STANDARD & POOR'S

RATINGSDIRECT®

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Summary:

Chula Vista, California; Appropriations; Non-School State Programs

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Table Of Contents

Rationale

Outlook

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Credit Profile		
Chula Vista approp (MBIA)		
Unenhanced Rating	A-(SPUR)/Stable	Downgraded
Chula Vista certs of part (Civic Ctr Proj - Phase 2) ser 2006 (AMBAC)		
Unenhanced Rating	A-(SPUR)/Stable	Downgraded
Chula Vista certs of part (Police Facility) ser 2002 dtd 06/20/2002 due 06/20/2033		
Unenhanced Rating	A-(SPUR)/Stable	Downgraded
Chula Vista 2003 rfdg certs of part (Twn Centre II Pkg Proj) dtd 06/11/2003 due 09/01/2003-2013		
Unenhanced Rating	A(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services lowered its underlying rating (SPUR) one notch on Chula Vista, Calif.'s series 2002, 2004 and 2006 certificates of participation (COPs) to 'A-' from 'A' based on a prolonged trend of drawing down reserves, including unaudited fiscal 2007 results, which indicates reserves will fall below the district's 8% fund balance policy due primarily to slower-than-projected growth in the economy and city revenues. The outlook remains stable.

At the same time, Standard & Poor's affirmed its 'A' rating on the city's 2003 COPs that are secured by the state's motor vehicle license fee (MVLF) revenue intercept mechanism. Participating localities agree to allow a state intercept of local MVLF revenues in favor of bondholders in the event a locality fails to pay scheduled principal and interest on its bonds as due. To qualify for the 'A' intercept rating, localities must demonstrate at least 2.5x coverage of local MVLF revenues. Chula Vista's 2007 MVLF revenues of $17.7 million generated 12.0x coverage.

The 'A-' rating on the series 2002, 2004, and 2006 COPs reflects:

- The city's strong general creditworthiness ('A' GO debt rating) as lessee and obligor, and
- A lease structure that includes a covenant to budget and appropriate lease payments.

City officials expect development impact fees, which are dependent on building development activity in the city, will primarily finance debt service on the bonds. The 2006 COPs represent the second of a three-phase civic center complex project that includes a city hall, a public services building, a former police department facility, the community development building, and the legislative building. The first phase, completed in late 2005, consisted of the construction of a new city hall. Officials used 2006 proceeds to fund the renovation of the public services building, in the city's civic center complex, and finance the renovation of exhibits in the city's Nature Center. The city is in the midst of completing the third and last phase, which includes the renovation and reconstruction of the former police department facility, financed through internal cash funding.

Chula Vista's general credit characteristics include:

- A large, diverse property tax base that participates in the San Diego area's broad economic base;
- Above-average income and wealth indicators; and
- Strong written policies and formalized practices as measured by Standard & Poor's Financial Management Assessment (FMA).

Tempering factors include:

- Five consecutive years of general fund drawdowns, including unaudited fiscal 2007 results, which have weakened the general fund's reserves below the city's fund balance policy, mitigated in part by proactive steps by management to balance the budget;
- Exposure to the subprime mortgage industry evidenced in part by a 6% decline in year-over-year home prices in the San Diego MSA according to the S&P/Case-Shiller Housing Index; and
- An above-average overall net debt burden of $4,385 per capita and 4.5% of market value.

The series 2002, 2004, and 2006 certificates are secured by lease purchase payments by Chula Vista to the Chula Vista Public Financing Authority for the acquisition of the leased assets.

Chula Vista, eight miles south of San Diego and seven miles north of Mexico's border, is a rapidly growing city with about 223,423 residents. The city participates in the San Diego MSA, but its access to Mexico creates a strong economic link to nearby Tijuana. Chula Vista's disposable income levels have been increasing since 1998; 2006 median household income was 114% of the national average. The median sales price of a single-family home in 2006 was close to $600,000. Unemployment of 4.7% in 2006 was roughly equal to the state's and nation's rates.

The property tax base is strong. Assessed value has grown by an average of 17% annually since fiscal 2003 to $21.7 billion in fiscal 2007 from $10.1 billion. The tax base is very diverse, with the 10 leading taxpayers accounting for just 5% of total assessed value. Market value, as a measure of wealth, is an above-average $100,079 per capita, an increase from $48,671 in fiscal 2000. Building activity in the area has been considerable since 1999 due to relatively low land prices and easy commuter access to nearby employment, making Chula Vista one of the fastest-growing cities in San Diego County. In addition, various developments are underway that will continue to contribute to the property and sales tax bases, including continued expansion of a new large shopping mall, several new auto dealerships, and a new freeway that will improve access to the city. However, within the past two years, the city has seen a considerable slowdown in the housing market as a result of general economic conditions and, in particular, the subprime mortgage industry. Specifically, residential permits fell to 843 units in fiscal 2007, or nearly one-fourth the level experienced in fiscals 2001, 2003, and 2004.

As a result of the slowdown in economic activity, the city will miss revenue projections in fiscal 2007 in its development fees, which account for nearly one-fifth of total government revenues, and sales taxes and franchise fees, which combined account for 29% of general fund revenues. Unaudited fiscal 2007 results indicate the unreserved fund balance will decline for the fifth consecutive year to an estimated 6% of operating expenditures, or roughly $11 million, from a high of $34 million in fiscal 2002, which equaled 33% of operating expenses. This decline is primarily the result of increases in operating expenses outpacing increases in revenues. Furthermore, as the budget process was completed for fiscal 2008 based on revised revenue projections that accounted for slower economic growth, management projected a $7 million shortfall, which would reduce the unreserved fund balance to a negligible level. In response, management has enacted a plan to reduce expenses.

Specifically, the city has met with its labor unions and is currently negotiating with the unions to reduce the city's salary and payroll expenses, which account for roughly 80% of expenditures. At a minimum, the city has enacted a hiring freeze for fiscal 2008. Management also plans to offer an early retirement program to senior employees. Combined, these initiatives are expected to generate at least $3 million in savings in the current fiscal year. In addition, management plans to reorganize and realign some of its administrative departments, which is estimated to generate up to $1 million in savings. Finally, management is in the process of formulating a decrement plan that will be finalized by council in November and that is expected to reduce operating expenditures by 10%, or roughly $16.5 million on an annual basis. Implementation of the plan is expected shortly thereafter, providing the city with six months of savings in fiscal 2008, or an expected $8.75 million. Combined, the savings are expected to stabilize reserves at 6% of operating expenditures at fiscal year-end 2008 and rebuild reserves to no less than the 8% reserve policy at the end of fiscal 2009.

Chula Vista's management practices are considered 'strong' under Standard & Poor's Financial Management Assessment (FMA). An FMA score of 'strong' indicates that practices are strong, well embedded, and likely sustainable. The city has formal written policies that cover investment, reserve, and debt management policies, although debt management policies do not address the use of derivative products. Investment results are reviewed quarterly, with quarterly review of actual to budget variances for general fund revenues and expenditures. The city utilizes various outside and inside resources to generate budget assumptions, including the UCLA economic forecast and internal housing growth projections. The city engages in multiyear financial planning, with a five-year forecast, and its capital plan also covers a period of five years and fully identifies sources and uses of funds. The city has a formal reserve policy for the general fund, established in 1996, requiring an 8% reserve that is tied to economic fluctuations, cash flow needs, and contingencies.

The city's current overall net debt burden is high at an estimated $4,385 per capita and 4.5% of market value. Only one-fifth of the overall debt burden, however, is direct debt, with overlapping debt accounting for nearly four-fifths of the total burden.

Outlook

The stable outlook reflects the city's participation in the San Diego area's vibrant and growing economy. The outlook also reflects our expectation that management will be able to implement in a timely manner the savings plan that it expects to have in place by November 2007 to restore reserves back to at least the city's 8% of operations policy. However, given the city's reliance on sufficient building activity and the associated development fees to fund capital expenditures, including a substantial portion of the COPs previously issued, a continued decline in the housing market could lead to fiscal stress in the general fund. If management is not able to successfully implement its restructuring plan, or if a continued significant decline in the housing market persists, a further rating action could be warranted.

Complete ratings information is available to subscribers of RatingsDirect, the real-time Web-based source for Standard & Poor's credit ratings, research, and risk analysis, at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; under Credit Ratings in the left navigation bar, select Find a Rating, then Credit Ratings Search.