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May 29, 2012

Summary:
San Diego, California; Appropriations; General Obligation

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Credit Profile		
US$140.51 mil lse rev rfdg bnds (San Diego) ser 2012A due 04/15/2028		
Long Term Rating	A+/Stable	New
US$71.1 mil lse rev bnds (San Diego) (Cap Imp Proj) ser 2012A due 04/15/2042		
Long Term Rating	A+/Stable	New
US$17.615 mil lse rev rfdg bnds (San Diego) (Fire & Life Saftey Facs Rfdg) ser 2012B due 04/15/2032		
Long Term Rating	A+/Stable	New

Rationale

Standard & Poor's Ratings Services assigned its 'A+' long-term rating to San Diego Convention Center Expansion Financing Authority, Calif.'s series 2012A lease revenue refunding bonds secured by rental payments from the City of San Diego.

Standard & Poor's also assigned its 'A+' long-term rating to the San Diego Public Facilities Financing Authority's series 2012A lease revenue bonds (capital improvement projects) and 2012B lease revenue refunding bonds (fire and life safety facilities refunding).

In addition, Standard & Poor's affirmed its 'AA-' issuer credit rating on San Diego and its 'A+' long-term rating on various authorities' lease revenue bonds and certificates of participation (COPs), issued for the city of San Diego.

The city's COPs represent an interest in, and the lease revenue bonds are secured by, lease payments by San Diego, as lessee, to various authorities as lessor, for the use and possession of the leased assets. The rating on the authorities' lease revenue bonds and COPs reflects our view of the city's general credit characteristics and its covenant to budget and appropriate annual lease payments for various properties' use.

The outlook on all ratings is stable.

The ratings reflect what we view as San Diego's:

- Strong financial management practices, including the practice of multiyear forecasting and proactive budget adjustments, which have allowed management to identify future fiscal imbalances in time to develop and implement solutions;
- Reserves, which meet its reserve policies and that the city projects will remain at strong levels in fiscal years 2012 and 2013, particularly after the recent stabilization of the general fund revenue; and
- Strong long-term economic fundamentals, including the city's role as the anchor and center for the majority of employment in the county, despite some dependence on tourism and the military.

These credit strengths are partially tempered, in our view, by the city's:

- Limited revenue-raising flexibility; and
- Significant pension and other postemployment benefits (OPEB) liabilities that, despite recent plan reforms and flat annual required contributions (ARC) in fiscal 2013, we believe continue to represent a large share of the city's annual budget.

The San Diego Convention Center Expansion Authority's series 2012A lease revenue refunding bonds are secured by lease payments by San Diego, as sublessee, to the San Diego Convention Center Expansion Financing Authority, as sublessor, under a facility lease agreement for the use of the 1998 convention center expansion site and completed improvements. Under a separate expansion lease agreement, the owner and lessor of the property, the San Diego Unified Port District, will lease the property to the San Diego Convention Center Expansion Financing Authority. The facility lease agreement allows for abatement of lease payments for damage and destruction of the property but requires the city procure use and occupancy insurance--or to deposit an amount into a loss of use and occupancy fund held with the trustee--sufficient to cover 24 months of base rental payments. We understand that the series 2012A bond proceeds will be used solely to refund the authority's existing series 1998A lease revenue bonds.

The San Diego Public Facilities Financing Authority's series 2012A lease revenue bonds and 2012B lease revenue refunding bonds are secured by lease payments by San Diego, as sublessee, to the San Diego Public Facilities Financing Authority, as sublessor, under a facility lease agreement for the use of various city-owned properties. Under a separate site lease agreement, the city will lease the property to the San Diego Public Financing Authority. The lease agreement allows for abatement of lease payments for damage and destruction of the property but requires the city procure use and occupancy insurance sufficient to cover 24 months of base rental payments. The city intends to use the series 2012A lease revenue bond proceeds for capital improvements related to its deferred capital program. We understand the series 2012B lease revenue refunding bond proceeds will be used to refund the authority's series 2002B lease revenue bonds outstanding.

None of the series 2012 bonds includes a debt service reserve fund; however, lease payment dates of April 10 and Oct. 10, which occur more than three months after the city's fiscal year-end, mitigate late budget risk, in our view.

Based on San Diego's May 2012 year-end budget monitoring report, the city expects to end fiscal 2012 with revenue exceeding expenditures by $17.8 million due in part to higher-than-budgeted revenue and lower-than-budgeted expenditures. City officials estimate the fiscal 2012 year-end general fund balance will increase to $131.7 million, or 11.8% of general fund expenditures. We understand the city will budget a portion of the balance in fiscal 2013 to bring the general fund balance to $119 million, or about 10% of the proposed budget, which is still above the city's 8% reserve target. Risks to San Diego's projected fiscal 2013 budget, however, include another economic downturn and lower-than-estimated revenue, potential diversion of gas tax revenue to California, and potential higher costs to the general fund after the dissolution of redevelopment agencies (RDAs) in the state. City officials estimate a $13 million-$20 million exposure to the general fund due to the RDA dissolution, although we understand San Diego has set aside $14 million of general fund reserves that it could use to address the potential impact of the RDA dissolution on the general fund.

The San Diego County's assessor's preliminary estimates of the city's fiscal 2013 total assessed value (AV) reflect a 1.1% year-over-year decline. Due to these preliminary AV estimates, the city's May revision to its proposed fiscal 2013 budget reflected a $2 million projected decline in property tax revenue. Despite the projected decline in property tax revenue, the May-revised fiscal 2013 budget includes higher projected ongoing transient occupancy tax and sales tax revenue.

We consider San Diego's management practices "strong" under our Standard & Poor's Financial Management Assessment (FMA) methodology. An FMA of strong indicates practices are strong, well embedded, and likely sustainable.

San Diego (estimated population of 1.32 million) is a primary employment center in San Diego County, representing about half of the county's total employment. The economy consists of various high-tech clusters, including biotech and telecommunications, combined with a reliance on tourism, and the military and defense industries. Its economic base is also anchored by higher education and major scientific research institutions, including the University of California-San Diego, San Diego State University, Scripps Research Institute, the Salk Institute for Biological Studies, and the San Diego Supercomputer Center. The U.S. Navy and the U.S. Marine Corp. have a significant presence in the region and directly and indirectly contributed $30.5 billion of economic impact and 354,627 jobs (or about 26% of total county jobs) to the San Diego County economy in fiscal 2009, according to a San Diego Military Advisory Council Report dated April 2011. We believe that, historically, the military presence in the region has stabilized the regional economy, although it moderates income levels somewhat. Still, we consider the city's median household effective buying income strong at 114% of the national average in 2011. Unemployment for the city was 9.5% in March 2012, which remains below the state level of 11.0%, based on seasonally unadjusted data by the Bureau of Labor Statistics.

In our view, overall net debt is a moderate $4,353 per capita and 3.6% of market value. We consider amortization slightly below average, with about 40% of principal retired in 10 years and 80% in 20 years. Annual debt service carrying charges represented what we consider a moderate 11.7% of governmental expenditures, less capital outlay, in fiscal 2011. City officials estimate that several years of minimal debt issuance and deferring costs associated with maintaining capital have created an $800 million-$900 million need to maintain or restore streets, buildings, and storm drains in good condition. We understand the series 2012A lease revenue bonds (capital improvement bonds) will begin to fund San Diego's capital improvement plan and the city intends to issue between $80 million and $90 million of appropriation debt annually in the next four years to contribute toward these capital projects. San Diego also expects to issue $15 million of additional lease revenue bonds in 2012 for a parking structure, subject to council approval. While a future convention center expansion could cost a total of $520 million, officials expect future debt for the project would be secured primarily by a new hotel special tax and up to $200 million of general fund-backed lease debt. Even if the city immediately issued all anticipated debt, we calculate the debt burden would remain moderate at about 4% of market value, although general fund debt service carrying charges would likely rise. San Diego has no variable-rate debt outstanding.

The city has contributed the ARC to the San Diego City Employees' Retirement System for its employee retirement benefits in the past several years, including $231 million in fiscal 2011. In addition to pension benefits, the city provides OPEB for retirees hired before July 1, 2005. The unfunded OPEB actuarial liability was $1.1 billion at fiscal year-end 2011 with an ARC of $120 million. We calculate that the city's combined pension and OPEB ARC in fiscal 2011 represented about 20% of governmental expenditures, which we consider high. In addition, the general fund share of all retirement-related benefits costs, including a supplemental pension plan and employee contribution offsets, represent a high, in our view, 24% of the fiscal 2013 general fund budgeted expenditures.

(For more information on San Diego's general credit characteristics, see the full rating report published April 25, 2012, on RatingsDirect on the Global Credit Portal.)

Outlook

The stable outlook reflects our view of management's history of proactive budget adjustments, practice of long-term financial and capital forecasting, and recent economic improvement. We don't expect to raise the rating in the next two years due to currently high fixed charges related to San Diego's combined pension and OPEB ARCs as well as city income levels that are just over the national average due, in part, to the region's military presence. Although we expect the city will continue its practice of regular budget monitoring and midyear budget adjustments to offset additional potential costs and to maintain strong reserve levels, should it fail to maintain reserve levels that we consider strong and in line with its minimum targets in the next two years, we could lower the rating.

Related Criteria And Research

- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007
- USPF Criteria: Key General Obligation Ratio Credit Ranges – Analysis Vs. Reality, April 2, 2008
- USPF Criteria: GO Debt, Oct. 12, 2006

Ratings Detail (As Of May 29, 2012)		
San Diego ICR due 04/30/2040		
Long Term Rating	AA-/Stable	Affirmed
San Diego 2003 certs of part (1993 Balboa Park/Mission Bay Pk Rfdg)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
San Diego Convtn Ctr Expansion Fing Auth, California		
San Diego, California		
San Diego Convtn Ctr Expansion Fing Auth lse rev bnds ser 1998A		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
San Diego Mtdb Auth, California		
San Diego, California		
San Diego Mtdb Auth (San Diego) 2003 lse rev rfdg bnds (San Diego Old Twn Lt Rail Transit Extension Rfdg)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
San Diego Pub Facs Fincg Auth, California		
San Diego, California		
San Diego Pub Facs Fincg Auth (San Diego) lse rev rfdg bnds ser 2007A		
Long Term Rating	A+/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	A+/Stable	Affirmed
San Diego Pub Fac Fing Auth lse rev bnds (Fire & Life Safety Fac Proj) ser 2002B (MBIA of Illinois)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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