S&P Global Ratings

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San Diego Housing Commission, California; General Obligation

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Credit Profile		
San Diego Hsg Comm ICR		
Long Term Rating	AA/Stable	Affirmed

Rationale

S&P Global Ratings affirmed its 'AA' issuer credit rating (ICR) on the San Diego Housing Commission (SDHC), Calif. The outlook is stable.

The ICR reflects our assessment of the following credit strengths, specifically SDHC's:

- Very strong overall strategy and management, evidenced by its strategic planning process and consistency of strategy that supports its mission to provide quality low-income housing;
- Very strong enterprise risk profile supported by economic fundamentals reflecting the high cost of housing in San Diego;
- Very strong liquidity, based on the levels of funding available for operations and debt service;
- Very strong financial profile, due to an extremely strong debt profile, liquidity position, and financial policies that offset a below-average financial performance; and
- Successful development arm that maximizes external resources for financing mixed-finance projects.

Partially offsetting the preceding credit strengths, in our view, are SDHC's:

- Appropriation risk associated with strong reliance on federal funding streams, including the risk of underfunding of federal operating fund subsidies and the federal Housing Choice Voucher (HCV) program, and the potential for decline in federal capital fund grants; and
- Vulnerable financial performance compared to similarly rated peers.

In our opinion, there is a "moderate" likelihood that the U.S. federal government would provide timely and sufficient extraordinary support to SDHC in the event of financial distress. In accordance with our criteria for government-related entities (GREs; "Rating Government-Related Entities: Methodology and Assumptions," published March 25, 2015, on RatingsDirect), our view of a "moderate" likelihood of extraordinary government support is based on our assessment of SDHC's:

- "Strong" link with the U.S. federal government based on the federal government policy, supported by a record of providing strong credit support for the public housing sector under certain circumstances; and
- "Limited importance" role to the federal government because credits default of SDHC would have a limited impact for the government.

This combination of the "strong" link and "limited importance" role leads us to believe that the likelihood of extraordinary support that may be available to this GRE when required is moderate.

Created in 1979, SDHC is one of the newest public housing authorities (PHAs) and its fairly young housing stock includes approximately 2,414 multifamily units in scattered sites throughout San Diego. A key rating factor is our view of the management team and what we consider its well-developed and a steady strategic plan with clear goals and overall objectives. SDHC enjoys the reputation as a model PHA and the innovative programs serving the low-income and homeless individuals, along with its vital contribution by recommending in reducing the overall cost of affordable housing construction which was instrumental to get the commission recognized in California.

S&P Global Ratings believes that SDHC's management has the wherewithal to balance new development and rehabilitation prudently, in a manner that makes the most use of its resources, to improve its overall housing stock. In 2009, SDHC transitioned out of the federal public housing program in favor of a private-sector affordable housing real estate model. In our view, the commission effectively maintains a level of financial stability while achieving its overall affordable housing goals.

S&P Global Ratings believes SDHC has demonstrated a strong ability to leverage resources and to develop partnerships in its efforts to revitalize its communities, as evidenced by the commission's multifamily mortgage revenue bond program. Since 1982, the bond program has issued more than $1 billion in tax-exempt bonds to provide below-market-rate financing for affordable housing projects. Although the housing commission acts as the issuer of the bonds, there is no financial liability to the city, the housing authority, or the SDHC in connection with the issuance or repayment of bonds. The bonds are special, limited obligations of the housing authority payable solely from private revenue sources such as project cash flows and equity payments.

Factors constraining the rating, in our view, include the current environment of federal appropriations for PHAs.

SDHC is vulnerable to potential funding cuts from the U.S. Dept. of Housing and Urban Development (HUD), given its reliance on government support for approximately 83% of its revenues.

The HUD is the main source of public funding for affordable housing, and as an entity of the federal government, it is bound to congressional budget decisions. Sectors with less federal support will see more financial stress. Declining or stable asking rents, which are subject to income restrictions, offset some of the benefits that affordable multifamily properties enjoy, such as declining vacancy rates, relatively stable operating costs, and locations in low-cost markets. Without explicit federal guarantees, the ratings on these properties are much more subject to market forces. However, SDHC has a strong strategy to combat the limited financial resources.

Outlook

The stable outlook reflects our view of SDHC's management and what we consider clear, directive strategic plans to maximize its position in the San Diego market. We believe that current and future market demand for affordable housing far outweighs SDHC's existing and planned portfolio, as evidenced by a strong need for this segment of the housing market. A key factor to maintaining the rating, in our view, will be SDHC's ability to preserve market stability and tenant occupancy for continued profitability of its portfolio due to the low reliance on federal subsidies for its units. In addition, the stable outlook reflects our view of SDHC's participation in business activities that provide the commission with additional income sources. The commission's inability to maintain and/or increase additional leveraged resources, net working capital, and/or profitability could in the long term impair its financial strength and have a negative credit impact. In addition, further stresses in the commission's financial profile (i.e., EBITDA-to-revenues ratio falling below 10%, or the liquidity ratio declining below 1.25x) could result in a downgrade. We do not anticipate raising the rating during the two-year outlook period.

Comparative Analysis

Table 1 details how SDHC compares in key measurements with seven U.S. PHA peers (Philadelphia, Boston, Chicago, San Francisco, Vancouver, Seattle, and Housing Catalyst). Like those of other rated U.S. PHAs, the commission's revenue stream is primarily derived from federal subsidies; SDHC's financial performance is below average, in our view, compared to those of similarly rated PHA. The debt profile of the authority is very strong and its EBITDA-to-revenue ratio is low compared to both domestic and international housing authorities. However, the liquidity ratio is extremely strong and above all its peers.

Table 1

Peer Comparison

Entity	SACP Rating	Proportion of revenues from Social Housing Activity (%)	Annual Pop. Growth (%)	Average social rent as % of market rent in the main region of operation	Vacancy Rates (3yr Average) (%)	Average age of the portfolio (years)	EBITDA / Revenues (3yr Average or 5 year ave) (%)	Debt/EBITDA(3yr Average or 5 year ave) (X)	EBITDA/ Interest (3yr Average or 5 year ave) (X)	Liquidity Ratio (outlook period)
Philadelphia Hsg Auth	a+	85.7%	1.8%	24.5%	5.5%	41	10.2%	6.9	3.0	7.1
Boston Hsg Auth	a+	84.0%	0.7%	18.4%	2.0%	46	9.3%	5.8	4.1	3.2
Chicago Hsg Auth	aa	89.0%	0.1%	18.5%	2.0%	36	17.0%	1.1	11.5	1.8
San Diego Hsg Comm	aa	83.3%	0.9%	18.7%	5.1%	32	12.7%	4.8	6.0	9.8
San Francisco City and Cnty Hsg Auth	a+	85.7%	4.0%	16.4%	5.0%	50	1.9%	N/A	13.2	1.8
Vancouver Hsg Auth	aa	42.2%	1.5%	43.6%	3.0%	42	39.4%	9.4	3.1	2.0
Hsg Auth of City of Seattle	aa	66.9%	1.7%	31.9%	4.9%	40	27.8%	3.1	12.7	2.7
Housing Catalyst (formerly Fort Collins Hsg Auth)	aa-	49.5%	2.2%	55%	5.2%	33	26.4%	8.2	7.6	6.7

N/A--Not applicable.

Extraordinary Government Support

Under our GRE criteria, we view SDHC as a government-related entity (GRE), and therefore, we apply the applicable criteria. Under the GRE criteria, we view SDHC as having a "strong" link with the U.S. federal government based on the federal government policy, supported by what we see as a track record of providing strong credit support for the public housing sector under certain circumstances. We also view SDHC as having a "limited importance" role to the government because, in our view, a credit default of SDHC would have a limited effect on the government. According to our criteria, this combination of the "strong" link and "limited importance" role leads us to believe that there is a moderate likelihood of extraordinary support that may be available to this GRE when required. Despite this, SDHC's stand-alone credit rating of 'AA' is in a rating category under which a moderate likelihood of support would not result in no–notch upgrade of the ICR rating on SDHC.

Enterprise Profile

Industry risk: U.S. PHAs' focus on affordable housing lends further stability, with low competitive risk. We score the U.S. PHA industry risk at '2', representing a combination of individual assessments:

- Sub-scores of '2' for cyclicality and competitive risk, with no adjustment for the government support toward the industry;
- Economic cycles are more likely to affect U.S. PHAs than other types of social services because real estate fluctuations can change asset values;
- Real estate markets also tend to be overbuilt, leading to depressed occupancy rates, rentals, and property values, while residential rental markets typically pose less risk relative to other property classes; and
- U.S. PHAs' collective focus on affordable housing typically lends further stability. Competitive risk is fairly low due to effective entry barriers in many jurisdictions, minimal substitution risk, and overall stability in growth and margins.

In addition, ongoing government subsidies and government oversight limit volatility, along with the overall importance of the service delivered, thereby limiting the potential for negative government intervention, in our opinion.

Economic fundamentals and market dependencies

SDHC was established by the San Diego City Council for the benefit of housing low-income San Diegans through a variety of programs. These programs include owning and managing housing units, providing rental assistance for families and individuals, offering financial assistance for qualifying first-time homebuyers, and rendering both financial and technical assistance to low-income households whose older homes need rehabilitation. SDHC owns and/or operates more than 2,400 family and elderly units in 155 sites scattered throughout the city, 155 of which are public housing units. In addition, SDHC administers more than 14,000 HCVs. SDHC provides housing services for more than 75,000 residents of San Diego and is the youngest PHA in the U.S., with its oldest housing development built in 1979.

In 2009, SDHC launched its multiyear plan to transition out of public housing units in favor of a private-sector, affordable housing real estate model. This allowed SDHC access to equity and, in our view, to better use revenues generated by 1,366 apartment units at 150 properties previously under HUD control. The result of the transition is evident in an average social rent as a percentage of market rent in the operating region of 21.1%, which is higher than that of most U.S. PHAs we rate, and more in line with international social housing providers.

SDHC is one of 39 PHAs designated as a Moving to Work (MTW) demonstration agency with HUD. The MTW demonstration program allows SDHC to be exempt from certain public housing and HCV regulations by permitting the commission to combine operating, capital, and tenant-based assistance funds into a single agency-wide funding source and creating new and additional housing programs to meet local needs.

S&P Global Ratings believes the conversion of public housing units to SDHC-owned units, and subsequent increase in Section 8 vouchers, along with SDHC's MTW designation, will enable the commission to grow its affordable housing program. With the significant wait list for the HCVs and because SDHC administers the vouchers for San Diego, we believe that the additional housing units mandated by HUD will not encounter low utilization and occupancy rates. We believe this is evident as occupancy rates for SDHC-owned property have historically experienced full utilization with a long wait list.

Strategy and management

S&P Global Ratings believes SDHC's business plan provides a clear and exhaustive path for the commission to pursue. In 2004, the commission's leadership team began using three-year business plans as a strategic management tool to identify priorities, guide SDHC's activities, and align staff and resources behind common goals. Under its 2014-2016 business plan, the management focused on creating and preserving quality affordable housing. The commission is currently operating under the 2016-2020 business plans. The plan consolidates its objectives into three main goals:

- Maximize resources through operational efficiencies and technological innovations,
- Increase the number of housing opportunities that serve low-income and homeless individuals and families in San Diego, and
- Advocate for more effective affordable housing policies and resources.

SDHC is governed by the San Diego Housing Authority. The mayor recommends, and the San Diego City Council approves, seven members to serve as the more general structure of the SDHC board, who report to the nine city council members. The functions of the San Diego Housing Authority are to provide public and affordable housing to San Diegans; these functions are performed by SDHC. Consistent with HUD regulations, two of the appointees are residential members, including one elderly resident member.

SDHC's organizational structure comprises a president and CEO, two executive vice presidents (chief of staff and chief strategy officer), four senior vice presidents, nine vice presidents. The president and CEO are responsible to the board of commissioners and the San Diego Housing Authority. SDHC's executive vice presidents and the senior vice presidents report to the president and CEO, while the remaining senior vice presidents and vice presidents report to one of the two executive vice presidents.

Asset quality and operational performance

SDHC owns and operates more than 2,414 units in 155 multifamily projects, including 39 scattered single-family homes throughout San Diego. Included in its portfolio are 1,366 housing units that were formerly public housing units, mixed-use sites (including commercial components), and mixed-finance properties, with market-rate units mixed in with properties. Unit size ranges from one- to five-bedroom units. The bulk of the portfolio consists of two- and three-bedroom units. The unit occupancy rate has improved the past two years, averaging about 95% in the past three years. Rent collected as a percentage to gross rent charged has remained steady during the past three years, with approximately 96% of rent collected on average. Management has indicated that SDHC plans to continue increasing SDHC's affordable housing portfolio by seeking and evaluating additional acquisition opportunities. SDHC received HCVs for the like amount of transitioned PHA units. Under this transition, HUD mandated that the commission add 350 additional affordable housing units so that current residents of public housing will remain fully supported. We believe that the scope of work for future development is within SDHC's realm of experience.

Financial Profile

Financial performance: Mostly stable, but low EBITDA-to-revenues ratio

SDHC's score of '5' results from the average EBITDA-to-revenues (E/R) ratio of 12.7%, which has increased since our last review, and remains below average compared to those of other PHAs. Furthermore, in fiscal 2015, the commission's EBITDA and revenues increased considerably, primarily due to an increase in the rental income and a slight increase in the grants and controlled expenses. We view SDHC's financial position as vulnerable, compared to its rated peers, and should its financial performance continue to decline, e.g., if the E/R ratio falls below 10%, a score of '6' would result, which could lead to a negative rating action.

Debt profile: extremely strong debt profile among global and U.S. peers

SDHC's debt obligations are low, which is in line with the majority of U.S. PHAs we rate. The commission's debt-to-EBITDA ratio of 4.8x is average compared to those of other U.S. PHAs and low among those of international social housing providers. To help fund the costs of long-term development projects, SDHC's outstanding debt grew to $125 million in 2011 from $67 million in 2010. Since 2011, the commission's debt has stabilized, growing only 3.2% between 2010 and 2014. The total debt surged in 2015 by 10% to $142 million. However, at the same time, EBITDA also increased to $35 million from $21 million. In addition, the commission's EBITDA-to-interest ratio is extremely strong, in our view, at 7x. Both measurements lead to a final score of '1'.

Liquidity: Ratios fluctuate but remain extremely strong

SDHC's liquidity ratio remains extremely strong, which could reflect the commission's improved cash and liquid investments. SDHC's liquidity position is one of the strongest among rated U.S. PHAs and stronger than those of other international social housing providers. Due to the strength of its liquidity ratio, we gave a score of '1' to SDHC's liquidity position. All else being equal, the commission's liquidity position could improve in fiscal 2016 due to a scheduled lower debt service payment. On the other hand, should the liquidity ratio fall below 1.25x, a score of '2' would result, which could lead to a negative credit action.

Table 2

Sources Of Liquidity		
	2016	**2017**
Forecasted cash generated from continuing operations	$26,503,385	$26,503,385
Cash and liquid investments	$71,065,544	$71,065,544
Total sources of liquidity	$97,568,928	$97,568,928

Table 2

Sources Of Liquidity (cont.)		
	2016	**2017**
Uses of liquidity (enter as positives)		
Forecasted working capital excluding cash outflows	$ 6,926,929	$ 6,926,929
Interest and principal payments due on debt over the next 12 months	$ 3,079,355	$ 2,282,222
Total uses of liquidity	$10,006,284	$ 9,209,151
Liquidity Ratio	9.75	10.59

Financial policies: Positive credit impact, with a high degree of transparency

S&P Global Ratings believes that SDHC's financial policies are well established and contain sufficient oversight and prudence consistent with our '1' score. The commission's finances are managed through its finance department, which consists of four units: budget, general ledger, accounts payable/accounts receivable, and treasury. SDHC's financial management benefits from thorough planning and budgeting, and implementation is enhanced through an extensive financial reporting system, as well as a written financial policy and procedure.

SDHC follows all applicable HUD requirements concerning cash management and the investment of funds not required for current operations. SDHC's investments are short term and consist of treasuries, mortgaged-backed securities backed by GSEs, collateralized repurchase agreements, and other federally supported instruments. Maximum maturity under the investment policy is six months. The commission maintains a contingency reserve for unanticipated capital repairs and replacement. Moreover, SDHC emphasizes preventive maintenance to reduce unmet capital needs.

Table 3

Financial Ratios			
	Fiscal year end		
	2013	**2014**	**2015**
1.) BALANCE SHEET			
A.) Assets			
Total Current Assets	46,164,770	66,146,304	86,307,980
Total Long Term Assets	542,653,991	544,995,590	567,518,384
B.) Liabilities			
Total Current Liabilities	13,940,575	28,077,161	14,882,109
Total Liabilities	142,808,581	152,599,187	165,769,683
C.) Net Assets / Equity			
Unrestricted Net assets	239,275,479	243,182,012	248,990,276
Permanently Restricted	206,734,701	215,360,695	239,066,405
Total Net Assets / Equity	446,010,180	458,542,707	488,056,681
Average Equity	435,424,268	452,276,444	473,299,694
Total Liabilities & Net Assets / Equity	588,818,761	611,141,894	653,826,364

Table 3

Financial Ratios (cont.)

	Fiscal year end		
	2013	**2014**	**2015**
2. INCOME STATEMENT			
A.) Revenue			
Rental Income	29,288,464	29,733,281	32,547,805
Total Contributions and Grants	188,240,947	186,987,316	191,703,603
HUD operating subsidies	18,325,447	18,068,976	13,557,932
HUD capital grants	-	52,230	-
Other grants&HAP	169,915,500	168,866,110	178,145,671
Developer Fees	2,095,699	2,212,364	3,055,940
Other Income	1,997,229	3,364,244	2,926,834
Total Revenues	221,622,339	222,297,205	230,234,182
B.) Expenses			
Operations and Maintenance	8,759,106	9,369,102	10,859,900
Housing assistance payments	150,905,154	147,311,387	145,836,071
Real Estate Taxes	-	-	-
Depreciation/Amortization	4,469,638	5,453,090	5,869,174
General &Adminstrative	32,359,440	33,712,692	33,825,752
Other Expenses	6,650,674	17,115,718	11,103,144
Total Operating Expenses	203,144,012	212,961,989	207,494,041
Total Net Operating Income	18,478,327	9,335,216	22,740,141
C.) Adjustments to Net Operating Income			
Gain (loss) on sale of assets	38,220	-	-
Interest and Investment Income	8,644,071	9,122,231	9,749,147
Interest Expense	6,379,112	6,381,320	6,729,116
Other income	6,340	456,403	3,753,802
Change in Net Assets / Equity (Net Income)	20,787,846	12,532,530	29,513,974
Net Assets / Equity at Beginning of the Year	424,838,356	446,010,180	458,542,707
Equity transfers of component units/	383,978	-	-
Net Assets / Equity, End of the Year	446,010,180	458,542,710	488,056,681
3.) CASH FLOW STATEMENT			
A.) Operating Activities			
Change in Net Assets / Equity	20,787,846	12,532,530	29,513,974
Adjustments to reconcile changes in net assets			
Depreciation and amortization	4,469,638	5,453,090	5,869,174
Other adjustments from operating activities	(4,948,628)	(513,524)	(15,859,384)
Net Cash provided by operating activities	20,308,856	17,472,096	19,523,764
B.) Investing Activities			
Net Cash provided by investing activities	7,373,701	(12,413,058)	21,576,963

Table 3

Financial Ratios (cont.)

	Fiscal year end		
	2013	**2014**	**2015**
C.) Financing Activities			
Interest Paid	(5,857,170)	(5,886,026)	(5,542,396)
Payments of LTD	(3,091,553)	(3,095,439)	(3,079,610)
Proceeds from sale of bonds/notes	1,265,860	588,552	-
Other adjustments from financing activities	(11,980,462)	(2,237,708)	(16,597,079)
Net Cash provided by financing activities	(19,663,325)	(10,630,621)	(25,219,085)
Net Increase/Decrease in cash equivalents	8,019,232	(5,571,583)	15,881,642
Key Measurement			
EBITDA ($)	29,327,077	21,169,626	35,338,431
Debt ($)	128,554,378	129,342,166	142,418,468
Debt Service ($)	8,948,723	8,981,465	8,622,006
Government Support Percentage (%)	84.9	84.1	83.3
Voids, Vacancy (%) of Revenues	7.7	3.5	4.1
Arrears (% of Revenues)	0.1	4.8	6.4
Market rent in the main region of operation ($)	18,845	18,461	23,688
Social rent in main region of operation ($)	1,054.30	1,070.31	1,123.58
Average social rent as a percentage of market rent in the main region of operation	17.9	17.2	21.1
Average Market Dwelling Price ($)	519,714	556,228	568,155
Average National dwelling Price ($)	324,500	343,400	360,600
Average dwelling Price as (%) of national average	160.2	162.0	157.6
EBITDA / Revenues (%)	13.2	9.5	15.3
Debt / EBITDA (x)	4.4	6.1	4.0
EBITDA interest coverage (x)	6.0	4.6	7.4
Funds from Operations ($)	18,072,971	18,606,224	17,593,101
Cash from Operation ($)	20,308,856	17,472,096	19,523,764
Cash and Liquidity ($)	35,772,990	56,579,867	68,050,009
Net Working Capital ($)	32,224,195	38,069,143	71,425,871
Working Capital excluding Cash ($)	(3,548,795)	(18,510,724)	3,375,862
Population Growth	1.2	1.2	0.9
# of Units	2315	2315	2414