S&P Global
Ratings

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Summary:

San Diego County, California; Appropriations; General Obligation

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Credit Profile		
US$49.81 mil certs of part (Youth Transition Campus) ser 2021 due 10/01/2051		
Long Term Rating	AA+/Stable	New
San Diego Cnty GO		
Long Term Rating	AAA/Stable	Affirmed
Unenhanced Rating	NR(SPUR)	

Rating Action

S&P Global Ratings assigned its 'AA+' rating to San Diego County, Calif.'s anticipated $49.81 million series 2021 certificates of participation (COPs. At the same time, S&P Global Ratings affirmed its:

- 'AAA' issuer credit rating (ICR) on the county;
- 'AAA' long-term rating and underlying rating (SPUR) on the county's pension obligation bonds (POBs) outstanding; and
- 'AA+' long-term rating on the county's COPs and lease revenue bonds outstanding.

The outlook on all ratings is stable.

The series 2021 COPs are secured by base rental payments made by the county, as lessee, to the San Diego County Capital Asset Leasing Corp., the lessor, for the use of the county's Assessor Recorder County Clerk Building (East County), Rancho San Diego Sheriff Station, Alpine Branch Library, Borrego Springs Library, and the Ramona Library. The county's outstanding lease revenue bonds and COPs also have an interest in base rental payments made by the county for use of other county properties as leased assets. These leased assets meet our minimum threshold for seismic risk during the life of the bonds. The county has agreed to budget and appropriate lease payments during the obligations' life. We note that these payments are subject to annual appropriation, as well as to abatement in the event of damage to or the destruction of the leased facilities. To mitigate the risk of abatement, the county has covenanted to maintain at least 24 months of rental interruption insurance. Although the COPs do not have the added security of a debt service reserve, we believe the payment schedule mitigates risk related to late budget adoption, with three months between the beginning of the fiscal year and the Oct. 1 debt service payments. The COPs are rated one notch off the ICR due to the appropriation risk. COP proceeds will be used to finance the construction of a new youth transition campus.

The POBs are obligations of the county and are payable from any source of legally available funds of the county. We rate the county's POBs on par with its general creditworthiness due to our view that the county's ability to pay the obligation is closely tied to its operations and the revenue used to secure its POBs is not limited in scope and not distinct and separate from the county's general fund.

The county ICR is eligible to be rated above the sovereign because we believe the county can maintain better credit characteristics than the U.S. can in a stress scenario. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings--Methodology And Assumptions", U.S. local governments are considered to have moderate sensitivity to country risk. County-derived revenue and state grants are the primary revenue sources for the county, and the institutional framework in the U.S. is predictable, with significant local government autonomy and flexibility demonstrated by independent treasury management.

Credit overview

The outstanding ratings for the county reflect our view that the county will likely be able to weather the recessionary pressures that remain from the recent recession as well as the effects from the ongoing COVID-19 pandemic. We consider the county's local economy to be very strong, reflecting strong income and wealth figures compared with the nationwide average although we note the strength of the local economy may come under pressure should unemployment rates remain high for the remainder of the fiscal year. While sales tax revenue has declined due to the pandemic, we believe updated projections provided by the county reflect much better sales tax collection results compared to the county's previous projection that was created in March 2020. The recovery in sales tax revenue is expected to continue into fiscal 2022. The stable outlook reflects our view that the county will maintain a very strong financial position with the recent growth in property tax revenues and the recovery in sales tax revenues going into fiscal 2022. We anticipate recovery in the county's revenue streams to continue and that the county will make the necessary budgetary adjustments to avoid a substantial weakening of its financial performance and position.

For more information on S&P Global Economics latest forecast, see "Economic Outlook U.S. Q4 2021: The Rocket Is Leveling Off", published Sept. 23, 2021, on RatingsDirect.

The ratings reflect our view of the county's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with operating results that we expect could weaken in the near term relative to fiscal 2020, which closed with slight operating surpluses in the general fund and at the total governmental fund level in fiscal 2020;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2020 of 25% of operating expenditures;
- Very strong liquidity, with total government available cash at 73.3% of total governmental fund expenditures and 18.5x governmental debt service, and access to external liquidity we consider exceptional;
- Very strong debt and contingent liability profile, with debt service carrying charges at 4.0% of expenditures and net direct debt that is 22.7% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value, but a large pension obligation; and
- Strong institutional framework score.

Environmental, social, and governance (ESG) factors

We analyzed the county's ESG risks relative to its economy, management, financial measures, and debt-and-liability profile. Our ratings incorporate our view of the health and safety risks posed by the COVID-19 pandemic and the recent economic recession. In addition, we believe the county's tax base is somewhat exposed to environmental risks posed by the threat of wildfires, drought and, in the longer term, sea level rise. We note the county maintains a hazard mitigation plan as well as a countywide resilience program, which somewhat mitigates these risks to its tax base and other assets. We consider the county's governance risks in line with our view of the sector standard.

Stable Outlook

Downside scenario

The rating could be lowered if the county's available general fund reserves are depleted to adequate levels or below while reflecting a general fund deficit without a plan to restore balance during the next two fiscal years.

Credit Profile

Very strong economy

We consider the county's economy very strong. San Diego County, with an estimated population of 3.4 million, is in the San Diego-Carlsbad, CA MSA, which we consider to be broad and diverse. The county has a projected per capita effective buying income of 114% of the national level and per capita market value of $183,532. Overall, the county's market value grew by 3.4% during the past year to $618.5 billion in 2022. The county unemployment rate was 9.2% in 2020.

San Diego County has a diversified economy based on tourism, international trade, education, health care, military, and high-technology manufacturing. Recessionary pressures from the recent recession as well as the ongoing pandemic have resulted in declines in sales tax revenue collections, temporary closures from certain retail businesses, and an increased unemployment rate for the county that began in fiscal 2020 and continues into fiscal 2021. Management indicates their unemployment rate reached a high of 15.9% in April 2020, although this rate has declined in each month thereafter, ending at 6.6% in August 2021. Management indicates their economy reflects a recovery in recent months with certain businesses being able to reopen under state guidelines. Assessed values (AVs) continue to strengthen in fiscal 2022, reflecting ongoing residential and commercial developments as well as a housing market that remains robust. We note that the county assessor temporarily reduced the AV for certain commercial properties that were affected by the pandemic, resulting in $2.9 billion temporary AV reductions in fiscal 2022. However, the growth in AV in other sectors, such as residential properties far outweigh the reduction in AV from commercial properties, which ultimately resulted in a 3.4% increase in total countywide AV. We believe the continued demand for housing throughout the county will likely keep home prices high and we expect this positive trend to continue for the foreseeable future.

Very strong management

We view the county's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

The county has written policies that both address long-term planning and track shorter-term changes between budgeted and actual numbers. The county has policies guiding its investments, with at least a quarterly review, and a comprehensive debt management policy. Its reserve policy requires reserves of no less than 16.7% of audited general fund expenditures based on the county's assessment of its needs for cash flow and unexpected events. We note that the county board temporarily relaxed its reserve policy due to the ongoing pandemic, and reserves are projected to dip below the county reserve policy. However, management plans to begin restoring its unassigned fund balance back to compliant levels starting in fiscal 2022 with an expectation to fully restore the balance by fiscal 2024. Actual-to-budget variances for general fund revenues and expenditures are reviewed monthly, and the county can make changes to its budget as needed. The county uses various external and internal resources to generate budget assumptions, including several economic publications and its own historical trend analysis. It also engages in multiyear financial planning, and its capital plan spans five years and fully identifies potential sources and uses of funds.

Adequate budgetary performance

San Diego County's budgetary performance is adequate in our opinion. The county had slight operating surpluses of 0.9% of expenditures in the general fund and 1.3% across all governmental funds in fiscal 2020. While we expect San Diego County to have at least balanced operating results, we do not expect results to be as favorable as they had been in 2020. General fund operating results have been stable, at 2.7% in 2019 and 2.9% in 2018.

Property tax revenues are the largest discretionary revenues for the county which have reflected good growth during the past several years. While the recent economic recession and the ongoing pandemic have placed pressure on the county's sales tax and transient occupancy tax revenues, we note that these two revenue streams are a relatively small portion of the county's overall budget. The county also received approximately $388 million in CARES Act funding from the federal government, which helped fund pandemic-related expenditures. Certain non-essential capital projects were also delayed temporarily, which provided some flexibility in the county's budget. Overall, management projects to use about $209.3 million in its unassigned general fund balance for use on various one-time projects and programs in fiscal 2022, although overall unassigned fund balance levels are still higher compared to the previous fiscal year (2020) due to higher-than-expected budgetary performance in fiscal 2021. We note that the county expects to receive a total of $648.4 million in federal funds under the American Rescue Plan Act (ARPA) which will be used for COVID response related expenditures and other various social programs.

Very strong budgetary flexibility

San Diego County's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2020 of 25% of operating expenditures, or $1.1 billion.

We note that the county intends on using approximately $209.3 million of its unassigned general fund balance for use of one-time projects, although the projected ending unassigned general fund balance of $765.1 million is still higher than the previous unassigned general fund balance of $707.9 million in fiscal 2020. We note that the county experienced better-than-expected financial results in fiscal 2021 compared to its previously budgeted figures in the general fund. The county's budget for fiscal 2022 includes the increase in property tax revenues expected for the fiscal year and does not assume a substantial drawdown of existing general fund reserves. Overall, we expect the county's budgetary flexibility to remain very strong during the next two years.

Very strong liquidity

In our opinion, San Diego County's liquidity is very strong, with total government available cash at 73.3% of total governmental fund expenditures and 18.5x governmental debt service in 2020. In our view, the county has exceptional access to external liquidity if necessary.

The county's exceptional market access is supported by issuances of lease revenue bonds, POBs and COPs during the past several years. We expect very strong levels of liquidity in future years. The county has not issued tax revenue anticipation notes for cash flow needs during the past seven years, as internal liquidity has been sufficient. In addition, we note that the county does not have any direct purchase or private placement debt outstanding. A large majority of the county's investments are held in conservative assets such as federal securities. We do not expect liquidity to weaken over the near term.

Very strong debt and contingent liability profile

In our view, San Diego County's debt and contingent liability profile is very strong. Total governmental fund debt service is 4.0% of total governmental fund expenditures, and net direct debt is 22.7% of total governmental fund revenue. Overall net debt is low at 2.8% of market value, which is in our view a positive credit factor.

The county funds most of its capital projects with pay-as-you-go funding; however, management reports that there are currently no plans to issue additional long-term debt during the near future. We do not expect that the county's debt metrics will weaken during the next two years due to the issuance of additional debt.

In our opinion, a credit weakness is San Diego County's large pension obligation. San Diego County's combined required pension and actual OPEB contributions totaled 10.7% of total governmental fund expenditures in 2020. The county made 102% of its required pension contribution in 2020. The funded ratio of the county's pension plan is 76%.

- We do not view pension and OPEB liabilities as an immediate source of credit pressure for the county.
- Although the size of the current pension contributions are currently large in our view, we believe the county will be able to budget for those increased costs over the medium term.
- The county offers a limited OPEB benefit, which does not pose a significant credit risk, in our view.

The county participates in San Diego County Employees Retirement Assn. (SDCERA) and paid above the annual required contribution (ARC) in fiscal years 2005 to 2007, 2011, 2013, 2018, 2019, and 2020 to address the decline in the funded level. The fiscal 2019 SDCERA valuation shows the plan funded at 76.3%. We understand SDCERA has assessed its assumed rate of return and revised it downward in fiscal 2019 to 7.00% from 7.25% which increased the county's pension costs in the short term. In our view, a discount rate higher than our 6.0% guideline could lead to contribution volatility that could stress the county's budget. However, we believe this effort to reduce the assumed discount rate to address the county's large and increasing unfunded pension liability is prudent for the county's long-term financial health despite the short-term increase in pension costs. Furthermore, the county no longer contributes both the employer and employee contribution rate to its pension plans. Since fiscal 2019, the county has only been responsible for the employer portion, lowering its annual cost increases. We view the efforts to address pension benefits from now on as a viable management plan, and we do not believe current costs will cause budgetary stress.

Based on a 7.0% discount rate with a measurement date of June 30, 2019, the county's net pension liability ended at roughly $3.79 billion with a funded ratio of 76%. We understand that the county estimated its OPEB unfunded actuarial accrued liability at only $106 million, which we consider to be relatively small, and that officials are currently paying the full OPEB ADC. OPEB is not a vested benefit and is only available to Tier I and Tier II employees since 2007.

Strong institutional framework

The institutional framework score for California counties required to submit a federal single audit is strong.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 2020 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of October 22, 2021)		
San Diego Cnty certs of part (Justice Facs Rfdg)		
Long Term Rating	AA+/Stable	Affirmed
San Diego Cnty rfdg certs of part ser 2020A due 10/01/2041		
Long Term Rating	AA+/Stable	Affirmed
San Diego Cnty rfdg certs of part ser 2020B due 10/01/2041		
Long Term Rating	AA+/Stable	Affirmed
San Diego Cnty taxable pension oblig bnds (Auc Rate Secs) ser 2004B (Syncora) (AGC)		
Unenhanced Rating	AAA(SPUR)/Stable	Affirmed
San Diego Cnty APPROP		
Long Term Rating	AA+/Stable	Affirmed
San Diego Cnty APPROP		
Long Term Rating	AA+/Stable	Affirmed
San Diego Cnty APPROP		
Long Term Rating	AA+/Stable	Affirmed
San Diego Cnty GO (MBIA) (National)		
Unenhanced Rating	AAA(SPUR)/Stable	Affirmed
San Diego Cnty GO (Syncora)		
Unenhanced Rating	AAA(SPUR)/Stable	Affirmed
San Diego Cnty ICR		
Long Term Rating	AAA/Stable	Affirmed
San Diego Cnty APPROP		
Long Term Rating	AAA/Stable	Affirmed
Unenhanced Rating	NR(SPUR)	
San Diego Regl Bldg Auth, California		
San Diego Cnty, California		
San Diego Regl Bldg Auth (San Diego Cnty) APPROP		
Long Term Rating	AA+/Stable	Affirmed

Ratings Detail (As Of October 22, 2021) (cont.)	
Unenhanced Rating	NR(SPUR)
Many issues are enhanced by bond insurance.	