

New Issue: MOODY'S ASSIGNS Aa3 RATING TO SAN DIEGO COUNTY (CA) 2011 CERTIFICATES OF PARTICIPATION

Global Credit Research - 19 Jul 2011

Approximately \$417.8 Million In Lease Obligations Affected, Including Current Issue

County
CA

Moody's Rating

ISSUE	RATING
Certificates of Participation (County Administration Center Waterfront Park)	Aa3
Sale Amount	\$32,100,000
Expected Sale Date	07/25/11
Rating Description	Certificates of Participation

Opinion

NEW YORK, Jul 19, 2011 -- Moody's Investors Service has assigned an Aa3 rating to the County of San Diego (CA) Certificates of Participation (County Administration Center Waterfront Park) to be issued in the approximate amount of \$32.1 million. Concurrently, Moody's has affirmed the county's Aa1 Issuer Rating, Aa2 Pension Obligation Bond ratings, and the Aa3 ratings on the county's outstanding general fund lease obligations. The outlook on the county's ratings is stable.

RATINGS RATIONALE

The county's long-term ratings are based on its sizable tax base and resident socioeconomic profile. The county's economy has experienced challenges in the recent recession but nonetheless remains large and diverse. The county's ratings also incorporate its sound financial position and strong, conservative financial management. The county's satisfactory debt levels, conservative debt structuring, and commitment to debt reduction are all key positive credit factors. The ratings on the county's lease financings, including the current issue, are also based upon the structure of the financings.

The Certificates of Participation (COPs) are secured by lease payments to be made by the county for use and occupancy of the leased asset, a detention center. The two notch rating distinction between the rating on the lease financing and the county's Issuer Rating represents Moody's standard notching for essential purpose, fixed asset leases. Broadly speaking, the two notches reflect the risk of abatement and the narrower, general fund security pledge for leases compared to the unlimited property tax pledge securing general obligation bonds.

LARGE ASSESSED VALUE SHOWS CONTINUED MODEST DECLINE

San Diego County, located on the Mexican border, is one of the most populous counties in the state with a population of approximately 3 million. Wealth levels in the county are quite varied, ranging from higher income coastal cities to lower income border communities. Overall per capita income represented 106% and median family income 107% of the US level. The county's economy is diverse, built upon foundation sectors of defense, technology-producing industries, trade and tourism. The diversity of the county's economy has helped to keep unemployment approximately in line with the nation's and lower than the state's: as of February 2011 the county's unemployment rate was 10.1% compared to the state's 12.3% and the nation's 9.5%.

San Diego County assessed value (AV) remains sizable at \$390.8 billion, after falling modestly in fiscal 2010 and 2011 by 2.5% and 1.4% respectively as a result of both appeals and county-initiated reviews. There are signs that the tax base is improving, but material weakness remains. In 2010 the assessor reduced the value on nearly 197,000 of the total 979,000 parcels in the county, lowering their AV by a total of \$8 billion. While the 2010 experience was negative, it was an improvement over the prior year when the assessor decreased the value on 216,000 parcels lowering AV by \$22.6 billion. The total AV reduction requested by owners filing appeals has remained approximately level over the past three years at about \$20 billion, although the nature of the appellants has shifted with the number of commercial appeals rising while residential appeals decreased. On a positive note, home sales are yielding increased AV growth: following residential change in ownership, 2008 reassessments averaged a \$16,000 increase in AV, 2009 reassessments averaged \$33,300 increase, while calendar 2010 year-to-date reassessments are averaging \$60,900. Moody's does not anticipate large changes, either upward or downward, in the county's AV in the coming year.

COUNTY'S FINANCIAL POSITION REMAINS STRONG

The county benefits from very strong, conservative fiscal management. Fund balances in the general fund rose in fiscal 2010, nearly erasing the relatively small decline in the prior year. As of fiscal year end 2010 the county had \$1.2 billion in total fund balances of which \$1.1 billion was unreserved, a healthy 37.1% and 32.1% of general fund revenues respectively. On a percentage basis these two figures are the strongest they have been in the past five years, positioning the county well in the current, challenging fiscal environment.

For fiscal 2011, the county is currently projecting a small decline of about \$32 million in its total general fund balance. In response to decreased revenues the county continued its cost cutting, following fiscal 2010 reduction of 774 full-time equivalent (FTE) with an additional 573 FTE cut in fiscal 2011. It did fund two capital projects, \$55 million for its women's detention facility replacement project and \$120 million for the second phase of its county operations center construction. The county has established reserve policies, and meets or exceeds all required policy levels.

Demonstrating the county's fiscal conservatism is its contribution to its pension system and to the retiree health plan in excess of the actuarially

required amount. The county charges its departments a pension rate in excess of the amount required by the San Diego County Employees Retirement Association (SDCERA) Board. As a result, the county contributed 102.2% of the actuarially required contribution (ARC) in 2010. The county generated an excess \$3.8 million in fiscal 2010 and is estimating \$32 million above ARC in 2011. The county has been setting aside funds in a "Pension Stabilization Fund" which now totals \$15.4 million. For fiscal 2012 \$14 million of this fund is expected to be drawn down to cover its pension payment, which is expected to increase \$65 million above the current estimate for fiscal 2011.

The county's retiree health plan is also offered by SDCERA. The county's contribution was \$17.9 million in 2010, 106.1% of ARC. The plan was created pursuant to IRS Code Section 401(h) under which total amount of employer contributions are limited. The health insurance allowance is not a vested benefit and may be reduced or discontinued at any time by the SDCERA Board.

COUNTY WELL POSITIONED TO ADDRESS CHALLENGES DERIVING FROM STATE FISCAL 2012 BUDGET

Fiscal 2012 is likely to be challenging for the county, as for all California counties, as it prepares to take on new responsibilities. On June 30, 2011 California's governor signed the 2011-12 California state budget which includes a major realignment from state to local government of responsibility for public safety programs and management of offenders. The county will be responsible for realigned programs effective October 1, 2011. The county is in a good position to address the challenges associated with realignment given its strong financial position and its routine adherence to its policies, including that program revenue-based services are matched to available revenue (i.e. that the county will not backfill state funding cuts). This year that policy will particularly be tested, however. It is also unclear whether one-time funding that the state is providing this year will be sufficient to cover the transition costs of realignment, and whether the dedicated revenue stream will be sufficient on a long-term basis to fund the county's realigned responsibilities. Again the county's strong management and financial position mitigate these risks.

The County anticipates that the most immediate operational impacts will occur within the Probation Department with an estimated 100-200 persons released to community supervision per month beginning October 1st. Realignment is funded by the dedication of 1.0625 cents of an existing sales tax rate and the redirection of vehicle license fee revenue, plus one-time funding of \$25 million to cover transition costs, both of which became effective at the start of this fiscal year. The sales taxes need to fund not just the new responsibilities but also certain programs which previously were funded from the expired portions of vehicle licensing fees and from other state funds. Moody's believes that county's strong management will rise to the task of adapting its new responsibilities to available revenues, pursuant to its policies.

The fiscal 2012 State budget also phases out redevelopment agencies effective October 1, 2011, unless the sponsoring city/county elects to continue redevelopment in a Voluntary Alternative Redevelopment Program. The county believes that it will benefit to the extent that agencies are dissolved because it would receive additional funding; otherwise, this provision is neutral for the county.

LOW DEBT LEVELS; CURRENT ISSUE STRUCTURED AS TYPICAL CALIFORNIA LEASE FINANCING

The county's direct debt is low at approximately 0.3% of AV, and its total annual lease payments comprise approximately 1.2% of its total general fund revenues, a very manageable level. The county has made a commitment to decreasing its debt outstanding: it has retired early \$264 million of its financings since 2007, including its \$100 million variable rate pension obligation bond. The county no longer has any variable rate debt outstanding and is not a party to any derivative products.

The current issue will add a comparatively small \$32.1 million to the county's outstanding portfolio of lease obligations. The bonds will contribute funding to a major improvement project surrounding the county's historic Administration Center coordinated by the city of San Diego, part of San Diego and the county. The current issue is secured by lease payments on the largest detention facility operated under the county sheriff's jurisdiction: a maximum security facility with an average daily population of 1,500 inmates. The facility includes six housing units, a medical area, and several administrative areas. The county's insurance services value the replacement cost of the facility at \$75.8 million. The county covenants to budget and appropriate the full lease payment subject only to abatement. Insurance requirements under the documents are standard, including title insurance and a minimum of two years' rental interruption insurance. The structure includes a cash funded reserve fund sized using the standard three-part test.

Outlook

The stable outlook on the county's rating recognizes the short term vulnerability but long term strength of the county's large and diverse economy. The outlook also incorporates the financial challenges which the county, like most in the state, is facing as a result of the state's budget cutbacks and the weak economy. The county has demonstrated its fiscal strength and its conservatism, including its ability to adjust its budget as needed in response to revenue challenges; Moody's expects it will continue to do so in the current and coming years.

What Could Make The Rating Go Up

- substantially higher socioeconomic profile
- substantially stronger cash and fund balances
- return to growth trend in assessed value

What Could Make The Rating Go Down

- weakened economic position and socioeconomic profile
- weakened financial position
- long-term trend of declining assessed value

KEY STATISTICS

Assessed value (AV), fiscal 2011: \$390.8 billion

AV change, fiscal 2010-2011: -1.4%

Total fund balance as % of revenue, fiscal 2010: 37.1%

Unreserved fund balance as % of revenue, fiscal 2010: 32.1%

Direct debt as % of AV, fiscal 2010: 0.3%

Net lease burden as % of fiscal 2010 revenues: approx. 1.2%, including current issue

Per Capita Income (2000 Census): \$22,926 (106.2% of US)

Median Family Income (2000 Census): \$53,438 (106.8% of US)

The principal methodology used in this rating was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in December 2008. Please see the Credit Policy page on www.moody's.com for a copy of this methodology .

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