MOODY'S INVESTORS SERVICE

CREDIT OPINION
10 May 2017

Update

Rate this Research

Contacts

Michael Wertz 212-553-3830
VP-Senior Analyst
michael.wertz@moodys.com

Alexandra J. Cimmiyotti 415-274-1754
VP-Senior Analyst
alexandra.cimmiyotti@moodys.com

San Diego County, CA

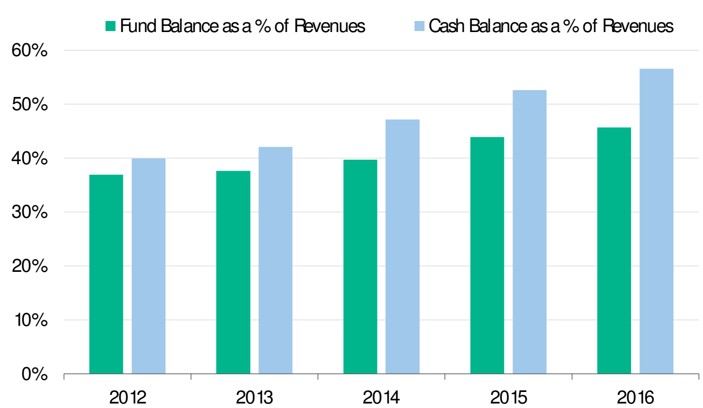
San Diego County, CA

Summary Rating Rationale

The Aaa Issuer Rating, Aa1 lease rating and Aa2 pension obligation bond rating reflects the county's very large, diverse and growing tax base, healthy financial position, and moderate debt profile. The county's low combined annual lease and retirement costs as well as the structure of the obligations is also factored into the rating.

The notching difference between the county's Issuer and lease-backed rating reflects the standard legal structure for these California abatement lease financings and "more essential" leased assets. These leased assets include the county's detention facilities, courthouse, administration buildings, transit facilities, and skilled nursing facilities among others. The notching also reflects certain strong legal features of California general obligation bonds that are not shared by lease-backed obligations.

Exhibit 1
Fund Balance and Cash Balances are Strong and Improving



Source: Moody's Investors Service

Credit Strengths

» Very large, diverse and growing economic base

» Healthy and consistent operating results

» Moderate debt profile

Credit Challenges

- Growing pension costs
- Uncertain future health costs
- Exposure to sometimes volatile state budget

Rating Outlook

The stable outlook results from the our expectation that the county will continue to benefit from a strong economy that will help produce healthy financial results. We also anticipate that will not make any materially detrimental changes to its debt profile.

Factors that Could Lead to an Upgrade

- N/A

Factors that Could Lead to a Downgrade

- Significant and protracted decline of the assessed valuation
- Material weakening of the cash and reserves
- Significant economic deterioration resulting in lower revenue base
- Deterioration of the resident socioeconomic profile

Key Indicators

Exhibit 2

San Diego County

San Diego (County of) CA	2012	2013	2014	2015	2016
Economy/Tax Base					
Total Full Value ($000)	$ 392,000,000	$ 392,958,843	$ 405,983,622	$ 429,240,743	$ 453,315,509
Full Value Per Capita	$ 126,431	$ 125,215	$ 127,542	$ 133,177	$ 137,844
Median Family Income (% of US Median)	114.5%	113.6%	113.9%	113.9%	113.9%
Finances					
Operating Revenue ($000)	$ 3,396,511	$ 3,509,555	$ 3,657,157	$ 3,725,283	$ 3,810,172
Fund Balance as a % of Revenues	36.9%	37.6%	39.7%	43.9%	45.7%
Cash Balance as a % of Revenues	39.9%	42.0%	47.2%	52.6%	56.5%
Debt/Pensions					
Net Direct Debt ($000)	$ 1,193,753	$ 1,165,792	$ 1,108,339	$ 1,048,134	$ 960,921
Net Direct Debt / Operating Revenues (x)	0.4x	0.3x	0.3x	0.3x	0.3x
Net Direct Debt / Full Value (%)	0.3%	0.3%	0.3%	0.2%	0.2%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.8x	1.9x	2.1x	2.0x	2.1x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	1.5%	1.7%	1.9%	1.8%	1.8%

Source: Moody's Investors Service

Detailed Rating Considerations

Economy and Tax Base: Extremely Large, Diverse and Growing Economy

San Diego County's local economy continues to expand and remains exceptionally large and diverse. Key and traditional drivers of the economy are a large military presence, robust tourism, and significant education, healthcare and technology sectors. As the economic recovery continues, those strengths have been joined by solid growth in the housing market and low unemployment. We anticipate that the County's economy and tax base will continue to expand and remain consistent with the rating.

The County's 2017 tax base grew as expected to reach a substantial $483 billion placing the County among the largest in the nation by this measure. The tax base has risen in concert with improving home values since 2013, which now have a median value of $495,000. The rate of home sales and new home construction are both rising, a signal of solid additional tax base growth to come in 2018. The County projects 4% assessed valuation growth in 2018 based on a continuation of Prop. 8 value restorations, new home construction, and continued increases in home values.

The County's 4.3% unemployment rate remains impressively low for such a large county and is below both the state and national marks. 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: Healthy Fiscal Position that will Remain Strong

The County's fiscal 2016 operating results were consistent with our expectations that it would continue to produce a healthy financial position highlighted by strong reserves and liquidity and consistent operating surpluses. The County's financial strength will retain these markers of solid fiscal health in fiscal 2017 and 2018.

Fiscal 2017 will produce another operating surplus and an increase in reserves, which will keep the County's financial profile consistent with the rating. The County conservatively budgets revenues and expenditures. This practice has resulted in the actual year-end unassigned reserves exceeding budget projections $46.6 million in over the last four years. This trend will likely continue in fiscal 2017. The County maintainted its prudent budgeting practices including an assumption of 3% assessed valuation growth versus actual growth of 5.6%. The County anticipates allocating approximately $300 million of fund balance to fund various one-time projects and capital expenses.

The County's total operating budget for fiscal 2017 is $5.3 billion with approximately 77% consisting of general fund resources. The remainder consists of special revenue funds (8.7%), internal service funds (8.6%), debt service funds (1.5%) capital funds, enterprise funds, and special district/successor agency funds. General fund revenues are primarily derived from taxes, state and federal sources. The County projects that the year-end unassigned fund balance will be $823 million, a $76 million increase from the prior year and 20% of operating revenues. However, we expect that the county will again produce actual results that exceed projections.

For fiscal 2018, the County expects to conclude its labor unit negotiations with two of its nine units by June 30, 2017 and the remainder completed one year later. The County will also set aside money to fund anticipated cost increases in health services if the Affordable Care Act is repealed. The strength of the County's economy will provide a strong base for ongoing stability in tax revenues while federal and state sources will be sufficient to produce continued additional operating surplus.

LIQUIDITY

The County's fiscal 2016 operating cash balance is an exceptionally strong 56.5%, more than double the median for California counties. In fiscal 2017, 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 74.6% for fiscal 2016. This level of cash comfortably greater than US county median and will remain so in fiscal 2017.

Debt and Pensions: Modest General Fund Debt Burden

The County's $898 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 general fund revenues. Debt service net of various offsets falls to only 1.6% of 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 County also adheres to a strong and conservative policy that debt service requirements cannot exceed 5% of general fund revenue.

The County's $605 million in outstanding pension obligation bonds is 67% of the total debt outstanding. The remaining 33% is represented by $292.5 million of certificates of participation and lease revenue bonds.

The leases, COPs, and POBs include debt service reserves funded at both the standard three-tier test and 50% of MADS. Considering the totality of the County's strong fiscal position and credit profile, the lower reserve amounts do not warrant additional notching.

The County's assets for its various 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 2016, the County's combined pension, OPEB and debt service costs were a manageable 14% of revenues. 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 2.1 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.

Management and Governance

California counties have an institutional framework score of “A” or moderate. Revenues consist primarily of a mix of state aid, property and sales and use taxes. Property taxes are fairly predictable, given the state's constitutional formula, known as “Prop. 13.” State and federal revenues are more variable. Counties' ability to raise revenues is very limited. Most county expenditures are state and federal mandates, which are funded with state and federal revenues. Counties have shown their ability and willingness to reduce expenditures during years when the state reduces 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 leases 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 assets. The County's POBs are secured by all legally available revenues.

Use of Proceeds

N/A

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 December 2016. An additional methodology used in the lease rating was Lease, Appropriation, Moral Obligation, and Comparable Debt of US State and Local Governments published in July 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

REPORT NUMBER 1072826

Contacts

Michael Wertz 212-553-3830
VP-Senior Analyst
michael.wertz@moodys.com

Alexandra J. Cimmiyotti 415-274-1754
VP-Senior Analyst
alexandra.cimmiyotti@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

MOODY'S INVESTORS SERVICE