STANDARD & POOR'S
RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:

San Diego County, California; Appropriations; General Obligation

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Table Of Contents

Summary:

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Credit Profile		
US$109.61 mil rfdg lse rev bnds ser 2016A due 10/15/2035		
Long Term Rating	AA+/Stable	New
San Diego Cnty GO Pension		
Long Term Rating	AA+/Stable	Affirmed
Unenhanced Rating	NR(SPUR)	Current
San Diego Cnty ICR		
Long Term Rating	AAA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA+ long-term rating to the San Diego Regional Building Authority, Calif.'s lease revenue refunding bonds, series 2016A, issued on behalf of San Diego County. At the same time, Standard & Poor's affirmed its 'AAA' issuer credit rating (ICR) on the county and affirmed its 'AA+' long-term rating and underlying rating (SPUR) on the county's certificates of participation (COPs), lease revenue bonds, and pension obligation bonds (POBs). The outlook on all ratings is stable.

The 2016A lease revenue refunding bonds have an interest in base rental payments made by the county, as lessee, to the San Diego Regional Building Authority, as lessor, for the use of county's operations center as the leased asset. 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. The leased asset meets our minimum threshold for seismic risk during the life of the bonds. To mitigate the risk of abatement, the county has covenanted to maintain at least 24 months of rental interruption insurance. The bonds will be secured by a debt service reserve fund. We understand the 2016A bond proceeds will be used to refund the county's outstanding series 2009A bonds.

The county's other outstanding COPs and lease revenue bonds are secured by pledged lease revenues, subject to abatement in the event of damage, destruction, or impairment of the leased assets. The county's pledge, not an unlimited ad valorem tax levy, secures the POBs.

The county's 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," U.S. local governments are considered to have moderate sensitivity to country risk. County-derived revenues 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 is demonstrated by independent treasury management.

The ratings reflect our view of the county's:

- 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;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2015;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2015 of 34% of operating expenditures;
- Very strong liquidity, with total government available cash at 65.7% of total governmental fund expenditures and 16.5x governmental debt service, and access to external liquidity we consider exceptional;
- Strong debt and contingent liability position, with debt service carrying charges at 4.0% of expenditures and net direct debt that is 37.3% of total governmental fund revenue; and
- Strong institutional framework score.

Strong economy

We consider the county's economy strong. San Diego County, with an estimated population of 3.2 million, is located in the San Diego-Carlsbad, Calif. MSA, which we consider to be broad and diverse. The county has a projected per capita effective buying income of 105.4% of the national level and per capita market value of $140,454. Overall, the county's market value grew by 5.6% over the past year to $453.3 billion in 2016. The county unemployment rate was 6.4% in 2014.

San Diego County has a diversified economy based on tourism, international trade, military, and high-technology manufacturing. County unemployment continues to decline and has historically tracked below the state level, a trend that is on track to continue. Assessed values (AVs) continue to strengthen, and 2016 AV grew due in large part to changes in ownership for real estate, which added almost half of the county's AV growth. The number of notices for defaults and foreclosures has declined steadily since its peak in 2009, and notices of default are close to 2005 levels. County AV is projected to grow another 3% for the next fiscal year, reflecting Proposition 8 restorations, increases in median home prices, and slight increases in sales and new construction activity.

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 address both long-term planning and tracking 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 17% of discretionary revenues based on the county's assessment of its needs for cash flows and unexpected events. Actual-to-budget variances for general fund revenues and expenditures are reviewed monthly. The county uses various external and internal resources to generate budget assumptions, including various 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.

Strong budgetary performance

San Diego County's budgetary performance is strong in our opinion. The county had operating surpluses of 4.5% of expenditures in the general fund and of 2.6% across all governmental funds in fiscal 2015.

The county has benefited from increasing property tax and sales tax revenues, which have enabled it to maintain its very strong financial position in recent years. For fiscal 2015, the county was able to renegotiate employee contribution payments to pensions. The agreement states that the portion of employee contributions that are actually paid by the county will be phased out in fiscal years 2017-2018. The county also received some one-time revenues from the state, which repaid certain mandated costs and costs associated with a facilities project. The county's budget also underestimated AV growth, at 4.0%, versus actual growth of 6.2%, providing the county with revenue cushions. For fiscal 2016, the county is presenting a balanced general fund budget at $4.12 billion. Revenue assumptions include AV growth of 4.0%, which the assessor office has indicated will actually be 5.6%, providing for some revenue cushion, similar to previous years. For fiscal 2017, management is projecting to have balanced operations at a minimum.

Very strong budgetary flexibility

San Diego County's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2015 of 34% of operating expenditures, or $1.2 billion.

Included in the county's available reserves is $55 million for emergency contingencies that are held as committed reserves. The county's reserve policy, which was recently turned into an ordinance, ensures a minimum 17% of reserves will be available for various types of contingencies, and we expect management will continue to meet this level. The county's 17% policy also requires the maintenance of 10% of general fund minimum unassigned fund balance for economic uncertainty, 5% for unforeseen catastrophic events, and 2% for contingencies. In addition, the county has a history of what we regard as conservative budgeting. Expenditure controls have helped maintain positive operations, which are necessary due to the county's limited direct revenue-raising flexibility. Management has consistently met its reserves policies and first-quarter projections for fiscal year-end show increases in both total and unassigned reserves. Furthermore, first-quarter results are often conservative, and it is likely reserves will end higher than currently estimated. While it is possible reserves could fluctuate, as some are used for planned capital expenditures, we do not anticipate any weakening of the budgetary flexibility assessment, given policies and practices.

Very strong liquidity

In our opinion, San Diego County's liquidity is very strong, with total government available cash at 65.7% of total governmental fund expenditures and 16.5x governmental debt service in 2015. In our view, the county has exceptional access to external liquidity if necessary.

The county's exceptional market access is supported by frequent issuances of lease revenue bonds, COPs, and tax anticipation notes. We expect very strong levels of liquidity in future years. This is the second year the county has not issued tax revenue anticipation notes for cash flow needs. 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.

Strong debt and contingent liability profile

In our view, San Diego County's debt and contingent liability profile is strong. Total governmental fund debt service is 4.0% of total governmental fund expenditures, and net direct debt is 37.3% of total governmental fund revenue.

The county's debt portfolio no longer contains variable-rate bonds. Its general fund debt service is below 5% of its general fund revenues, a level we view as low. In addition, the county has paid off its 2005 COPs while continuing to pay down its POBs, one series of which will be paid off in fiscal 2015-2016.

San Diego County's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 9.8% of total governmental fund expenditures in 2015. The county made 100% of its annual required pension contribution in 2015.

The county continues to address its pension obligations. The county participates in San Diego County Employees Retirement Association (SDCERA) and paid above the annual required contribution (ARC) in fiscal years 2005 to 2007, in fiscal 2011, and in fiscal 2013 to address the decline in the funded level. The fiscal 2015 audit shows the plan funded at 80.5% for fiscal 2015. The county has also restructured its pension plans and created a different tier of benefits it believes will likely decrease costs. However, we understand SDCERA has assessed its assumed rate of return and most recently revised it downward to 7.50% from 7.75%, which will cause the unfunded levels to rise. However, it does indicate the county is working proactively to understand and address its liability.

Furthermore, the county's pension costs should decline, as it will no longer contribute both the employer and employee contribution rate to its pension plans. By fiscal 2017-2018, the county will be responsible only for the employer portion, lowering its annual costs. We view the lower annual costs to the county and 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. In addition, we understand that the county estimated its OPEB unfunded actuarial accrued liability at $164.4 million and that officials are currently paying the OPEB ARC.

Strong institutional framework

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

Outlook

The stable outlook reflects Standard & Poor's opinion of San Diego County's deep and diverse economy, strong reserves, formal policies, manageable debt, and conservative budgeting, where actual results typically exceed projections. We do not expect to lower our ratings within the outlook's two-year horizon, based on our belief that management will likely maintain good finances and reserves.

Downside scenario

A change in management practices or policies that weakens the county's budgetary flexibility or performance could lead to a lower rating; however, given management's track record and strong revenue strength, we do not see a downward rating action as likely during the two-year outlook horizon.

Related Criteria And Research

Related Criteria

- USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- USPF Criteria: Financial Management Assessment, June 27, 2006
- USPF Criteria: Debt Statement Analysis, Aug. 22, 2006
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007
- USPF Criteria: Non Ad Valorem Bonds, Oct. 20, 2006
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions, Nov. 19, 2013
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Standard & Poor's Earthquake Model, Oct. 25, 2012
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- Institutional Framework Overview: California Local Governments

Ratings Detail (As Of February 2, 2016)		
San Diego Cnty certs of part (Cedar & Kettner Development Project Parking Structure) due 02/01/2042		
Long Term Rating	AA+/Stable	Affirmed
San Diego Cnty rfdg COPS due 11/01/2019		
Long Term Rating	AA+/Stable	Affirmed
Unenhanced Rating	NR(SPUR)	Current
San Diego Cnty COPS (Justice Facilities Rfdg)		
Long Term Rating	AA+/Stable	Affirmed
Unenhanced Rating	NR(SPUR)	Current
San Diego Cnty APPROP		
Long Term Rating	AA+/Stable	Affirmed
Unenhanced Rating	NR(SPUR)	Current
San Diego Cnty APPROP		
Long Term Rating	AA+/Stable	Affirmed
Unenhanced Rating	NR(SPUR)	Current
San Diego Cnty APPROP		
Long Term Rating	AA+/Stable	Affirmed
San Diego Cnty APPROP		
Long Term Rating	AA+/Stable	Affirmed
San Diego Cnty COPs (Edgemoor II Proj) ser 2006		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
San Diego Cnty GO		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Ratings Detail (As Of February 2, 2016) (cont.)		
San Diego Cnty GO pension (XLCAPITAL)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
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
Unenhanced Rating	NR(SPUR)	Current

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.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.