S&P Global
Ratings

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Summary:

San Diego County, California; Appropriations; General Obligation

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Summary:

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Credit Profile		
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

S&P Global Ratings affirmed its 'AAA' issuer credit rating (ICR) on San Diego County, Calif. 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) outstanding. The outlook on all ratings is stable.

The lease revenue 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.

The county's other outstanding COPs and lease revenue bonds are secured by pledged lease revenues, subject to abatement in the event the leased assets are damaged, destroyed, or impaired. The county's pledge of legally available funds, not an unlimited ad valorem tax levy, secures the POBs. We rate both the COPs and POBs one notch off of the ICR.

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. 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 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 2016;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2016 of 31% of operating expenditures;
- Very strong liquidity, with total government available cash at 69.3% of total governmental fund expenditures and 17.3x 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 36.1% 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 3.3 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 101.7% of the national level and per capita market value of $145,432. Overall, the county's market value grew by 5.5% over the past year to $478.3 billion in 2017. The county unemployment rate was 5.2% in 2015.

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 2017 AV grew due in large part to changes in ownership for real estate ($11.9 billion), followed by the increases from the Proposition 13 base adjustment ($5.4 billion), growth in property values from assessment appeals during the recession ($4.2 billion), and finally new construction ($4.1 billion). 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 4% for the next fiscal year, reflecting Proposition 8 restorations, increases in median home prices, and 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 both address both 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 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 3.1% of expenditures in the general fund and of 1.9% across all governmental funds in fiscal 2016. General fund operating results of the county have been stable over the last three years, with a result of 4.3% in 2015 and a result of 2.0% in 2014.

The county has benefited from increasing property tax and sales tax revenues, which have enabled it to maintain its 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's budget also underestimated AV growth, at 4.0%, versus actual growth of 6.2%, providing the county with revenue cushions. For fiscal 2017, the county is presenting a balanced general fund budget at $4.12 billion. The county currently projects a surplus for fiscal 2017. For fiscal 2018, management is projecting balanced operations. We expect that the county will continue to have strong financial performance over the near term.

Very strong budgetary flexibility

San Diego County's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2016 of 31% 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 current projections for fiscal year-end show increases in unassigned reserves. 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 69.3% of total governmental fund expenditures and 17.3x governmental debt service in 2016. 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. We do not expect liquidity to weaken over the near term.

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 36.1% of total governmental fund revenue.

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 was paid off in fiscal 2015-2016. We do not expect that the debt will weaken.

San Diego County's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 9.4% of total governmental fund expenditures in 2016. The county made its full annual required pension contribution in 2016.

The county continues to address its pension obligations. 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, in fiscal 2011, and in fiscal 2013 to address the decline in the funded level. The fiscal 2016 audit shows the plan funded at 76.9% for fiscal 2015. However, we understand SDCERA has assessed its assumed rate of return and most recently revised it downward to 7.25% from 7.50%, 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 no longer plans to 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 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. 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 our 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 two-year outlook 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, but given management's track record and the strength in revenues, we do not consider a downward rating action likely over the two-year outlook horizon.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, July 27, 2016
- 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
- 2016 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of March 29, 2017)		
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 lse rev bnds		
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		
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San Diego Cnty APPROP		
Long Term Rating	AA+/Stable	Affirmed
San Diego Cnty GO		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
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 the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.