S&P Global Ratings

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Summary:

# San Diego County, California; Appropriations; General Obligation

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**Summary:**

# San Diego County, California; Appropriations; General Obligation

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|---|---|---|
| US$172.725 mil COPs (County Public Health Lab And Cap Imp) ser 2023 due 10/01/2053 | | |
| *Long Term Rating* | AA+/Stable | New |
| San Diego Cnty APPROP | | |
| *Long Term Rating* | AA+/Stable | Affirmed |
| San Diego Cnty ICR | | |
| *Long Term Rating* | AAA/Stable | Affirmed |

## Credit Highlights

- S&P Global Ratings assigned its 'AA+' long-term rating to San Diego County, Calif.'s approximately $172.725 million series 2023 certificates of participation (COPs).
- At the same time, S&P Global Ratings affirmed its 'AAA' issuer credit rating (ICR) on the county and its 'AAA' long-term and underlying rating (SPUR) on the county's outstanding pension obligation bonds.
- Finally, S&P Global Ratings affirmed its 'AA+' rating on the county's outstanding certificates of participation (COPs) and lease revenue bonds.
- The outlook is stable.

### Security

The series 2023 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 Youth Transition Campus, Rancho San Diego Library, Sheriff's Alpine Station, and the Crime Lab building. 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. We have reviewed the lease under our criteria and view the lease terms as standard. Furthermore, the leased assets meet our minimum requirements for seismic resilience during the term of the COPs. We rate the COPs one notch below our view of the county's general creditworthiness to reflect our view of the risk of nonappropriation inherent to the lease structure.

Although the series 2023 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 a portion of the construction of the public health lab, the consolidation of uses and departments currently housed in the four existing, four-story office buildings, the construction of a parking structure, and major renovations to the county administrative center.

The ICR reflects our view of the county's general creditworthiness. The POBs are obligations of the county and are payable from any source of legally available funds of the county.

### Credit overview

The county's local economy remains very strong, driven by strong income levels and a growing tax base supported by very strong home prices. Property tax revenues, which represent the county's largest discretionary revenue stream, continues to grow going in 2023, in tandem with its growing assessed value (AV). Management indicates that strong home prices in the region continue to bolster AV, despite the high mortgage rates and that they expect this trend to continue with a 3.5% projected AV growth for fiscal 2025.

Management reports that sales tax revenues have recovered since the pandemic and have demonstrated growth in fiscal 2022 with a projection of further growth for the foreseeable future. Coupled with the growth in property tax revenues, management reports that they expect to end fiscal 2023 with an operating surplus and will add approximately $17.8 million to its unassigned general fund balance. In fiscal 2022, the county's general fund reserve levels remained very strong. Overall, we expect the county will likely report balanced operations at a minimum for fiscals 2023 and 2024. Coupled with the county's very strong management and its strong financial management policies and practices, we expect the county will maintain its very strong financial position during the next two years.

The ratings reflect our view of the county's creditworthiness, including its:

- Very strong economy, with access to a broad and diverse metropolitan statistical area. The county's taxable AV continues to grow at a good pace, driven by strong home prices;
- Very strong management, with well-embedded financial policies and practices including a track record of conservative budget assumptions, multiyear budget forecasting, budget reviews with the governing body four times a year, and formal policies for investment management, debt management, and reserve levels; along with a strong institutional framework score;
- Strong budgetary performance, with balanced operating results in the general fund and total governmental fund level in fiscal 2022;
- Very strong budgetary flexibility and liquidity--with exceptional access to external liquidity, as evidenced by frequent issuances of debt during the past several years; and
- Very strong debt and contingent liability profile without immediate plans for additional debt, although we note the county has a practice of funding its capital projects through both pay-go funding and issuance of lease obligations. In addition, management has manageable pension costs, with a practice of making additional voluntary contributions toward its pensions that are above the annually determined contribution level.

### Environmental, social, and governance

We believe the county's tax base has elevated exposure to acute physical risks that include wildfires, drought, flooding and sea level rise. We note that 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 social and governance risks as neutral in our credit analysis.

## Outlook

The stable outlook reflects our view of the county's very strong economy, very strong management including strong financial management policies and practices, and the county's strong financial position that include growing property tax and sales tax revenues and the maintenance of its very strong general fund reserves.

### 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 with further tax base growth

San Diego County has a diversified economy based on tourism, international trade, education, health care, military, and high-technology manufacturing. The county's tax base has continued to grow going into fiscal 2024, reflecting a 7% growth from the prior year. The AV increase is primarily due to the ongoing development of residential and commercial properties, as well as very strong home prices that bolster the county's taxing base. Despite the high mortgage rate environment, which has resulted in a slowdown in real estate activity, we expect the tax base will remain stable with home prices remaining high and demand staying strong for the foreseeable future.

### Very strong management with robust institutionalized policies and practices

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. Actual-to-budget variances for general fund revenues and expenditures are reviewed monthly, and the county can change 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 funding sources and fund uses.

### Strong budgetary performance with another modest surplus expected in fiscal 2023

Property tax revenue comprise the county's largest discretionary revenue and have reflected good growth during the past several years. We expect the county's growing AV and property tax revenue trends to continue. Sales tax revenue also increased in fiscal 2023 (based on estimated figures), which reflects a strong recovery from the pandemic. Management indicates they expect another operating surplus in fiscal 2023 and project adding about $17.8 million toward the unassigned general fund balance. Overall, we expect the county to maintain balanced operations at a minimum for both fiscals 2023 and 2024.

### Very strong budgetary flexibility with maintenance of very strong general fund reserves and liquidity

The county maintains very strong reserve levels, further supported by the general fund's operating surplus in fiscal 2022, with another expected in fiscal 2023. We understand management does not have any immediate plans to materially draw down its reserves.

The county also maintains very strong liquidity levels. We believe the county has exceptional market access, as evidenced by the frequent issuance of lease revenue bonds, pension obligation bonds, and certificates of participation during the past several years. We note that the county has not issued tax revenue anticipation notes for cash-flow needs during the past nine years, as it has had sufficient internal liquidity. In addition, we note that the county does not have any direct-purchase or private-placement debt outstanding. The majority of the county's investments are held in conservative assets, such as federal securities. We do not expect liquidity to weaken in the near term.

### Very strong debt and contingent liability profile and no additional near-term debt plans

The county funds most of its capital projects with pay-as-you-go funding and management reports that it has no plans to issue additional long-term debt in the near future. As such, we do not expect the county's debt metrics to weaken during the outlook horizon.

In our opinion, a credit weakness is San Diego County's large pension costs, with combined required pension and actual other postemployment benefit (OPEB) contributions totaling 10.5% of total governmental fund expenditures in 2022. We note that this weakness is partly offset by its 76.7% funded ratio, which we consider above average, as well as management's historical practice of voluntarily funding pensions above its annually required contribution in certain years.

- We do not view pension and OPEB liabilities as an immediate source of credit pressure for the county.
- Although we consider the county's current pension contributions as large, we believe it will be able to budget for those increased costs in 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 2005-2007, 2011, 2013, 2018, 2019, and 2020 to address the funded level decline. The fiscal 2022 SDCERA valuation (as of June 30, 2022) shows the plan funded at 76.7%. We understand SDCERA's discount rate is 6.5% as of 2022. In our view, a discount rate higher than our 6.0% guideline could lead to contribution volatility that could stress the county's budget.

### Strong institutional framework

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

### Ratings above the sovereign

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. in a stress scenario. Under our criteria "Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions", published Nov. 19, 2013, on RatingsDirect, 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.

| San Diego County, California--Key credit metrics | | | | |
|---|---|---|---|---|
| | **Most recent** | **Historical information** | | |
| | | **2022** | **2021** | **2020** |
| **Very strong economy** | | | | |
| Projected per capita EBI % of U.S. | 117.04 | | | |
| Market value per capita ($) | 213,401 | | | |
| Population | | 3,362,964 | 3,355,456 | 3,370,232 |
| County unemployment rate(%) | | | 6.50 | |
| Market value ($000) | 717,659,794 | 618,546,467 | | |
| Ten largest taxpayers % of taxable value | 3.02 | | | |
| **Strong budgetary performance** | | | | |
| Operating fund result % of expenditures | | 0.75 | (4.54) | 0.94 |
| Total governmental fund result % of expenditures | | 0.98 | (3.75) | 1.27 |
| **Very strong budgetary flexibility** | | | | |
| Available reserves % of operating expenditures | | 19.06 | 19.90 | 24.57 |
| Total available reserves ($000) | | 1,009,970 | 1,067,009 | 1,122,521 |
| **Very strong liquidity** | | | | |
| Total government cash % of governmental fund expenditures | | 70.61 | 65.51 | 73.33 |
| Total government cash % of governmental fund debt service | | 2,128.36 | 2,467.61 | 1,846.89 |
| **Very strong management** | | | | |
| Financial Management Assessment | Strong | | | |
| **Very strong debt & long-term liabilities** | | | | |
| Debt service % of governmental fund expenditures | | 3.32 | 2.65 | 3.97 |
| Net direct debt % of governmental fund revenue | 19.68 | | | |
| Overall net debt % of market value | 2.44 | | | |
| Direct debt 10-year amortization (%) | 48.66 | | | |
| Required pension contribution % of governmental fund expenditures | | 10.22 | | |
| OPEB actual contribution % of governmental fund expenditures | | 0.30 | | |
| **Strong institutional framework** | | | | |

EBI--Effective buying income. OPEB--Other postemployment benefits. Data points and ratios may reflect analytical adjustments.

## Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022
- 2022 Update Of Institutional Framework For U.S. Local Governments

## Ratings Detail (As Of October 4, 2023)

| Ratings Detail (As Of October 4, 2023) (cont.) | | |
|---|---|---|
| San Diego Cnty GO | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| *Unenhanced Rating* | NR(SPUR) | Current |
| San Diego Cnty certs of part (Justice Facs Rfdg) | | |
| *Long Term Rating* | AA+/Stable | Affirmed |
| San Diego Cnty certs of part (Youth Transition Campus) ser 2021 due 10/01/2051 | | |
| *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 GO (Syncora) | | |
| *Unenhanced Rating* | AAA(SPUR)/Stable | Affirmed |
| San Diego Cnty APPROP | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| *Unenhanced Rating* | NR(SPUR) | |
| **San Diego Regional Building Authority, California** | | |
| San Diego County, California | | |
| San Diego Regl Bldg Auth (San Diego Cnty) APPROP | | |
| *Long Term Rating* | AA+/Stable | Affirmed |
| *Unenhanced Rating* | NR(SPUR) | |

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.

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