MOODY'S
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San Diego County, CA

New Issue- Moody's Assigns Aa2 to San Diego County's (CA) Lease Revenue Refunding Bonds. Outlook is Stable

Summary Rating Rationale

Moody's Investors Service has assigned an Aa2 rating to the San Diego County Lease Revenue Refunding Bonds, Series 2016A. The bonds will have an expected par value of $109.6 million. We have also affirmed the Aa2 rating on the county's $977 million of outstanding lease revenue obligations, certificates of participation, and pension obligation bonds. The Aaa Issuer Rating has also been affirmed. The outlook is stable.

The rating assignment reflects the county's financial strength, which includes large reserves, consistent operating surpluses, and stable and effective management. The county's financial profile benefits from a strong economic base inclusive of an exceptionally large and diverse assessed valuation, solid resident wealth metrics and a strong likelihood of continued economic expansion. The county's debt portfolio presents minimal credit risks and consists of only fixed rate obligations and modest debt burden.

The Issuer Rating is equivalent to what the county's general obligation bond rating would be if it had any such debt. The difference between the county's Issuer Rating and its lease rating is based on the relative weakness of the pledge on the leases compared to the county's theoretical general obligation promise as reflected by the Issuer Rating. The county's pledge to repay its lease debt and pension liabilities is a contractual obligation, on parity with the county'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 pension obligation bonds and lease pledges. Under California law, an issuer's GO pledge is an unlimited ad valorem property tax pledge. The county must raise property taxes by whatever amount necessary to repay the obligation, irrespective of the county's general financial position.

Moody's is currently evaluating comments we received on our proposed, methodological revisions to rating state and local government lease-backed obligations. Our comment period closed on December 2, 2015, and the publication of the final, revised methodology could affect the county's lease-backed obligation ratings. With respect to the county's abatement lease ratings, we note that we have proposed to "eliminate the additional downward notch we currently assign for lease-backed obligations with abatement risk relative to lease-backed obligations with appropriation risk.

Credit Strengths

» Exceptionally large and diverse economic base

» Strong and consistent operating performance

» Deep and effective management team

» Moderate debt profile

Credit Challenges

» Growing pension costs

» Vulnerable to Federal spending reductions as a result of unusually high military presence

» Exposure to relatively volatile state budget

Rating Outlook

The stable outlooks results from the strong probability that the county will continue to produce solid fiscal operations, benefit from ongoing economic stability, and will not make any materially detrimental changes to its debt profile.

Factors that Could Lead to an Upgrade

» Sustained broadening of the county's fiscal position

» Additional security of lease payments by a separate investment grade revenue stream

» Reconsideration of credit fundamentals in light of a methodological change

Factors that Could Lead to a Downgrade

» Protracted and material economic decline resulting in diminished assessed value and weaker economically sensitive revenues

» Significant erosion of the county's fiscal position including weakened cash and reserves

» Multi-year deficits that materially lower the county's financial profile

Key Indicators

Exhibit 1

San Diego (County of) CA	2011	2012	2013	2014	2015
Economy/Tax Base					
Total Full Value ($000)	$ 390,777,048	$ 392,000,000	$ 392,958,843	$ 405,983,622	$ 429,240,743
Full Value Per Capita	$ 125,417	$ 125,290	$ 124,742	$ 127,094	$ 132,995
Median Family Income (% of US Median)	116.8%	114.5%	114.5%	114.5%	114.5%
Finances					
Operating Revenue ($000)	$ 3,372,404	$ 3,396,511	$ 3,509,555	$ 3,657,157	$ 3,725,283
Fund Balance as a % of Revenues	35.5%	36.9%	37.6%	39.7%	43.9%
Cash Balance as a % of Revenues	39.2%	39.9%	42.0%	47.2%	52.6%
Debt/Pensions					
Net Direct Debt ($000)	$ 1,216,969	$ 1,193,753	$ 1,165,792	$ 1,108,339	$ 1,048,134
Net Direct Debt / Operating Revenues (x)	0.4x	0.4x	0.3x	0.3x	0.3x
Net Direct Debt / Full Value (%)	0.3%	0.3%	0.3%	0.3%	0.2%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	1.8x	1.9x	2.1x	2.0x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	1.5%	1.7%	1.9%	1.8%

Source: Moody's Investors Service

Detailed Rating Considerations

Economy and Tax Base: Extremely Large, Robust and Expanding

San Diego County has an exceptionally large economy that benefits from a diverse range of core industries, a growing housing market, very low unemployment, and sounds prospects for a continuation of these strengths.

In 2016, the county's tax base grew by 5.6% to reach an exceptionally large $453.3 billion. This is a high assessed valuation even relative to other sizable counties and underscored by San Diego being the largest Moody's Aaa-rated county. The 2016 growth rate essentially mirrors the 5.7% captured in 2015 reflecting the consistent and steady expansion of the local economy.

The county's economy will continue to expand as its key industries of defense, tourism, education and technology remain healthy. Strength in these areas combined with a wide variety of other business sectors has contributed to the county having an unemployment rate of just 4.8%, which is below both the state and national figures. The City of San Diego (Aa2/Stable), the 8th largest in the nation and the county's employment hub has unemployment of just 4.6%, a low mark for a city of such size. Through 2015, the addition of 47,800 jobs gave the county the 6th highest employment growth rate in the country. The increase in jobs is reflected by steady growth in the county's key employment bases of transportation, government, and professional services. Each of these areas have grown consistently since 2013 and will continue that pattern in 2016. Layoffs at Qualcomm, the 4th largest employer in the county will weaken the rate of net job creation but will not large enough to materially impact the overall economy.

Building permit activity, another leading economic indicator, is continuing its positive trajectory with both the number of units and valuation of new construction rising in each of the last two years. Foreclosure activity, which has always been lower than the hardest areas of the state, are at just 1.61 per 10,000 compared to the national mark of 4.01. We anticipate that will also remain low as the housing market continues to improve.

San Diego County resident median family incomes are 114% of the national mark and at the higher end of the spectrum for highly populated counties. Most of this wealth is centered in the northern and coastal portion of the county.

Financial Operations and Reserves: Well Above Average Fiscal Position that will Remain Strong

The county's financial profile remains strong and highlighted by consistent operating surpluses resulting in growth to already very large reserves and liquidity. We expect the county will produce another surplus in fiscal 2016 and conclude the year with a fiscal position comparable to its robust standing in fiscal 2015.

As expected, the county completed fiscal 2015 with a surplus that was 4% of general fund revenues. This surplus came despite budgeted expectations of essentially level operations. These results are consistent with the county's operating performance since fiscal

2010 when increases to reserves have averaged 4% of general fund revenues. The fiscal 2015 ending operating fund reserve balance of 49.8% is a moderate improvement over the 44.5% average fund balance maintained from fiscal 2011 to 2014. The reserve balance is also well above the typical amount of a large county and comfortably stronger than the Aaa-median amount.

The county's total governmental activities operating results have been equally impressive with solid surpluses in each of the last seven years. The fiscal 2015 operating surplus was a very strong 8% of total revenues.

For fiscal 2016, the county will continue its strong operating performance. Despite the planned use of some funds for one-time capital improvements, the first quarter budget projections show an expected $100 million increase to the county's fund balance. This ending balance will likely be higher as the county continues its history of conservative revenue estimates exemplified a 3% increase in property taxes despite assessed valuation growth that will likely be at least 5.5%

LIQUIDITY

The county's fiscal 2015 operating cash balance is an exceptionally strong 52.6%, more than double the median for California counties. In fiscal 2016, the operating cash balance will be comparable to this amount as the county will again produce a surplus.

Net cash as a percentage of revenues across all governmental funds is an extremely strong 72% for fiscal 2015. This level of cash comfortably greater than US county median of 56.7% and will remain so in fiscal 2016.

Debt and Pensions: Modest General Fund Debt Burden

The county's $977 million of lease, COPs and pension obligations constitute a low 0.2% of the county's total assessed valuation. Peak debt service on these obligations occurs in 2018 and is only 3.4% of total operating revenues. The county does not have any outstanding general obligation bonds.

DEBT STRUCTURE

All of the county's obligations are fixed rate with largely level debt service through 2025. Debt service then gradually declines through maturity in 2042 for the leases and COPs and 2027 for the pension obligation bonds. Management maintains a practice of setting aside all payments for debt service at the beginning of the fiscal year in which they are due.

The bonds being refunded had reserve funds funded by a combination of cash and surety to meet the standard three-prong test. The refunding lease will have a cash funded reserve equal to 50% of MADs. Though the lack of a fully funded reserve is a weakness relative to obligations that meet that standard, the low levels of general fund debt and the totality of the county's credit profile preclude it from warranting a rating distinction from the county's other COPs. The leased asset is the 35.5 acre County Operations Center, which is home to 20 county departments, and approximately 3,100 staff.

The county's assets for its various other COPs and lease obligations consist of essential facilities such as its central office complex and jails. Other provisions of the COP and lease obligations include the typical features of two-years of rental interruption insurance, title insurance, and provisions for asset substitution.

DEBT-RELATED DERIVATIVES

The county does not have any debt–related derivatives.

PENSIONS AND OPEB

The county's pension benefit system is administered by the San Diego County Employees Retirement Association (SDCERA) which manages the county's cost-sharing, multiple-employer defined benefit pension and OPEB plans.

In fiscal 2015, the county's combined pension and OPEB expense was $228 million , which is a manageable 6.3% of total operating funds. Combined with its lease and COP obligations, the total annual fixed cost is 9.7% of operating revenue. The county has paid more than 100% of the OPEB required contribution in each of the last three years.

Moody's adjusted net pension liability (ANPL) for the county, under our methodology for adjusting reported pension data, is 2.02 times operating revenues. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace the county's reported liability information, but to improve comparability with other rated entities.

The county's OPEB liability is unusually low with an UAAL of just $164.4 million, which is 6% of the county's $2.5 billion pension UAAL. The county has sought to improve its pension funding by making payments well above the ARC in recent years. Pension contributions exceeded the ARC by $29.6 million and $14.2 million in fiscal 2011 and fiscal 2013 respectively.

Management and Governance

California counties have an institutional framework score of "A" or moderate. Primary sources of unrestricted revenues come from property tax and sales tax. Service charges and state aid make up significant sources of county revenues as well, however are usually restricted to specific purposes. Property taxes are fairly predictable, given the state's constitutional formula, known as "Prop. 13", while sales taxes are extremely sensitive, either to the local economy or the state's financial position. Expenditure flexibility is similarly limited, although somewhat less so than revenues.

San Diego County's credit profile continues to benefit from a deep and effective management team. The quality of management manifests itself in the form of well-conceived financial policies, conservative budget management, and financial metrics that are generally strongly above average.

Legal Security

Debt service for the bonds is secured by base rental payments made by the county to the San Diego County Regional Building Authority in exchange for the use and occupancy of the leased asset.

Use of Proceeds

Proceeds from the sale will be used to advance refund the county's Series 2009A lease revenue bonds, which were originally issued to finance improvement of the County Operations Center.

Obligor Profile

San Diego County is the southernmost major metropolitan area in California. The county covers 4,261 square miles, extending 75 miles along the Pacific Coast from the Mexican border to Orange County, and inland 75 miles to Imperial County. Riverside and Orange counties form the northern boundary. San Diego County is approximately the size of the State of Connecticut with a population of approximately 3.2 million residents.

Methodology

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

Ratings

Exhibit 2

SAN DIEGO (COUNTY OF) CA

Issue	Rating
Lease Revenue Refunding Bonds (County Operations Center) Series 2016A	Aa2
Rating Type	Underlying LT
Sale Amount	$109,610,000
Expected Sale Date	02/05/2016
Rating Description	Lease Rental: Abatement

Source: Moody's Investors Service

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