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June 30, 2011

Summary:

San Diego County, California; Appropriations; General Obligation

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Credit Profile		
US$32.105 mil certs of part ser 2011 due 02/01/2042		
Long Term Rating	AA+/Stable	New
San Diego Cnty GO Pension		
Long Term Rating	AA+/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA+' long-term rating and stable outlook to San Diego County, Calif.'s series 2011 certificates of participation (COPS), issued for the County Administration Center and Waterfront Park projects, and affirmed its 'AA+' long-term rating and underlying rating (SPUR), with a stable outlook, on the county's existing COPS.

Standard & Poor's also affirmed its 'AA+' long-term rating, with a stable outlook, on the county's lease-revenue bonds and its 'AA+' long-term rating and SPUR, with a stable outlook, on the county's pension obligation bonds, secured by a general obligation pledge of the county but not by an unlimited ad valorem tax levy.

At the same time, Standard & Poor's affirmed its 'AAA' issuer credit rating (ICR), with a stable outlook, on the county.

The COPs rating reflects our opinion of the county's:

- General creditworthiness ('AAA' ICR), and
- Pledge to budget and appropriate sufficient annual lease payments to pay debt service.

The ICR reflects our opinion of the county's:

- Sizable, deep, and diverse economic base and favorable location that exhibits relatively stable assessed valuation (AV), coupled with, what we consider, a strong wealth indicator;
- Consistent record of, what we believe to be, strong reserves, often exceeding financial forecasts; and
- Low-to-moderate and manageable debt burden and cash funding of some capital projects and one-time discretionary projects.

We understand officials will use these bonds to develop the county's downtown area with the intent of providing and enhancing a waterfront destination.

The 2011 COPs have an interest in lease payments under a county lease; the pledged leased asset is the George Baily Detention Facility, constructed in 1991 and fully operational in 1994, in Otay Mesa. We understand the county will lease the property backing the COPS to San Diego County Capital Asset Leasing Corp., a nonprofit, public-benefit corporation; the authority will then lease the assets back to the county under a sublease, in which the county pledges to budget and appropriate sufficient annual lease payments to pay debt service. Under the lease, the county can abate lease payments in the event of damage or destruction to the leased assets. To mitigate the risk of abatement in such a case, the county has agreed to maintain at least two years' rental payments of rental-interruption insurance, as well as casualty insurance, equal to the lesser of the facilities' replacement value or the bonds' principal amount. In addition, the structure provides for a debt service reserve.

San Diego County, with a population estimate of 3.1 million, has, in our opinion, a diverse economy, which includes tourism, international trade, military, and high-tech manufacturing. The county's seasonally unadjusted unemployment decreased to 9.8% as of April 2011: It remained below the state's 11.7% rate. Leading county employers include the government; education; military; and health care sectors, all of which, in our opinion, are very stable sectors. County median household and per capita effective buying income indicators are, in our view, a strong 120% and 112%, respectively, of national levels. County AV has declined by 1.6% in fiscal 2011 to $393 billion, after declining slightly by 2.5% in fiscal 2010. Growth, however, averaged, what we consider, a good 9.8% annually between fiscals 2004 and 2009. Management notes that it believes AV appeals will likely shift toward commercial properties from residential properties and that it believes county AV will increase by 0.5% for fiscal 2012. We view fiscal 2011 market value as an extremely strong $127,456 per capita.

The county's financial position remains, what we consider, strong with surpluses in five of the past six fiscal years. Audited generally accepted accounting principles unreserved general fund balances increased to $1.1 billion, or, what we consider, a very strong 35% of expenditures, in fiscal 2010. Of the $1.1 billion, we understand officials have designated $100 million for economic uncertainty while $493.6 million remains unreserved, undesignated for a total of $593.6 million, or 20% of expenditures; this is available for unforeseen expenditures or revenue declines. We also understand the county has designated the remaining unreserved general fund balance for specific uses.

For fiscal 2011, the county is currently projecting to end with similar available reserve levels of $525.9 million, which is higher than the previously expected $420.6 million. Management notes a combination of slightly higher revenue and expenditure cuts resulted in the higher-than-expected fund balance. Available reserves will be above the county's policies, which require 10% of general purpose revenue for economic uncertainty, 5% for general purposes, and 2% for contingency purposes.

In addition, we believe the county has a history of conservative budgeting. In our opinion, expenditure controls have helped maintain positive financial operations, which are necessary due to the county's limited direct revenue-raising flexibility. The county has responded to declining revenue by continuing to cut expenditures. The county reduced 573 full-time-equivalent positions in 2011 following a reduction of 774 full-time-equivalent positions in fiscal 2010.

Despite tightening budgetary pressures, the county continues to address its pension obligations. In fiscal 2011, it budgeted to contribute above the annual required contribution (ARC) amount to help pay down the unfunded actuarial accrued liability (UAAL). Management indicates it does not intend to backfill state cuts with general purpose revenue. In our opinion, not using county revenue to fill state funding gaps can help mitigate the effect of state cuts on the general fund. For fiscal 2012, management expects a balanced budget; it is exploring several options to achieve the balanced budget, including raising fees and postponing some expenditures, if necessary.

Standard & Poor's considers the county's financial management practices "strong" under its Financial Management Assessment methodology, indicating practices are strong, well embedded, and likely sustainable.

As of fiscal 2010, San Diego County's overlapping net debt burden is, in our opinion, a moderate $3,200 per capita, or a low 2.5% of market value. The county's carrying charge as of audited 2010 was, what we consider, a low 8%. A prepayment of $100 million of its pension obligation bonds has eliminated the county's variable-rate debt and associated swaps.

The county contributed above its required ARC between fiscals 2005 and 2007 and in fiscal 2011. The funded ratio of the county's pension fund, as of fiscal 2010, was 84%, down from a high in fiscal 2008 due to market losses. We understand the pension program now has an underlying assumption of a return of 8%, a decrease from previous years. We understand this will likely decrease the funded level, and the county is working to ensure it addresses this problem. Beyond contributing to the pension fund, the county has restructured its pension plans, creating a different tier of benefits that management believes will likely decrease costs. In addition, we understand that the county recently estimated its other postemployment benefits UAAL at $197.2 million and that the county currently intends to pay its ARC.

Outlook

The stable outlook reflects Standard & Poor's view of the county's deep and diverse economic base, strong reserves, formalized policies, manageable debt burden, and record of conservative budgeting where actual results typically exceed initial projections. We do not expect a change in the rating within the outlook's two-year horizon due to our belief that the county will likely maintain, what we consider, good financial performance and contingency reserves despite the economic downturn and uncertainty over state funding.

Related Criteria And Research

- USPF Criteria: GO Debt, Oct. 12, 2006
- USPF Criteria: Key General Obligation Ratio Credit Ranges – Analysis Vs. Reality, April 2, 2008
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007

Ratings Detail (As Of June 30, 2011)		
San Diego Cnty rfdg COPS due 11/01/2019		
Long Term Rating	AA+/Stable	Affirmed
San Diego Cnty taxable pension oblig bnds (Cap Apprec Bnds) ser 2004C dtd 06/29/2004 due 08/15/2009-2015		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
San Diego Cnty COPS (Justice Facilities Rfdg)		
Long Term Rating	AA+/Stable	Affirmed
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
San Diego Cnty ICR		
Long Term Rating	AAA/Stable	Affirmed
San Diego Cnty Pension Obligation Ref bnds (Fixed Rate) ser A		
Long Term Rating	AA+/Stable	Affirmed
San Diego Cnty certs of part (North & East Cnty Justice Facs Rfdg) ser 2005		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
San Diego Cnty certs of part (2001 MTS Tower Rfdg)		

Ratings Detail (As Of June 30, 2011) **(cont.)**		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
San Diego Cnty certs of part (2005 Edgemoor Proj & 1996 Regl Comm Sys Rfdg) ser 2005		
Unenhanced Rating	AA+(SPUR)/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
San Diego Cnty GO pension		
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) lse rev bnds (Cnty Ops Ctr & Annex Redev Proj) ser 2009A		
Long Term Rating	AA+/Stable	Affirmed

Many issues are enhanced by bond insurance.

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