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San Diego Public Facilities Financing Authority, California
San Diego; Appropriations; General Obligation

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Credit Profile		
US$168.255 mil lse rev rfdg bnds (San Diego) (Master Rfdg Proj) ser 2010A due 03/01/2040		
Long Term Rating	A-/Stable	New

Rationale

Standard & Poor's Ratings Services assigned its 'A-' long-term rating, and stable outlook, to San Diego Public Facilities Financing Authority, Calif.'s series 2010A lease revenue refunding bonds for the city of San Diego. Standard & Poor's also affirmed its 'A-' rating on the city's lease revenue bonds, and certificates of participation (COPs), and affirmed its 'A' rating on the city's general obligation (GO) bonds outstanding.

The rating on the city's 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 bond documents require a debt service reserve funded at 50% of maximum annual debt service (MADS); furthermore, lease payments are due March 1 and Sept. 1 of each year. Although the Sept. 1 lease payment date is only two months after the close of the city's fiscal year, the combination of a reserve funded at 50% of MADS and a continuing appropriation clause in the city's charter that requires an automatic re-appropriation of prior-year gross lease payments in the event of a late budget mitigate late budget risk, in our view.

The GO bond rating reflects our view of the city's general credit characteristics, which include San Diego's:

- Practice of multiyear forecasting, which has allowed it to identify future fiscal imbalances in time to develop and implement solutions;
- Reserves that the city projects to remain at good levels even after expected drawdowns to balance the budget for fiscal 2010 and the recent adoption of plans to eliminate the significant shortfall that it had projected for fiscal 2011; and
- Strong long-term economic fundamentals despite vulnerability to the economic downturn in the last year, including its role as the anchor and center for the majority of employment in the county, and what we consider strong household incomes and per capita property values.

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

- Limited revenue-raising flexibility and budget pressures that we expect will continue given the use of one-time solutions to bridge a budgetary gap in fiscal 2011; and
- Significant deferred maintenance needs and pension and other postemployment benefits (OPEB) liabilities, which we believe could either contribute to future budget pressure or constrain the city's ability to fully eliminate its structure deficit, especially if negative revenue trends continue.

The COPs represent an interest in, and the lease revenue bonds are secured by, lease payments by San Diego, as lessee, to the San Diego Public Facilities Financing Authority, as lessor, for the use and possession of the leased assets. Unlimited ad valorem taxes levied on taxable property within the city secure the GO bonds.

The fiscal 2009 unreserved general fund balance totaled $80.5 million, or what we consider a good 7.3% of expenditures after a $10.4 million operating deficit equal to 1% of budget. In December 2009, officials amended the fiscal 2010 budget including savings of $24.6 million from departmental reductions to address declining revenues and meet a general fund reserve target of 7% of expenditures. Since December, city officials estimate a $22 million budgetary gap in fiscal 2010, which they expect to cover with decreases in discretionary spending across all departments and the potential use of reserves, which officials project would cause the unreserved balance to fall short of the 7% target.

The city council adopted the mayor's proposed fiscal 2011 budget in December 2009 as an early action to address an identified $179 million budgetary gap with a combination of one-time and ongoing solutions (see the last full report on San Diego published Dec. 23, 2009, on RatingsDirect). Since December 2009, declining revenues and an unexpected pension contribution (which is $60 million above the city's previous estimates due to a 19% loss of retirement asset market value) led to a newly identified $28 million budget gap for fiscal 2011. In April 2010, the mayor released his full fiscal 2011 budget that proposes to close the new operating gap in fiscal 2011 primarily with departmental savings, including a revised fee structure for vehicle usage among departments, and deferring the first annual debt service payment to fiscal 2012 for the city's anticipated financing of a $25 million payment related to the McGuigan Settlement. The fiscal 2011 proposed budget incorporates the solutions identified in December 2009 and assumes generally flat property tax and transient occupancy tax revenues and a 1.3% increase in sales taxes compared with estimated collections for fiscal 2010. The revised budget proposal maintains the general fund reserve at 7% in fiscal 2011 instead of the original 7.5% target set forth in the city's policy. Also, in April 2010 in conjunction with the mayor's proposed revised fiscal 2011 budget, San Diego released a revised five-year outlook for fiscals 2011 through 2015, which also incorporates the budget corrections from December 2009 and reflects improved budget gaps of between $48.1 million and $72.5 million for fiscals 2012-2015, compared with its previously projected gaps of $136.5 million-$165.9 million for these years. In the revised five-year outlook, the city assumed a return of revenue growth beginning in fiscal 2012, increasing contributions to the city's pension annual required contribution (ARC), and contributions to its general fund and liability fund reserve targets. The outlook also includes projected debt service for an expected $240 million of additional debt through fiscal 2014 for deferred maintenance needs.

We consider San Diego's management practices "good" under our Standard & Poor's Financial Management Assessment (FMA) methodology. An FMA of good indicates our view that practices exist in most areas, although not all might be formalized or regularly monitored by government officials.

San Diego's population of 1.38 million has risen about 1% per year since the 2000 U.S. Census. The city is a significant employment center within the county, representing about 45% 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. Median household effective buying income is also strong, in our view, at 117% of the national average in 2008. However, given rising unemployment rates we believe that this ratio might have moderated in the past year. According to the Bureau of Labor Statistics, the city's estimated unemployment rate has risen gradually from an annual average rate of 6% in 2008 to 9.7% in 2009. Net assessed value (AV) fell 0.62% in fiscal 2010 to $162.6 billion, excluding redevelopment area AV, due to falling home prices between 2007 and 2009 and a rise in foreclosures in the county to about 1.25% of housing units. For fiscal 2011, the county's preliminary estimates reflect a 2% decline in countywide AV.

In our view, overall net debt is a moderate $4,045 per capita and 3.1% of fiscal 2010 market value. On a per capita basis, we consider San Diego's market value extremely strong, at approximately $131,572, based on fiscal 2010 AV. We understand that the city has no plans to issue additional debt in the near term, but anticipates about $240 million of additional debt between 2012 and 2014 for capital projects and deferred maintenance needs. According to the five-year outlook, officials estimate the total deferred maintenance needs for the city at $800 million-$900 million. Debt service carrying charges for fiscal 2009 represented what we consider a moderate 8.3% of all governmental expenditures less capital outlay.

Outlook

The stable outlook reflects opinion of San Diego's practice of long-term financial forecasting, which contributes to the good FMA, and management's proactive efforts to address a significant projected deficit in fiscal 2011 by maximizing 18 months of budget savings. Furthermore, the outlook reflects our view that the city's budget pressures have not been fully resolved and will likely require continued substantial efforts to develop solutions to offset use of one-time solutions. In addition, in consideration of deferred reserve contributions and council's willingness to amend its reserve policies, San Diego's ability to maintain the current rating will depend, in part, on our view of the city's ability to successfully restore structural balance to its budget without spending down reserves to a level that we think no longer provides sufficient budget cushion for unexpected fiscal needs and cash flow.

Retirement Benefits

Since fiscal 2006, the city has made the ARC to the San Diego City Employee Retirement System (SDCERS). Although investment earnings had improved in previous years, the unfunded actuarial accrued liability (UAAL) increased to $2.1 billion as of June 30, 2009, from $1.3 billion in fiscal 2008, realizing an $811 million actuarial investment loss in fiscal 2009. The fiscal 2009 funded ratio fell to 66.5% from 78.2% in fiscal 2008. Since SDCERS uses a smoothing method to calculate the actuarial value of its assets, we believe the city's pension ARC is likely to increase in the next several years as recent market losses are incorporated. In fiscal 2010, the city's general fund portion of the pension ARC was about $125 million, or 11% of expenditures. In fiscal 2011, the city's general fund portion of the ARC is $180 million, or 16% of budgeted expenditures. The mayor's five-year outlook shows the fiscal 2012 general fund pension ARC will increase by $20 million to equal about 17.9% of the outlook's forecasted general fund expenditures and assumes the ARC will increase by 4% annually through fiscal 2015. In addition, we understand that certain retirement benefits remain a source of contention between the city and some current and retired employee groups in and out of the courts.

San Diego also provides limited retiree health benefits per year to employees who retired after July 1, 2005, and before Oct. 6, 1980. City employees who were hired after Oct. 6, 1980, through July 1, 2005, receive health care benefits upon retirement that in our view are significantly higher than the aforementioned group's benefits. The city's OPEB was actuarially valued at $1.3 billion, assuming a 6.69% discount rate and a 30-year amortization period. The city has chosen to fund the obligation on a pay-as-you-go basis, with some prefunding. In fiscal 2011, the OPEB ARC is $120 million and the city plans to prefund $25 million of the liability while also contributing its pay-as-you-go amount of $32.8 million.

Financial Management Assessment: 'Good'

We consider San Diego's management practices "good" under our Standard & Poor's FMA methodology. An FMA of good indicates our view that practices exist in most areas, although not all might be formalized or regularly monitored by government officials. The city council generally performs formal budget amendments in the midyear and year-end reviews; in addition, the comptroller publicly posts and presents monthly reports on actual general fund performance to the city council's budget and finance committee. San Diego prepares a long-term financial outlook, which projects general fund operations, revenue and expenditure trends, and future budgetary gaps for the next five years; the outlook also includes forecasts for additional debt service costs associated with future anticipated debt issuance related to its deferred maintenance capital plan. The city prioritizes and identifies funding for capital projects that are in process or planned for the budget year in its annual budget. The city reviews its formal investment policy annually and presents monthly reports on investment holdings and average yield to the city council. San Diego has a formal debt management policy that includes maximum debt burden thresholds for GO and lease revenue debt, as well as minimum coverage level targets for revenue bonds. Its reserve policy targets included a combined emergency, unallocated, and appropriated reserve equal to 8% of general fund revenue by fiscal 2012; the emergency reserve, to be used as a contingency for natural disasters or unforeseen catastrophic events, requires a minimum 5% of general fund revenue and requires a two-thirds council vote to access the reserve. The mayor recently proposed, and the city council approved, deferral of achieving these targets. Officials are in the process of revising the reserve policy, which will include the extension of the reserve targets.

Related Criteria And Research

- USPF Criteria: GO Debt, Oct. 12, 2006
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007

Ratings Detail (As Of May 7, 2010)		
San Diego caps imps prog certs of part (Balboa Pk & Mission Bay Pk) ser 1996A		
Long Term Rating	A-/Stable	Affirmed
San Diego rfdg certs of part (Balboa Pk & Mission Bay Pk Cap) ser 1996B		
Long Term Rating	A-/Stable	Affirmed
San Diego GO Bnds (Pub Safety Comm Proj) ser 1991		
Long Term Rating	A/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		

Ratings Detail (As Of May 7, 2010) **(cont.)**		
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 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.