



Fitch Affirms San Diego County, CA's Pension Obligation and Lease Rev Bonds at 'AA+'; Outlook Stable

Fitch Ratings-San Francisco-15 March 2017: Fitch Ratings has affirmed the following ratings for San Diego County, California:

- Issuer Default Rating (IDR) at 'AAA';
- \$649.9 million outstanding San Diego County pension obligation bonds (POBs) at 'AA+';
- \$311 million San Diego County certificates of participation (COPs) and San Diego Regional Building Authority lease revenue bonds (LRBs) at 'AA+'.

The Rating Outlook is Stable.

SECURITY

The POBs are absolute and unconditional obligations of the county imposed by law, and are payable from all lawfully available funds. COPs and LRBs are supported by annually appropriated lease payments for use and occupancy of various leased assets, subject to abatement.

KEY RATING DRIVERS

The 'AAA' IDR incorporates the county's strong operating performance, supported by solid expenditure and revenue frameworks, as well as moderate long-term liabilities. Ratings on the county's POBs and lease debt are one notch lower at 'AA+', consistent with Fitch's approach for contractual obligations and appropriation-backed debt.

Economic Resource Base

San Diego County is the nation's fifth most populous county with over three million residents and 18 incorporated cities. The core industries of its diverse economy include manufacturing, the military and related defense industries, and tourism. The county's tax base has experienced steady growth over the long term with a 51% increase in assessed value between 2005 and 2017.

Revenue Framework: 'aa' factor assessment

Historical revenue growth has outpaced overall U.S. economic performance and Fitch expects continued out-performance based on above-average population growth. The county retains authority to increase fines and fees and other cost-based charges, but its legal ability to raise revenues is constrained by state constitutional provisions that require voter approval for tax increases.

Expenditure Framework: 'aaa' factor assessment

Based on the county's current spending practices and a history of above-average revenue growth, Fitch expects the natural pace of expenditure growth to be slower to equal with revenue growth. Expenditure-cutting flexibility is solid and fixed costs for debt service and pensions are moderate.

Long-Term Liability Burden: 'aa' factor assessment

Long-term liabilities for overall debt and pensions are moderate relative to the county's resource base.

Operating Performance: 'aaa' factor assessment

Solid reserve levels and limited revenue volatility contribute to exceptionally strong gap-closing ability that has increased during the current economic recovery.

RATING SENSITIVITIES

Financial Flexibility: The IDR is sensitive to shifts in fundamental credit characteristics, most notably Fitch's expectations for ongoing expenditure growth relative to available revenues.

CREDIT PROFILE

The county's population growth has been well above the national average, rising 6.6% between 2010 and 2015. Employment levels have increased steadily since 2010 while unemployment rates have fallen below 5%. Median home values have similarly improved and now match pre-recession levels.

Revenue Framework

Intergovernmental revenues accounted for about 57% of total general fund revenues in fiscal 2016. Such revenues represent state

and federal support for mandated health and human services programs managed by the county, including transfer payments as well as sales taxes reserved for public safety. General taxes provided about 29% of general fund revenues in fiscal 2016 and consisted primarily of property taxes.

The growth of total general fund revenues is heavily influenced by the county's receipt of intergovernmental revenues, which are largely determined by caseload trends as well as state and federal service mandates. Both total general fund revenues and locally generated revenues have increased more rapidly than inflation historically. Fitch expects these trends to continue based on ongoing population and tax base growth.

Like other California local governments, the county's independent legal ability to raise revenues is limited by state constitutional provisions requiring voter approval for tax increases. The county retains the ability to set fees and service charges at sufficient levels to recover costs and updates such items regularly as part of its annual budget process.

Expenditure Framework

Health and social services spending represents more than half of total general fund expenditures, with an additional 37% accounted for by public safety spending. Like other California counties, health and social services spending is largely funded from state and federal revenues while locally generated property tax provides the majority of support for public safety expenses.

Based on current spending practices, Fitch expects the natural pace of expenditure growth to be in line with to marginally above revenue growth in the absence of policy action.

The county's ability to reduce expenditures is solid, and is supported by moderate fixed costs for debt service and retiree benefits, which accounted for approximately 12% of governmental expenditures in fiscal 2016. The county's long-standing practices of funding capital needs from current resources, pre-payment of debt, and funding of other post-employment benefits (OPEBs) at actuarial levels provide ready sources of additional flexibility should the county need to reduce expenditures to address a budgetary imbalance.

Long-Term Liability Burden

Long-term liabilities, including net pension liabilities and overall debt, are at the low end of the moderate range relative to the county's resource base at approximately 10% of personal income. Debt issuances of overlapping jurisdictions account for about 80% of such liabilities. The county participates in the San Diego County Employees Retirement System and the plan's estimated ratio of assets to liabilities was about 75% in fiscal 2016 based on a Fitch-adjusted assumed investment return rate of 7%. The county closed its OPEB plan to new entrants in 2007 and its unfunded liability was reported at \$152 million at the end of fiscal 2016, equal to a modest 0.1% of personal income.

Operating Performance

The county's gap-closing ability in a moderate recession scenario is very strong and is supported by solid reserves and a history of limited revenue volatility. Unrestricted fund balance of \$1.7 billion was equal to nearly 46% of general fund spending at the end of fiscal 2016. Fitch expects that the county would reduce expenditures to offset revenue declines in a downturn, with limited use of reserves.

Budget management is conservative and the county has increased financial flexibility during the current economic recovery with regular additions to its already healthy reserves. The county's fiscal 2017 budget is balanced and management reports expectations of further additions to fund balance at year end.

Contact:

Primary Analyst
Stephen Walsh
Director
+1-415-732-7573
Fitch Ratings, Inc.
650 California Street, 4th Floor
San Francisco, CA 94108

Secondary Analyst
Graham Schnaars
Analyst
+1-415-732-7578

Committee Chairperson

Laura Porter
Managing Director
+1-212-908-0575

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available at 'www.fitchratings.com'.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

Applicable Criteria

U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016) (<https://www.fitchratings.com/site/re/879478>)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?pr_id=1020618&cft=0)

Solicitation Status (https://www.fitchratings.com/gws/en/disclosure/solicitation?pr_id=1020618)

Endorsement Policy (<https://www.fitchratings.com/regulatory>)

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK:

[HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings)

(<https://www.fitchratings.com/understandingcreditratings>). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2016 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of

Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Solicitation Status

Fitch Ratings was paid to determine each credit rating announced in this Rating Action Commentary (RAC) by the obligator being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated, except for the following:

Endorsement Policy - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures (<https://www.fitchratings.com/regulatory>) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.