



News from

Council President Todd Gloria

City of San Diego

NEWS RELEASE

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City of San Diego's Investment Ratings Upgraded by Moody's *Financial Discipline, Increased Revenues Key to Strong Rating*

SAN DIEGO (November 14, 2014) – Council President Todd Gloria today announced that Moody's Investors Service has upgraded the City of San Diego's Issuer Rating to Aa2 from Aa3 and upgraded the city's outstanding Lease Revenue Bonds to A1 from A2. The outlook on the ratings is stable. Information from Moody's is attached.

“This upgrade demonstrates the improved financial strength of the City of San Diego that is the result of implemented reforms and continued fiscal discipline,” said Council President Gloria, who chairs the Budget and Government Efficiency Committee.

According to Moody's, the city's strengths include growth in top revenue sources, strong financial management with closely monitored budgets, and a reasonable and improving five-year financial outlook.

The good news came at the same time as the release of the City's Five-Year Financial Outlook, which shows continued improvement through Fiscal Year 2020. The annual report will be presented to the Budget and Government Efficiency Committee on Wednesday, November 19 at 2:00 p.m at the City Administration Building.

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MOODY'S

INVESTORS SERVICE

Rating Update: Moody's upgrades City of San Diego's (CA) Issuer Rating to Aa2 from Aa3 and upgrades its Lease Revenue Bonds to A1 from A2; the outlook is stable

Global Credit Research - 12 Nov 2014

Approximately \$294 million in lease revenue debt affected

SAN DIEGO (CITY OF) CA
Cities (including Towns, Villages and Townships)
CA

Opinion

NEW YORK, November 12, 2014 --Moody's Investors Service has upgraded the City of San Diego's Issuer Rating to Aa2 from Aa3 and upgraded the city's outstanding Lease Revenue Bonds to A1 from A2. The outlook on the ratings is stable.

RATING RATIONALE

The rating upgrade reflects the city's improved financial position, marked by growing cash and reserves over the past five fiscal years; a growing local economy with sound long-term prospects; new, stronger financial policies; and the city's continued commitment to addressing its pension and OPEB liabilities. The rating also incorporates the city's strong fiscal management that maintained a stable, albeit limited reserve position through the economic downturn with aggressive expenditure controls. The city's robust financial management has strengthened financial policies and increased reserve targets since the economic turnaround and is on pace to achieve these goals as a result of healthy growth in top revenue sources. Additionally factored in the rating is the large and diverse economy which has shown positive trends in key economic indicators including declining unemployment and improved socio-economic income and wealth measures. The city's debt burden is low and composed solely of fixed rate debt.

The Issuer Rating is equivalent to what the city's general obligation bond rating would be if it had any such debt. The difference between the city's Issuer Rating and its lease rating is based on the relative weakness of the pledge on the leases compared to the city's theoretical general obligation promise as reflected by the Issuer Rating. The city's pledge to repay its lease debt is a contractual obligation, on parity with the city's other unsecured obligations. This promise is notably in contrast to the stronger, voter approved general obligation pledge that provides a baseline for our estimate of the credit quality of lease pledges. Under California law, an issuer's GO pledge is an unlimited ad valorem property tax pledge. The city must raise property taxes by whatever amount necessary to repay the obligation, irrespective of the city's general financial position.

Key credit Strengths

- Growth in top revenue sources resulting in improved cash and reserve position
- Strong fiscal management with closely monitored budgets
- Reasonable and improving five year financial outlook
- Large and diverse local economy
- Above average wealth and income levels for a large city
- Pension reform enacted

Credit Challenges

- Significant portion of budget attributed to fixed costs

-Exposure to economically sensitive revenue sources

-While reserves have improved, overall reserve position falls below the median for the current rating category

DETAILED CREDIT DISCUSSION

GROWTH IN TOP REVENUE SOURCES AND STRONG FINANCIAL MANAGEMENT HAVE IMPROVED OVERALL FINANCIAL POSITION; HOWEVER, RESERVES STILL FALL BELOW NATIONWIDE MEDIANS

The city has grown General Fund net cash and reserves in three of the last four fiscal years and is expected to post additional growth according to unaudited FY 2014 results. Dynamic growth in city revenues as the economy emerged from the Great Recession combined with the city's continued expenditure controls has driven this increase in cash and reserves. The city has strong management that exercised aggressive expenditure controls in the depths of the recession, and these were carried through to subsequent years.

General Fund reserves grew to a total of \$222 million or 18.4% of revenues in FY 2013 and cash grew to \$242 million or 20% of revenues in the same year. The augmentation of reserves and cash were fueled by significant growth in the city's top revenue sources, of property taxes, sales taxes and transient occupancy taxes (TOT). Property taxes, which comprise a significant 34% of GF revenues, grew at an average rate of 2.12% annually to \$408.8 million in FY 2014, and city management reports better than the 4.8% budgeted growth is expected in the current fiscal year. Sales tax revenues, which make up 20% of revenues, grew at an average annual rate of 7.2% from 2010 to 2014 and are reported to be on track to exceed the budgeted 4.5% growth in the current year. Lastly, TOT grew an average 8.4% annually over the same time frame and comprises 7% of GF revenues. While city reserves have steadily grown over the past six years, it is important to note that the total GF reserve position is relatively weakness as it falls below the national median level of 32% for Aa2 rated cities in the US.

Fixed costs comprise a significant portion of the city's budget, with lease payments, pension and other post employee benefit (OPEB) contributions making up 25% of expenditures in FY 2013 and increasing to 29.8% of expenditures in FY 2014. While these costs make up a significant portion of the city's budget and limit financial flexibility, it is of positive note that part of the increase is due to the city's aggressive approach to address its long term pension and OPEB liabilities. The city's pension annually required contribution (ARC) increased to \$277 million in FY 2014 from \$231 million in FY 2013, however, \$27 million of this increase is due to the city's paying down the closed, defined benefit portion of the pension program over a shorter 15 year amortization schedule.

Pension reform was enacted with the voter approval of Proposition B in 2012, which closed the city's defined benefit program to new hires, excluding police, after June of 2012. The reform additionally required the city to negotiate non-pensionable pay increases with labor groups. The bulk of these reforms reduced the long term unfunded pension liability by \$194.9 million (on a \$2.2 billion liability) in 2013. While Proposition B and the resulting pension reform is currently the subject of litigation, Moody's believes that the city has garnered some financial flexibility in the current and future budgets to address an unfavorable outcome.

Strong fiscal management has been exercised by the city and enabled it to preserve its financial position through significant cost reductions including staff reductions, and reductions to overall pension and OPEB benefits. The strength of fiscal management has also been exemplified through the recent turnaround and growth years where management has increased its comprehensive reserve target to 14% of General Fund from 8%. The improvement to the city's reserve target was made in 2014 and according to unaudited results this target was achieved at the end of FY 2014.

LARGE AND DIVERSE LOCAL ECONOMY WITH ABOVE AVERAGE INCOME LEVELS FOR CITY OF ITS SIZE

The city's economy is highly diverse with tourism, the military, higher education, trade and biotechnology playing important roles. The population benefiting from this economy has historically boasted above average wealth and income levels and Census 2010 income indicators show further income gains with a per capita income at 119% of the nation and median family income at 120% compared to 109% and 106%, respectively in 2000. The unemployment rate for the city has also improved from its high of 12.4% in 2010, when unemployment exceeded national levels by nearly 3%. In 2013 unemployment levels declined and started to approximate national levels. The unemployment level was 6.2% as of August 2014, compared a 7.4% state rate and 6.3% for the US.

Assessed value in 2014 reached \$166 billion and exceeded the pre-recession high of \$163.7 billion in 2009. The city's 5 year average annual growth in assessed value was 0.3% in 2014. Assessed value per capita is strong at \$125,466 and comfortably exceeds the \$110,939 US median for Aa2 rated cities. Recent home price data also

suggest that among large cities throughout the country the city's home values are recovering from their lowest values in 2009 at a greater pace than their large city peers.

FAVORABLE DEBT POSITION

The city's direct and overall debt ratios of 0.4% and 4.1%, respectively, are in line with other cities in the state, and compare to most large cities in the country. The city's \$533 million of direct debt is composed of lease supported obligations. The resulting lease burden of approximately \$50 million represents a manageable 4.1% of 2013 GF revenues. The city expects to issue approximately \$120 million in lease obligation debt in the near term for capital upgrades. All of the city's outstanding debt is fixed rate.

Moody's adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, is a high 3.11 times operating revenues, compared to less than 1 times on average in the sector as of 2011. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities.

WHAT COULD CAUSE THE RATING TO GO UP

- Significant growth in city reserve position
- Significant growth in overall wealth and income levels

WHAT COULD CAUSE THE RATING TO GO DOWN

- Depletion of city reserve position or material challenges to the city's ability to generate structurally balanced budgets
- Significant contraction in the property tax base or overall economy

Outlook

The outlook on the ratings is stable. Moody's expects the city will continue to operate with strong fiscal discipline resulting in a stable financial position and reserves. We also expect continued improvement in the city and regional economy contributing to growth in the city's important revenue sources.

KEY STATISTICS

Assessed value, 2014: \$166.4 billion

A.V. per capita: \$ 125,466

Estimated Median family income, 120.1% of national median

General Fund balance, FY 2013: 18.4% of total General Fund revenues

Net General Fund Cash balance, FY 2013: 20.9% of total General Fund revenues

Institutional framework: A

5 -year average operating revenues/operating expenditures: 1.0x

Net direct debt/full value: 0.4%

Net direct debt/ operating revenue: 0.5x

3-year average adjusted net pensions liability/full value: 2.52%%

3-year average adjusted net pensions liability/operating revenues: 3.26x

The principal methodology used in the issuer rating was US Local Government General Obligation Debt published in January 2014. The principal methodology used in the lease rating was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in December 2011. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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