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San Diego Housing Commission, California; General Obligation

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San Diego Housing Commission, California; General Obligation

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

Rationale

Standard & Poor's Ratings Services raised its issuer credit rating (ICR) on the San Diego Housing Commission (SDHC), Calif. to 'AA' from 'A+'. The outlook is stable.

The ICR reflects our assessment of the following credit strengths:

- Extremely strong overall management and a strategic plan that supports the commission's mission to provide quality low-income housing;
- Very strong enterprise risk profile supported by economic fundamentals reflective of the high cost of housing in San Diego;
- Very strong financial profile, due to an extremely strong debt profile and liquidity position, and financial policies that offset a low score for financial performance;
- The very strong essentiality of SDHC housing, as evidenced by a waiting list of more than 16,200 for public housing and 29,000 for housing choice vouchers; and
- Strong development arm that maximizes external resources, which has been successful in developing 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 program, and the potential for decline in federal capital fund grants, and
- Liquidity ratios, which have fluctuated historically and have diminished in recent years (although they remain extremely strong, warranting a '1' score).

In addition, the rating reflects our view of the extremely strong management of SDHC, as evidenced by a trend of improvement in overall operational performance, portfolio quality, and financial management. Created in 1979, SDHC is one of the newest public housing authorities (PHAs), and its fairly young housing stock includes approximately 2,300 multifamily units within scattered sites throughout the City of San Diego.

A key rating factor is our view of the management team and what we consider its well-developed strategic plan with clear goals and overall objectives. Standard & Poor's 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. With this management decision, SDHC is able to access equity, and in our view, better utilize revenues generated from 1,254 of its 1,366 apartment units previously under the control of Housing and Urban Development (HUD). In our view, SDHC effectively maintains a level of financial stability while achieving its overall affordable housing goals.

Standard & Poor's believes SDHC has demonstrated a strong ability to leverage resources and to develop partnerships in its efforts to revitalize its communities, as evidenced through the housing 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 authority acts as the issuer of the bonds, there is no financial liability to the city, the housing authority, or the housing commission 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. Total HUD appropriations have declined, and in 2012 appropriations dropped by an additional 9%, or $3.8 billion, over 2011. As a result, housing authorities whose income comes largely from federal subsidies could experience declines in margins and a negative change in net assets to equity in any given year. In 2011, 85.5% of SDHC's total revenues came from federal subsidies, which is slightly lower than previous years.

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 position could in the long term impair its financial strength and have a negative credit impact. 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 three international entities (Sanctuary Housing in the U.K., Places for People in the U.K., and Stadgenoot in Amsterdam, Netherlands) and seven U.S. PHA peers (Chicago, Boston, Vancouver, San Francisco, San Bernardino, Houston, and Seattle). The commission differs from other rated U.S. PHAs (which traditionally operate under the Public Housing Program) in its transformation from public housing units in favor of a private sector, affordable housing real estate model, as evidenced by its significantly high social rent as a percentage of market rent in the main region of operation, which averaged 72.4% from 2009 through 2011. Like other rated U.S. PHAs, the commission's revenue stream is primarily derived from federal subsidies; however, SDHC's subsidies are mostly in the form of rental assistance payments. SDHC's financial profile is very strong, in our view, and is in line with those of other U.S. PHAs.

Table 1

Peer Comparison

	Enterprise Profile					Financial Profile			
	Economic fundamentals and market dependencies				Asset quality	Financial performance	Debt profile		Liquidity
ENTITY	Proportion of revenues from social housing activity (%)	Annual pop. growth (%)	Average social rent as a percentage of market rent in the main region of operation	Average dwelling price as a percentage of national average	Vacancy rates (three-year average) (%)	EBITDA/Revenues (%)	Debt/EBITDA (x)	EBITDA/Interest (x)	Liquidity ratio
Sanctuary	72.0	0.7	57.8	N.A.	1.4	32.9	11.8	1.6	1.79
PfP	74.0	0.5	60.7	61.1	2.0	31.7	16.6	1.2	1.86
Stadgenoot	85.0	1.4	55.0	115.7	2.5	36.4	17.4	1.5	1.79
San Diego PHA	85.5	1.2	72.4	151.0	3.5	12.1	2.9	7.6	3.70
Chicago PHA	90.8	0.4	16.9	N.A.	6.6	33.6	1.1	17.2	6.61
Boston PHA	88.0	1.2	20.6	N.A.	2.0	13.8	3.7	106.8	7.40
Vancouver PHA	44.3	1.6	62.9	97.0	4.4	43.4	6.8	3.3	1.23
San Francisco	90.4	0.9	12.6	276.0	5.2	8.9	3.5	37.8	8.03
San Bernardino	84.4	1.2	54.6	102.2	5.1	12.2	7.0	6.1	2.47
Houston PHA	87.7	2.2	43.8	N.A.	4.3	16.0	1.8	29.1	8.43
Seattle PHA	66.4	1.6	36.0	166.0	2.7	22.0	6.1	3.7	1.64

N.A.: Not available.

Extraordinary Government Support

Standard & Poor's views SDHC as a government-related entity (GRE), and therefore, we apply 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 impact for 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 a raised rating.

Enterprise Profile

Industry risk: U.S. PHAs' focus on affordable housing lends further stability with low competitive risk

The U.S. PHA industry risk scores a '2' (see table 2), a combination of individual assessments: sub-score of '2' for cyclicality and sub-score of '2' for competitive risk, with no adjustment for the supportiveness of government policies toward the industry. Economic cycles are most likely to affect U.S. PHAs more than other types of social services because real estate fluctuations can change asset values. Real estate markets can be overbuilt, leading to depressed occupancy rates, rentals, and property values; residential rental markets typically pose less risk relative to other property classes, and U.S. PHAs' focus on affordable housing typically lends further stability. Competitive risk is fairly low, due to effective barriers to entry in many jurisdictions, minimal risk of substitution, and overall stable trends in growth and margins. In addition, ongoing government subsidies, other support, and oversight limit volatility, with the overall importance of the service delivered, limit 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 2,200 family and elderly units in 156 sites scattered throughout the city, of which 76 are public housing units. In addition, SDHC administers more than 14,000 housing choice vouchers. 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 utilize revenues generated by 1,366 apartment units at 150 properties previously under HUD control. Simultaneously, SDHC received housing choice vouchers 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. The result of the transition is evident in an average social rent as a percentage of market rent in the operating region of 72.4%, which is significantly higher than any U.S. PHAs we rate, and more in line with international social housing providers.

Standard & Poor's believes that SDHC's importance to the market it serves is very strong. Like many other PHAs in the country, the market demand for SDHC's housing services exceeds the supply available, as evidenced by the number of people on the waiting list versus available units. SDHC has been, in our view, the leading provider of affordable housing opportunities for lower-income families and individuals in San Diego for at least the past 10 years. As of February 2012, SDHC's Section 8 waiting list contained almost 29,000 households, which indicates a significant need for affordable housing in the service area. The public housing waiting list was almost 16,200 families in fiscal 2011 and has not significantly changed in the past 12 months.

SDHC is a Moving to Work (MTW) demonstration agency with HUD. The MTW demonstration program allows SDHC to be exempt from certain Public Housing and Housing Choice Voucher regulations by permitting the commission to combine operating, capital, and tenant-based assistance funds into a single agencywide funding source and creating new and additional housing programs to meet local need.

Standard & Poor's 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 housing choice vouchers 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 waiting list.

Market Position

Strategy and management

Standard & Poor's believes SDHC's business plan provides a clear and exhaustive path for the commission to pursue. In 2004, the commission's leadership team began utilizing three-year business plans as a strategic management tool to identify priorities, guide SDHC's activities, and align staff and resources behind common goals. The commission is currently operating under the 2011 business plan. The plan breaks down all goals into 49 strategies in support of five business plan goals. Each goal has a starting date, action to implement, measurements of completion, scheduled completion date, and an estimated cost and funding source.

The five goals are:

- Broaden the housing commission's mission to provide affordable housing for a wider San Diego population, from assistance for the homeless to opportunities for workforce housing.
- Model effective application of private sector techniques in a public sector operation.
- Become a national model in initiating and implementing new, progressive ideas to address affordable housing needs across the country.
- Provide a positive customer experience through the seamless, efficient, and professional delivery of programs and services.
- Continue to be an employer of choice in San Diego by offering professional development initiatives and treating staff members in a fair and equitable manner.

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 chief executive officer (CEO), chief of staff, two senior vice presidents, and four vice presidents. The president and CEO is responsible to the board of commissioners and the San Diego Housing Authority. SDHC's chief of staff, the senior vice presidents, and two vice presidents report to the president and CEO, while two vice presidents report to the chief of staff.

SDHC's senior staff team consists of experienced professionals, in our view, with more than 40 years of public housing authority and affordable housing experience, collectively. SDHC has a formal succession plan that is administered through the commission's specialized professional development program. Since our 2011 review, the executive vice president/chief operating officer resigned and was replaced by an executive senior vice president and chief of staff who served for nine years on SDHC's board of commissioners and who we believe has sufficient experience to help guide the agency.

Asset Quality And Operational Performance

SDHC owns and operates more than 2,200 units in 156 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-bedroom to five-bedroom units. The bulk of the portfolio consists of two- and three-bedroom units.

Upon repositioning the portfolio from public housing to the private sector affordable housing model, SDHC received 1,354 HUD housing choice vouchers. Public housing residents, with low-income household earnings no greater than 80% of the area's median income, were immediately granted vouchers as the units became available at a varying range of affordable rents. Under the change in the portfolio, HUD required that SDHC implement a relocation program for families who wanted to utilize their vouchers in units outside of the SDHC portfolio. To date, only 15% of families receiving vouchers have opted out of SDHC units and participated in the relocation program. Standard & Poor's considers the low level of participants in the relocation program as an indicator of SDHC's strength and a direct indication of the prudent asset and property management that has led to tenant satisfaction with the commission.

The unit occupancy rate has generally been steady during the past five years, averaging about 96%. Rent collected as a percentage to gross rent charged has remained steady during the past five years with more than 98% of rent collected on average.

Standard & Poor's believes SDHC is proactively working to meet and exceed its HUD mandate to build 350 new affordable housing units. As of June 2012, SDHC has produced or financed 741 new units of affordable housing since the beginning of the conversion plan in 2010. These units include projects under development and the acquisition and rehabilitation of existing properties. Management has indicated that SDHC plans to continue increasing SDHC's affordable housing portfolio by seeking evaluating additional acquisition opportunities. Standard & Poor's believes that the scope of work for the development of these units is within SDHC's realm of experience.

Financial Profile

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

SDHC's score of '5' for financial performance is primarily due to its average EBITDA-to-revenues ratio of 12% during the three most recent audited years. Driving down the average is a weak financial performance in fiscal 2009, which resulted in an EBITDA-to-revenues ratio of 5.9%. Since 2009, SDHC's financial performance has improved and stabilized (largely due to increases in federal subsidies and Section 8 rental assistance payments), as evidenced by EBITDA-to-revenues ratios of 15.3% and 14.3% in 2010 and 2011, respectively.

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 2.9x is moderate compared to those of other U.S. PHAs and low among 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, boosting its EBITDA-to-debt ratio to 4.1x from 2x. Although higher than previous years, the 4.1x ratio is still consistent with those of other U.S. PHAs. In addition, the commission's EBITDA-to-interest ratio is also extremely strong, in our view, at 7.6x. Both measurements lead to a final score of '1' (see table 2).

Liquidity: ratios fluctuate but remains extremely strong

Historically, SDHC's liquidity ratios have been extremely strong (as high as 67.3x in 2007), in our view, but have dropped in recent years (see table 3). Despite the fluctuation and sharp decline in the commission's liquidity ratios, the ratio remains extremely strong (at 3.7x in 2011), in our view, and is in line with those of most other rated U.S. PHAs and stronger than those of other international social housing providers. The drop in the commission's liquidity ratios is largely due to significant increases in debt service payments in 2011 (to $7.7 million from $3 million) and 2012 (to $30.6 million, which also includes pay downs and refinancing of debt). SDHC projects debt service for 2013 to fall to approximately $7 million, and if its sources of liquidity remain stable, the liquidity ratio could improve to roughly 5x.

Due to the strength of its liquidity ratio, we gave a score of '1' to SDHC's liquidity position. Should the liquidity ratio fall below 1.5x, a score of '2' would result, which could lead us to lower the rating to 'A+' from 'AA'. Based on the projections we received from management, we do not expect the liquidity ratio to fall below 1.5x in the two-year outlook period.

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

Standard & Poor's believes that SDHC's financial policies are well established and contain sufficient oversight and prudence consistent with our '1' score. SDHC is among the highest-rated housing authorities that have represented high profitability. 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, with implementation enhanced through an extensive financial reporting system.

SDHC follows all applicable HUD requirements concerning cash management and the investment of funds not required for current operations. During the course of the fiscal year 2004 audit, auditors referred to various sections of the California Government Code regarding the formal establishment; they determined SDHC was consistent with HUD guidelines for investment policy and investment reports for all local agencies. SDHC's investments are short term in nature and consist of treasuries, mortgaged-backed securities backed by government sponsored entities, collateralized repurchase agreements, and other federally supported instruments. Maximum maturity under the investment policy is six months.

Table 2

Scores Assigned to SDHC

	Score	Weighting (%)	Weighted score
Enterprise profile			
Industry	2	30	0.60
Economic fundamentals	2	25	0.50
Strategy and management	1	23	0.23
Asset quality	2	23	0.45
Total for business profile			1.78
Financial profile			
Financial performance	5	30	1.50
Debt profile	1	30	0.30
Liquidity	1	25	0.25
Financial policies	1	15	0.15
Total for financial profile			2.20

Table 3

Financial Statistics (Fiscal Year End 2007-2011)

	2007	2008	2009	2010	2011
	Balance Sheet				
Assets					
Total current assets	86,181,719	90,274,579	48,245,038	73,496,074	106,547,651
Total long-term assets	251,408,451	278,024,286	340,627,563	389,358,859	435,166,354
Total assets	337,590,170	368,298,865	388,872,601	462,854,933	541,714,005
Average total assets	313,635,048	352,944,518	378,585,733	425,863,767	502,284,469
Liabilities					
Total current liabilities	7,459,114	7,737,947	8,830,481	11,509,235	34,965,187
Total long-term liabilities	33,335,638	31,743,527	29,678,495	68,507,722	102,234,175
Total liabilities	40,794,752	39,481,474	38,508,976	80,016,957	137,199,362
Net assets/equity					
Net assets/equity, end of the year	296,795,418	328,817,391	350,363,625	382,837,976	404,514,643
Average equity	283,495,904	312,806,405	339,590,508	366,600,801	393,676,310
Total liabilities & net assets/equity	337,590,170	368,298,865	388,872,601	462,854,933	541,714,005
	Income Statement				
Revenue					
Rental income	10,107,745	16,294,790	22,800,191	22,427,140	24,309,910
Total contributions and grants	156,818,906	171,967,626	158,414,617	188,982,162	184,611,944
Other income	2,121,580	1,539,636	1,645,817	3,546,925	4,204,555
Total revenues	171,471,741	191,887,410	184,509,222	216,769,640	215,994,015
Expenses					
Operations and maintenance	7,950,607	7,779,665	6,664,735	5,065,696	10,130,088
Housing assistance payments	113,252,745	126,587,352	139,234,699	144,790,881	145,876,110

Table 3

Financial Statistics (Fiscal Year End 2007-2011) (cont.)

Real estate taxes					
Depreciation/amortization	3,628,646	2,980,926	2,367,288	2,595,635	4,047,879
General & administrative	23,198,646	23,212,144	24,934,030	29,658,480	30,976,651
Other expenses	6,461,210	5,618,803	4,561,061	7,074,276	4,698,932
Total operating expenses	154,491,854	166,178,890	177,761,813	189,184,968	195,729,660
Adjustments to net operating income					
Gain (loss) on sale of assets	3,560,143	(132,480)	--	--	858,442
Tax expense					
Interest and investment income	7,339,612	6,858,050	6,374,263	7,312,333	6,974,862
Capital contributed/capital grants				550,000	
Interest expense	1,221,720	1,706,621	1,822,653	2,760,106	6,349,702
Other expenses	--	--	831,228	--	--
Other income	--	--	--	459,836	--
Change in net assets/equity (net income)	4,361,698	21,374,945	(1,083,644)	18,897,285	13,533,668
Net assets/equity at beginning of the year	270,196,390	296,797,520	327,458,621	337,963,514	370,319,006
Prior-period adjustments					
Net assets/equity, end of the year	296,797,520	327,458,621	337,963,514	370,319,006	391,858,096
			Cash Flow Statement		
Operating activities					
Change in net assets/equity (net income)	26,601,130	30,661,101	10,504,893	32,355,492	21,539,090
Net cash provided by operating activities	3,458,916	13,511,937	21,345,455	31,449,793	30,720,256
Investing activities					
Net cash provided by investing activities	(1,519,454)	(9,867,233)	(13,139,224)	(56,435,525)	(26,125,336)
Financing activities					
Net cash provided by financing activities	(1,329,461)	(4,689,396)	(4,665,859)	23,818,894	492,181
Net increase/decrease in cash equivalents	610,001	(1,044,692)	3,540,372	(1,166,838)	5,087,101
Key measurement					
EBITDA ($)	21,887,045	30,462,435	10,900,248	33,181,656	30,870,803
Debt ($)	33,213,976	30,450,915	27,769,404	67,468,770	125,321,940
Debt service ($)	1,221,720	1,706,621	4,504,164	3,299,774	7,736,259
Voids, vacancy (%) of revenues	2.80	4.80	0.00	7.00	3.60
Arrears (% of revenues)	0.20	0.90	2.77	4.70	1.30
Average social rent as a percentage of market rent in the main region of operation	38.83	55.67	80.33	69.88	67.02
Average dwelling price as (%) of national average	199	160	166	148	138
EBITDA/Revenues (%)	12.80	15.90	5.90	15.30	14.30
Debt/EBITDA (x)	1.5	1.0	2.5	2.0	4.1
EBITDA interest coverage (x)	17.9	17.8	6.0	12.0	4.9
Funds from operations ($)	6,986,092	15,463,524	22,522,877	32,037,936	26,930,192
Cash from operation ($)	3,458,916	13,511,937	21,345,455	31,449,793	30,720,256

Table 3

Financial Statistics (Fiscal Year End 2007-2011) (cont.)					
Cash and liquidity ($)	76,222,146	80,877,737	38,559,582	59,139,671	99,123,998
Net working capital ($)	78,722,605	82,536,632	39,414,557	61,986,839	71,582,464
Working capital excluding cash ($)	2,500,459	1,658,895	854,975	2,847,168	(27,541,534)
Liquidity ratio	67.3	56.3	13.5	28.3	3.7

Liquidity ratio (projected for 2012 and 2013, respectively): 2.22, and 5.03

Related Criteria And Research

Criteria: Public And Nonprofit Social Housing Providers, July 11, 2012