to bondholders. The obligation of the city to make installment payments is secured by a pledge of net revenues of the city's water system (the system) on a basis subordinate to the senior lien bonds.

KEY RATING DRIVERS

Solid Financial Results: Consistently sound financial performance is the primary rating driver. While Fitch acknowledges that rising operating and debt service costs could create pressure, the city has a strong history of prudent expense management leading to budget surpluses.

Improving Debt and Capital Profile: Debt levels are moderately high to high and will increase further, but have declined from recent estimates along with expected capital spending.

Imported Water Mitigates Elevated Customer Charges: The authority relies on imported water for up to 90% of supply, which contributes to the system's relatively high user charges. However, the city has demonstrated a willingness to raise rates where appropriate and pass through supply costs on a regular basis.

Extensive Service Territory: The service area is broad and diverse.

WHAT COULD TRIGGER A RATING ACTION

Reduced Financial Strength: Maintenance of sound financial metrics will be key to preserving credit quality.

Accelerating Costs: Rising capital and operating costs could reduce rate affordability further and pressure financial results.

CREDIT PROFILE

STRONG FINANCIAL PROFILE
System financial performance remains solid despite declining production in recent years resulting from drought restrictions and general customer conservation. For fiscal 2011, annual debt service (ADS) coverage of all debt was 1.8 times (x). Liquidity and cash flows were also strong, with the system maintaining 277 days cash for the year and generating surplus revenues equal to 122% of depreciation.

The city is projecting a weakening in ADS coverage through fiscal 2016 based on limited rate increases coupled with rising operating and ADS expenses. Overall, total ADS coverage is forecast to drop to 1.3x in fiscals 2012-2014 before improving slightly to 1.5x by fiscal 2016. The projected weakening in ADS coverage is a concern, but Fitch notes that city has demonstrated tight expenditure controls and expects that actual performance is likely to be more favorable based on the city's history of outperformance of forecast in recent years.

CAPITAL NEEDS MANAGEABLE AND DECLINING
Capital needs for fiscals 2012-2016 total $471 million with around 55% of costs attributable to requirements under a regulatory consent order. The size of the capital improvement program (CIP) has declined significantly from previous estimates with the completion and reprioritization of certain projects as well as a favorable construction environment.

With the decline in CIP costs, planned borrowings have also decreased and now account for 56% of planned CIP funding sources. Favorably, the reduction in planned borrowing will limit escalation in system leverage ratios, but Fitch notes that debt levels are relatively high and amortization of principal is below other similarly rated credits.

DEMONSTRATED WILLINGNESS TO RAISE RATES
The city council passed a series of rate hikes in recent years to support the city's capital demands, as well as the need to recover pass-through costs from the San Diego County Water Authority (CWA, the city's wholesale water provider). In total, rates were increased over 15% for fiscal 2009, 6.5% in fiscal 2010, and 6.5% in fiscal 2011. No additional escalations are currently forecast for fiscals 2012-2013, but it is expected that a new rate study will be performed in calendar 2012 with the results subsequently recommended to city council.

With these prior adjustments, as well as pass-through increases from CWA, the current average monthly residential bill has risen to a moderately high 1.4% of estimated median household income. While the 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 even with additional cost increases from CWA.

EXTENSIVE SERVICE TERRITORY WITH POSITIVE ECONOMIC SIGNS
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. Economic conditions in the city have shown positive signs in recent months, with job growth in the city expanding by 1.6% in 2011 compared to the national rate of 1.0%. While unemployment of 8.9% for December 2011 remained above the national rate of 8.3%, the recent level of job creation has narrowed the gap with the national average and positions the city for continued positive movement.

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Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable Criteria and Related Research:

--'Revenue-Supported Rating Criteria', June 20, 2011;
--'U.S. Water and Sewer Revenue Bond Rating Criteria', August 10, 2011.

For information on Build America Bonds, visit 'www.fitchratings.com/BABs.'

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