

# Municipal Secondary Market Disclosure Information Cover Sheet

This cover sheet should be sent with all submissions made to the Municipal Securities Rulemaking Board, Nationally Recognized Municipal Securities Information Repositories, and any applicable State Information Depository, whether the filing is voluntary or made pursuant to Securities and Exchange Commission rule 15c2-12 or any analogous state statute.

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IF THIS FILING RELATES TO ALL SECURITIES ISSUED BY THE ISSUER OR ALL SECURITIES OF A SPECIFIC CREDIT OR ISSUED UNDER A SINGLE INDENTURE:

Issuer's Name (please include name of state where Issuer is located):

**THE CITY OF SAN DIEGO, CALIFORNIA (OBLIGOR, PURSUANT TO CERTIFICATES OF UNDIVIDED INTEREST IN INSTALLMENT PAYMENTS PAYABLE FROM NET SYSTEM REVENUES OF THE WATER UTILITY FUND OF THE CITY OF SAN DIEGO, CALIFORNIA) (STATE: CALIFORNIA)**

**CERTIFICATES OF UNDIVIDED INTEREST IN INSTALLMENT PAYMENTS PAYABLE FROM NET SYSTEM REVENUES OF THE WATER UTILITY FUND OF THE CITY OF SAN DIEGO, CALIFORNIA, SERIES 1998**

**PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO, CALIFORNIA (STATE: CALIFORNIA)**

**SUBORDINATED WATER REVENUE BONDS, SERIES 2002**

Other Obligated Person's Name (if any): \_\_\_\_\_  
(Exactly as it appears on the Official Statement Cover)

Provide six-digit CUSIP\* number(s), if available, of Issuer:

**THE CITY OF SAN DIEGO, CALIFORNIA related CUSIP: 797263**

**PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO, CALIFORNIA related CUSIP: 79730C**

\*(Contact CUSIP's Municipal Disclosure Assistance Line at 212.438.6518 for assistance with obtaining the proper CUSIP numbers.)

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TYPE OF FILING:

Electronic:   7  

Paper \_\_\_\_\_

If information is also available on the Internet, give URL: **NOT AVAILABLE** \_\_\_\_\_

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WHAT TYPE OF INFORMATION ARE YOU PROVIDING? (Check all that apply)

**A. Annual Financial Information and Operating Data pursuant to Rule 15c2-12**

(Financial information and operating data should not be filed with the MSRB.)

**Fiscal Period Covered:**

**B. Audited Financial Statements or CAFR pursuant to Rule 15c2-12** Fiscal Period Covered:

**C. Notice of a Material Event pursuant to Rule 15c2-12** (Check as appropriate)

- |   |   |
|---|---|
| 1. Principal and interest payment delinquencies _____                                 | 6. Adverse tax opinions or events affecting the tax-exempt status of the security _____   |
| 2. Non-payment related defaults _____   | 7. Modifications to the rights of security holders _____                                  |
| 3. Unscheduled draws on debt service reserves reflecting financial difficulties _____ | 8. Bond calls _____   |
| 4. Unscheduled draws on credit enhancements reflecting financial difficulties _____   | 9. Defeasances _____  |
| 5. Substitution of credit or liquidity providers, or their failure to perform _____   | 10. Release, substitution, or sale of property securing repayment of the securities _____ |
|   | 11. Rating changes <u>XXX</u>   |

**D. Notice of Failure to Provide Annual Financial Information as Required**

**E. Other Secondary Market Information** (Specify): \_\_\_\_\_

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I hereby represent that I am authorized by the issuer or obligor or its agent to distribute this information publicly:

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Relationship to Issuer: DISCLOSURE REPRESENTATIVE

**Obligor Contact, if any:**

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Telephone \_\_\_\_\_ Fax: \_\_\_\_\_

**Press Contact:**

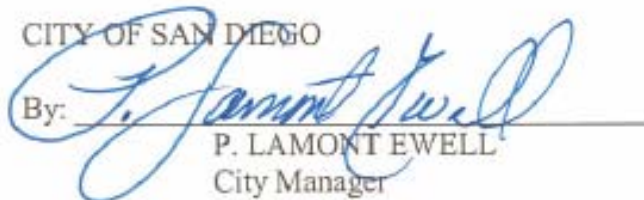
Name P. LAMONT EWELL Title CITY MANAGER  
Employer CITY OF SAN DIEGO  
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**MATERIAL EVENT NOTICE PURSUANT TO S.E.C. RULE 15c2-12(b)(5)(i)(C)  
OF MOODY'S INVESTORS SERVICE RATINGS DOWNGRADE**

**Dated August 3, 2005**

NOTICE IS HEREBY GIVEN that on August 2, 2005, Moody's Investors Service announced that it had downgraded its ratings on the City of San Diego, California's Certificates of Undivided Interest in Installment Payments payable from Net System Revenues of the Water Utility Fund to 'A2' from 'Aa3', and to 'A3' from 'A1' on the Subordinated Water Revenue Bonds, Series 2002. Moody's ratings also reflect a Negative outlook on all the affected issuances. The attached Moody's Investors Service publication, dated August 2, 2005, provides additional information regarding this action.

CITY OF SAN DIEGO  
By:   
P. LAMONT EWELL  
City Manager

**MATERIAL EVENT NOTICE PURSUANT TO S.E.C. RULE 15c2-12(b)(5)(i)(C)  
OF MOODY'S INVESTORS SERVICE RATINGS DOWNGRADE**

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Municipal Securities Rulemaking Board

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Rating Update: [San Diego \(City of\) CA Water Enterprise](#)

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**MOODY'S DOWNGRADES CITY OF SAN DIEGO WATER UTILITY CERTIFICATES TO A2 FROM Aa3**

**Subordinate Lien Obligation Also Downgraded To A3 From A1; Rating Outlook Negative**

Water/Sewer  
CA

**Opinion**

NEW YORK, Aug 2, 2005 -- Moody's has downgraded to A2 from Aa3 the rating on the City of San Diego's Certificates of Undivided Interest in Installment Payments payable from Net System Revenues of the Water Utility Fund, and to A3 from A1 the rating on the Subordinated Water Revenue Bonds, Series 2002. The rating action is based on significantly weaker than projected estimated financial performance in fiscal 2003, combined with uncertainty resulting from the lack of several years' audited financial reports. In addition, the reliance on potentially volatile connection fees has increased as debt service coverage has fallen. The rating also incorporates the current compliance of the water enterprise with all regulatory requirements, while noting that continued delay in accessing the capital markets could result in missed regulatory deadlines in fiscal 2006 and 2007. The fundamental strength of the enterprise remains a key credit factor, including its essentiality and its large, strong, and diverse service area, which together provide a relatively high degree of revenue stability. The negative outlook reflects the possibility that the trend of weakened financial results may have continued in recent years, and that continued lack of access to capital could result in increased capital and operating costs as well as failure to meet regulatory deadlines.

**FINANCIAL RESULTS APPEAR TO HAVE NARROWED; UNCERTAINTY PERSISTS DUE TO LACK OF AUDITED INFORMATION**

The finances of the water enterprise, which have consistently been narrow, appear to have taken a turn for the worse in fiscal 2003. Based upon preliminary information provided by the city, the financial performance of the enterprise in fiscal 2003 was significantly weaker than had been projected in association with the 2002 subordinated revenue bonds. Fiscal 2003 operating expenses exceeded operating revenues, and net revenues appeared to be about half the prior year level. Earlier in that year coverage of parity debt had been projected at over 1.8x, but actual results appear to have been significantly lower. The weak performance in fiscal 2003 follows operating losses in the prior year as well. In addition, auditors have made prior period adjustments to the fiscal 2002 figures for the enterprise, as they have for the city as a whole. These adjustments primarily affect depreciation expense, recognition of expense pertaining to cancelled projects, and pension costs of the enterprise. While the water enterprise has been contributing its full actuarial annual required pension contribution, recalculations of benefit costs have resulted in an increased but manageable net pension obligation.

As coverage levels decrease, the reliance of the water enterprise on connection fees becomes a more significant credit negative. Between fiscal 2000 and 2002, connection fees accounted for between one-third and one-half of total debt service coverage. Indications are that connection fees comprised an even larger portion of debt service coverage in fiscal 2003. As coverage levels decrease, reliance upon this inherently unstable revenue stream poses an increased credit risk as the financial performance of the enterprise becomes more vulnerable to a slowdown in the real estate development market.

A key source of uncertainty with regard to the financial position of the water enterprise is the absence of final audited figures for fiscal 2003, of preliminary audited figures for 2004, and of comparable information for fiscal 2005; this has left a very long period for which no externally validated information is available. Timing for the release of fiscal 2003 and 2004 audited financials remains uncertain, as it is dependent in part upon the outcome of various investigations. (For a detailed discussion of these, please see the August 2005 Rating Update for the City of San Diego.)

The flexibility of the water enterprise also is likely to have decreased somewhat, at least in the near term, as a result of the management and political changes occurring within the city. (Again, for details please see the August 2005 Rating update for the City of San Diego.) Were the city to need to take swift action, for example to increase rates in response to financial stress, it is unlikely this could be effected in the short term. However, rate-setting has always been accomplished with much community involvement and thus has required a great deal of lead time. There remain two years of adopted annual increases in the base fee rate and commodity charges, initially enacted by the council in April 2002, that were intended to increase retail

sales revenues by 6% each year (fiscal 2003 through 2007).

The water enterprise appears to have satisfactory liquidity. The city's formal reserve policies call for the maintenance of a 45-day operating reserve, funded at \$14.4 million in fiscal 2002 and at a consistent level in fiscal 2003. The city also maintains an emergency capital reserve of \$5 million. A separate "Secondary Purchase Reserve" is available to fund emergency water purchases. This fund was previously budgeted at 10% of the annual water purchase budget and totaled \$11.7 million in fiscal 2002; however, it has been drawn down and beginning in fiscal 2004 has been budgeted at only 6% of the water purchase budget. The city also established a rate stabilization fund, totaling \$26.5 million in fiscal 2002. This fund was drawn down, as expected, by \$6 million in fiscal 2003. The original projections called for this fund to be drawn down to \$9.5 million by fiscal 2007; the enterprise currently hopes to maintain this fund at approximately \$10 million on an ongoing basis.

#### DELAYED MARKET ACCESS MEANS ENTERPRISE IS LIKELY TO MISS SOME REGULATORY DEADLINES

Because of the investigations into the city's disclosure practices and the absence of audited financial reports since fiscal 2002, the water enterprise has been unable to access the bond market for funding. The enterprise is under a Compliance Order issued by the California Department of Health Services (DHS) in 1994 in connection with deficiencies primarily relating to reliability of various components of the enterprise. The Order sets deadlines for obtaining funding and completing specific projects; over the years the enterprise has requested and DHS has granted amendments to the Order. The enterprise is currently in compliance with all applicable standards and regulations of the Federal Safe Drinking Water Act, applicable State regulations, and the Compliance Order. All regulatory compliance projects awarded prior to December 2004 are fully funded through the current fiscal year, but the enterprise is unlikely to meet a 2007 deadline for certain pipeline projects. It is also possible that some projects with 2006 deadlines may be at risk soon as well. The enterprise reports that DHS has been generally sympathetic given the city's recent history of compliance, but will continue to monitor the situation.

#### LARGE, STRONG AND DIVERSE SERVICE AREA

The ratings on the city's water revenue bonds are in large part based upon the size, diversity and economic strength of the system's 330 square mile service area, which encompasses the city of San Diego as well as a few small areas outside the city limits. The enterprise provides primarily retail water service to the entire service area, which has a population of 1.3 million. The city's economy and tax base have exhibited strong and steady growth since the late-1990's. Real estate prices in the city continue to rise, and assessed value (AV) has increased at a healthy rate. In six out of the seven years between fiscal 1999 and 2006 AV increased approximately 8.5%, with the seventh year rising at 10.8%. Growth in fiscal 2005 was the slowest over that period, as AV rose by 8.1% to \$117.7 billion. Preliminary indications are that growth in fiscal 2006 may be slowing to more sustainable rates.

Retail service connections have grown steadily at approximately 1% annually since 2000 to reach nearly 270,000 in 2004. At that time single family domestic customers accounted for 39% and other domestic customers added 21% of water revenues (unaudited), while commercial/industrial customers represented 36%. There are no dominant commercial or industrial customers; the largest wholesale customer, California-American Water Company, accounted for 2.9% of fiscal 2004 revenues (unaudited). The only retail customers responsible for more than 1% of total water fund revenues were the City of San Diego which accounted for 4.55% at fiscal year end 2004, and the U.S. Navy which accounted for 2.45% (again, both figures unaudited).

The local economy is characterized by high technology industries including telecommunications, software development, biotechnology and electronics, as well as manufacturing, professional services and international trade. Tourism also is a major contributor to the local economy. The local economy performed well even through the last recession, maintaining positive employment growth. The unemployment rate has declined from a high of 5.8% in July 2003 (still low by comparison with the statewide rate of 6.9%) to 4.5% in June 2004 which is well below the 5.4% rate for the state as a whole. Tourism, which remained strong in 2004 by comparison with the nation and the state, is expected to remain stable in 2005. The military historically has been an important presence in the local economy, but the recent Base Realignment and Closure recommendations include a direct loss of 1,205 positions, which would also have a multiplier effect on non-military jobs. Nonetheless, in the context of total employment in the city this loss is not likely to have a material effect on the economy overall. Given the city's location on the U.S.-Mexican border, the local economy is expected to benefit significantly from the recently passed Central America Free Trade Agreement (CAFTA).

#### Outlook

The negative outlook for debt obligations of the water enterprise reflects the possibility that the trend of weakened financial results may have continued since fiscal 2002. The outlook also incorporates that fact that continued lack of access to capital could result in increased capital expenditures as the costs of needed capital projects rises. Operating costs also could rise if the enterprise is unable to fund regular repair and replacement projects. Finally, the negative outlook also recognizes the possibility that the water enterprise

may be unable to meet regulatory deadlines, the consequences of which are as yet unknown.

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