



Moody's Investors Service

Global Credit Research

New Issue

2 OCT 2008

New Issue: [San Diego \(County of\) CA](#)

**MOODY'S ASSIGNS A1 RATING TO SAN DIEGO COUNTY LEASE REVENUE BONDS, SERIES 2008**

Approximately \$296 Million Affected

San Diego (County of) CA  
County  
CA

**Moody's Rating**

ISSUE		RATING
Lease Revenue Bonds, Series 2008 A (County Op Ctr & Annex Redev Proj.)		A1
<b>Sale Amount</b>	\$221,120,000	
<b>Expected Sale Date</b>	10/07/08	
<b>Rating Description</b>	Lease Rental	
Lease Revenue Bonds, Series 2008 B-1 and B-2 (Variable Rate Demand Obligs) (County Op & Annex Redev Proj.)		A1
<b>Sale Amount</b>	\$75,000,000	
<b>Expected Sale Date</b>	10/07/08	
<b>Rating Description</b>	Lease Rental	

**Opinion**

NEW YORK, Oct 2, 2008 -- Moody's Investors Service has assigned an A1 rating to San Diego County's Lease Revenue Bonds (County Operations Center and Annex Redevelopment Project), Series 2008. Moody's also has affirmed the county's Aa2 Issuer Rating, Aa3 Pension Obligation Bond rating, and the A1 ratings on its lease financings. The ratings all carry a stable outlook. The current issue is expected to be sold in two series: fixed rate Series 2008A in the approximate amount of \$221 million and variable rate Series 2008B in the amount of \$75 million. Depending upon market conditions, however, some or all of the \$75 million may be sold as fixed-rather than variable-rate debt. The bonds are secured by lease payments to be made by the county for use and occupancy of the project being constructed, a new county administration complex.

Moody's also has affirmed the county's Aa2 Issuer Rating, Aa3 Pension Obligation Bond rating, and its lease ratings are based upon the county's fundamentally sound, large and economically diverse tax base. The somewhat modest wealth levels of its residents also are a factor in the county's ratings. The county's debt levels, and its commitment to debt reduction, are incorporated into the rating. The county's financial position is currently strong, reflecting concerted efforts by management. The coming year is likely to be difficult, but both the ratings and the stable outlook recognize management's proven ability to implement its fiscal policies. The ratings on the county's lease financings, including the current issue, are also based upon the structure of the financing.

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 related lack of seismic insurance coverage) and the narrower, general fund security pledge for leases compared to the unlimited property tax pledge securing general obligation bonds.

#### COUNTY APPEARS WELL POSITIONED TO ADDRESS STATE REVENUE CUTS

As expected, fiscal 2007 continued the county's trend of strong financial performance. Unreserved fund balance in the general fund totaled \$744.8 million, a sound 23.1% of revenues and the fourth consecutive year of increases. The county's most recent estimates show fiscal 2008 performance approximately level with the prior year, as unreserved fund balance decreased to \$723.9 million. The county reports that it continued to adhere to its policy of using one-time revenues for one-time expenditures. Moody's notes that the county has taken decisive action to reduce its Other Post Employment Benefits (OPEB) accrued actuarial liability, lowering its annual required contribution (ARC) from approximately \$60-70 million to \$23.6 million per year. The county is fully funding its ARC.

The county needs to make substantial adjustments to its fiscal 2009 budget, accounting for approximately \$50 million in revenue shortfalls. The general fund is affected by property tax revenues, which are now known to be lower by \$26 million than had been anticipated in the budget. This shortfall can readily be absorbed by the county's budgeted reserve for economic uncertainties. The county is also preparing to address challenges associated with the State's recently adopted budget. The county estimates that the general fund will lose approximately \$21 million in state funding, most of which pertains to specific health and human services programs or public safety activities. The county did adopt together with its budget the principle that cutbacks in programmatic revenues will be matched with cutbacks in the programs themselves. If the county is able to adhere to this principle, its general fund would only be minimally affected by these cuts in state revenues. The county's adopted budget for fiscal 2009 includes expenditures exceeding revenues by \$214 million, all of which are reported to be for one-time projects. Labor contracts are in place through June 2009, contributing some certainty to budgeted expenditures. The current rating presumes that the county will be able to maintain its financial health as it adjusts its budget to accommodate the state's budget solutions.

#### COUNTY COMMITTED TO LOWERING ITS DEBT LEVELS; CURRENT ISSUE STRUCTURED AS TYPICAL LEASE FINANCING

Subsequent to the current issue, the county's direct debt will represent 0.4% of assessed value (AV). The county's lease payments will comprise approximately 1.9% of its total revenues, a very manageable level. Of its \$1.6 billion debt portfolio only \$100 million is variable rate, plus up to \$75 million more planned with the current sale. Neither of these issues is hedged: the county currently has no swaps outstanding. The county has made a commitment to decreasing its debt level. To date the county has retired early \$227 million of its debt over the past five years. Maintaining its variable rate debt unhedged allows it to continue to lower debt levels as the opportunity arises. The county does not currently anticipate additional variable rate issuance.

The current financing is typical of abatement lease revenue bonds. The leased asset is the project being constructed, a new county administration complex. The county is contributing \$75 million in pay-go funding towards construction of the complex. Interest is being capitalized through November 2012, six months past anticipated completion of construction. Rental interruption insurance will be provided covering two years of lease payments. The reserve fund is being sized using the standard three-part test.

## ECONOMY STABLE THOUGH VULNERABLE; ASSESSED VALUE GROWTH IS WEAK

San Diego County, located on the Mexican border, is the third most populous county in the state with a population of 3.1 million in 2006. The county's economy is diverse, built upon foundation sectors of defense, technology-producing industries, trade and tourism. Wealth levels in the county are very varied, ranging from higher income coastal cities to lower income border communities. On average, wealth levels are moderate for the rating level. The county's historic position as a naval center tends to dampen the median income levels, but is a strong credit factor as it continues to spur growth. Shipbuilding and aerospace, in particular, are currently expanding as a result of funding from defense contracts. The county's economy also benefits from the research activities of the University of California at San Diego (UCSD) and other institutes; its biotech activity is thriving due to continued venture capital investment. Travel and tourism are lynchpins of the county's economy, which to date have held steady.

In the county, like elsewhere in the state and nation, the residential real estate market has shown extraordinary weakness. The median sales price for single-family homes has fallen to about 2003 levels, including a drop of about 25% year-over-year. This weakness persists despite what is effectively a complete halt in new residential construction. Assessed value (AV) growth has slowed reflecting this deterioration in the market. From a high of 13.1% in fiscal 2006, AV increases fell to an estimated 4.6% in fiscal 2009, resulting in a still sizable \$409.4 billion AV. Growth in AV is not likely to rebound in the near term. Mortgage delinquency rates have risen in line with nationwide rates. Notices of default and foreclosures are at levels seen during the last, major real estate downturn in the mid-1990's. Given the dynamics of the current market, growth in AV is resulting almost entirely from turnover of older properties with below-market assessed values, and from commercial development. Such growth is offset by the assessor's downward revaluation both in response to appeals and as a result of proactive reviews. The county estimates that approximately 5% of the total parcels in the county will have their AV reduced through one or the other of those methods.

Strength in the county's mainstay activities has enabled the local economy to absorb the impact of the residential real estate market decline and attendant job losses. The county's unemployment rate in April 2008 rose to 5.0%, up from 4.1% the prior year, but remained below the statewide rate of 6.1%. The county's economy remains vulnerable to recession, however, in part as a result of higher gas prices and the weakening business climate which could affect its travel and tourism sector.

### **Outlook**

The stable outlook on the long-term 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 weakening economy. The county's is likely to have a more difficult time than most as it implements necessary mid-year cuts as its original budget did not incorporate state budget cuts. Moody's expects the county will rise to this partially self-imposed challenge, emerging financially healthy.

### **KEY STATISTICS**

Assessed value (AV), fiscal 2009: \$409.4 billion

AV growth, fiscal 2008-2009: 4.6%

Five year average annual AV growth, fiscal 2005-2009: 9.9%

Total fund balance as % of revenue, fiscal 2007: 35.9%

Unreserved fund balance as % of revenue, fiscal 2007: 23.1%

Direct debt as % of AV, fiscal 2009: 0.39%

Net lease burden, fiscal 2007: 1.4%

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