FitchRatings

Fitch Rates San Diego (CA) Tobacco Settlement Revenue Funding Corp Asset-Backed Bonds

Ratings
21 Jun 2006 3:38 PM (EDT)

Fitch Ratings-New York-21 June 2006: Fitch Ratings assigns a rating of 'BBB' ratings to the City of San Diego Tobacco Settlement Revenue Funding Corporation's tobacco settlement asset-backed bonds, series 2006 turbo term bonds (series 2006). The issuance of the series 2006 taxable turbo term bonds rated by Fitch totals approximately $105.4 million and are due on June 1, 2032. The ratings of the above referenced bonds address the issuer's ability to pay timely interest and principal on the bonds by their maturity date. The series 2006 bond proceeds will be used to purchase the assets sold by the city of San Diego, fund the operating account, capitalized interest account, debt service reserve account, and pay costs of issuance incurred in connection with the issuance of the series 2006 bonds.

The collateral securing the series 2006 bonds consists of the City of San Diego Tobacco Settlement Revenue Funding Corporation's rights, title and interest in the tobacco settlement revenues that were sold to the corporation from city under a sale agreement. The city's share of the state's tobacco settlement revenues (TSRs) received represent a percentage of the state of California's tobacco settlement revenues under the California Consent Decree.

The corporation is a nonprofit public benefit corporation organized by the city of San Diego, CA, under the Nonprofit Public Benefit Corporation Law of the California Government Code. The corporation is a separate entity from the city and the state, and the rated bonds are obligations of the corporation and not of the city or state.

The ratings are based on the bond structure and the credit quality of the underlying collateral under the indenture, which consists of annual payments and strategic contribution payments by the three largest domestic tobacco manufacturers: Philip Morris Inc., Reynolds American Inc., and Lorillard Tobacco Co. (the original participating manufacturers [OPMs]), under a master settlement agreement (MSA) entered into with the attorneys general of 46 states, the District of Columbia, the Commonwealth of Puerto Rico, the U.S. Virgin Islands, the Commonwealth of Northern Mariana Islands, American Samoa, and Guam. Fitch's view of the credit quality of the collateral takes into account two fundamental characteristics of the MSA: since payments under the MSA are based on the relative market share of the domestic tobacco manufacturers, the payment obligation can be considered an industry obligation, which Fitch currently deems to be rated 'BBB-'; and the MSA should survive the bankruptcy of a domestic tobacco manufacturer, making it more likely that the manufacturer would continue to make payments under the MSA ahead of its unsecured indebtedness. These are the major characteristics of the MSA that support and, at the same time, limit the rating of the tobacco settlement senior bonds to 'BBB'.

Accordingly, the rating on this transaction is linked to and will move with Fitch's future assessment of the tobacco industry's overall credit quality. The credit quality of the industry, in turn, will be significantly influenced by the underlying ratings of the three major domestic tobacco manufacturers and Fitch's view of the relative strength of those three manufacturers within the overall domestic tobacco industry. For a more detailed discussion of the industry, see the report 'U.S. Tobacco Industry Report - On the Verge of Industry Altering Decisions" dated Oct. 10, 2005, and available on the Fitch Ratings web site at 'www.fitchratings.com'.

In addition, since payments under the MSA are subject to various adjustments and offsets based on several factors, including cigarette consumption, Fitch developed a series of cash flow stresses to determine the transaction's ability to make timely payments of interest and to pay principal on the bond's maturity dates. Therefore, the rating is also based on the transaction's ability to withstand cash flow stresses commensurate with a 'BBB' rating for the series 2006 bonds. Finally, the ratings reflect the transaction's sound legal and financial structures.

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