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Summary:

San Diego Community Facilities District No. 2 (Santaluz), Improvement Area No. 1, California; Special Assessments

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Credit Profile		
US$52.9 mil spl tax rfdg bnds ser 2011A due 09/01/2030		
Long Term Rating	BBB+/Stable	New

Rationale

Standard & Poor's Ratings Services assigned its 'BBB+' rating, and stable outlook, to San Diego Community Facilities District No. #2 (Santaluz) Improvement Area 1 series 2011A special tax refunding bonds.

The rating reflects what we view as:

- An only adequate 15.6:1.0 direct and overlapping value-to-lien ratio after reductions in assessed value (AV) in the past few years;
- A large 18% of the fiscal 2012 levy from properties without improvement value and 20% of the levy from properties with less than a 10:1 overlapping value to lien; and
- Only adequate coverage of 1.09x annual debt service from the 2012 special tax levy including property without improvement value.

The preceding credit weaknesses are offset in part by what we consider:

- A diverse, primarily residential district located in San Diego;
- Improved collection rate in past couple of years after increased delinquencies in 2008 and 2009; and
- A closed parity lien except for refunding purposes.

The bonds are secured by special taxes collected from real property within the district, net of administrative expenses.

San Diego Community Facilities District No. 2 is 20 miles northeast of downtown San Diego, and encompasses 2,546 gross acres. The district is primarily residential with about 90% of the parcels complete, although taxes from the completed parcels generate only about 80% of the special tax levy.

The district's direct and overlapping value-to-lien ratio as a whole is 15.6:1.0 in fiscal 2012, reflecting what we consider to be a relatively large amount of district debt. The direct overall value to lien in fiscal 2012 is 20.8:1.0. About 20% of the special tax levy in 2012 is paid by parcels with direct and overlapping value-to-lien ratios of less than 10:1. AV has fallen by 12% since fiscal 2009 to about $1.1 billion in fiscal 2012, after rising 128% in the previous three years. While the obligation to pay special taxes is unrelated to AV, AV does drive value-to-lien ratios on the properties.

In our view, the tax base is diverse, with the 10 leading taxpayers representing only 9% of the levy. The leading taxpayer, a golf course, comprises only 2.77% of the fiscal 2012 special tax levy. The next leading taxpayer, National Bank of Arizona, represents only 0.7% of the 2012 levy.

Special tax rates vary across parcels based on square footage. The fiscal 2012 actual special tax ranged from $1,588 for a parcel under 1,750 square feet to $8,040 for a residential custom lot; the corresponding assigned maximum rates range from $2,140- $10,830. An "undeveloped" property, as defined by the rate and method, is property owned by owners in the business of home building. The assigned maximum special tax for an undeveloped lot is very high, in our view, at $22,969; there are 24 undeveloped parcels left in the district. While the district has not levied special taxes on undeveloped property as defined by the rate and method, the 2012 special tax levy is imposed on parcels that are vacant and undeveloped and that are owned by nonhome builders. Officials indicate the represented 2012 levy of $4.5 million conservatively does not include taxes collected on 14 custom lots for which the owners have disputed previous years' levies based on their assertion that they should be classified as undeveloped property. District officials estimate about $640,000 could be owed in reimbursement of previously collected taxes if identified properties are reclassified as undeveloped. We understand these funds have already been set aside and that the district would not need to increase the levy to fund these reimbursements.

The median value for a noncustom home in the district is $817,000 and the median value for a custom improved lot is $2.2 million. For a sample residential unit in the district with an AV of $617,000, the total overlapping effective tax rate in fiscal 2012 was 1.5% of value. Likewise, the effective tax rate for a sample improved custom lot with AV of $2.2 million is about 1.5%; however, the sample effective tax rate for custom lots without improvement value is much higher at almost 3.0% of value. Maximum special taxes escalated 2% per year through July 2010 and if necessary, could escalate 2% in July of 2011 and 2012; however, the maximum tax cannot escalate beyond fiscal 2013.

Given the level of unimproved property, about 20% of the fiscal 2012 levy is generated by properties with a value to lien under 10:1, which we consider weak.

As of September 2011, delinquencies moderated to 1.6%, down from 5.2% and 6.8% in September of 2008 and 2009, respectively. Also as of that date, substantially all of the previous year delinquencies had been collected. We understand the district sets the actual levy based on historical delinquency rates, estimated administrative fees, and debt service. Officials have pursued judicial foreclosures of several properties that met delinquency thresholds.

The district's 2012 levy represents 73% of its maximum levy. The maximum tax levy would generate $6.2 million, which would cover pro forma annual debt service in each year by 1.5x. However, officials estimate a lower practical levy given state law that limits the levy increase to 10% on residential owners as a result of delinquencies. Assuming the district continued to levy at about 1.1x coverage, the district could withstand a 13% delinquency rate over the life of the bonds with the use of the debt service reserve.

Median household effective buying income for the City of San Diego is what we view as strong at 115% of the national levels. Unemployment for the city was 10.2% in August 2011, compared with 4.8% in August 2007. The city's August 2011 unemployment rate is above the 9.1% national levels; however, it remains below the 12.1% state level.

Outlook

The stable outlook reflects our view of the district's diversity and high medium home values, which we believe will likely provide support for a relatively high levy. The outlook also reflects our expectation that recent moderation of delinquency rates will continue. Given the level of unimproved properties in the district, we are unlikely to raise the rating in the next two years. If development in the long term causes AV in the district to increase such that debt ratios moderate, we could raise the rating. If delinquency rates were to return to the higher levels seen in previous years, we could lower the rating.

Related Criteria And Research

USPF Criteria: Special-Purpose Districts, June 14, 2007

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