S&P Global Ratings

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San Diego Housing Commission; General Obligation

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San Diego Housing Commission; General Obligation

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). 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:

- Vulnerable financial performance compared with similarly rated peers, and
- Uncertainty about the effects of levels of public sector funding in the medium term.

Factors constraining the rating, in our view, include susceptibility to the year-over-year federal funding level, which leads to volatility in financial performance. SDHC is vulnerable to potential funding cuts from HUD, given its reliance on government support for approximately 82% of its revenue. HUD is the main source of public funding for affordable housing and, as an entity of the federal government, is bound to congressional budget decisions. SDHC's federal funding relies on the Housing Choice Voucher (HCV) program, where anticipated cuts would be somewhat mitigated as a result of HCV funding history and stronger bipartisan support than other federal housing programs. In addition, we believe that SDHC is protected from potential funding cuts in fiscal 2018 as a result of the Omnibus spending plan. The funding increases in the spending plan alleviate some of operating risk to the commission, and we anticipate that SDHC will maintain consistent financial performance for the remainder of this year and sustain the number of households receiving housing vouchers. In addition, if the HCV program were to be cut, the commission is authorized to reduce the payments it makes, either by lowering rents paid to landlords or by removing tenants from the program.

As a result, in our opinion, operating finances would not be significantly affected.

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 2,559 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.

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.

Upside scenario

We could raise the rating if the commission can demonstrate consecutive years of improved EBITDA margins, along with a sustained liquidity position. We also believe another key factor is the commission's ability to leverage the needed resources to carry out its development plans, to continue to engage in business activities that provide it with additional income sources, and to continue to implement operational and administrative efficiencies. These factors could result in a higher stand-alone credit profile (SACP) and ICR.

Downside scenario

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.

Comparative Analysis

Table 1 details how SDHC compares in key measurements with eight U.S. PHA peers (Philadelphia, Boston, Chicago, Los Angeles, King County, 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 commission 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 similarly rated peers.

Table 1

Public Housing Authority Key Measurement Comparison

Entity	SACP Rating	Proportion of revenues from Social Housing Activity (%)	Annual population growth (%)	Average social rent as % of market rent in the main region of operation	Vacancy rates (three-year average; %)	Average age of the portfolio (years)	EBITDA/revenue (three- or five-year average; %)	Debt/EBITDA (three- or five-year average; x)	EBITDA/ Interest (3yr Average or 5 year ave) (X)	Liquidity ratio (outlook period)
San Diego Housing Commission	aa	82.1	0.7	19.2	2.4	33	15.3%	4.0	8.2	3.5
San Francisco City and County Housing Authority	a+	85.7	4.0	16.4	5.0	50	1.9%	NA	13.2	1.8
Vancouver Housing Authority	aa	41.9	1.4	45.4	2.7	43	41.0%	8.8	4.5	2.7

Table 1

Public Housing Authority Key Measurement Comparison (cont.)

Entity	SACP Rating	Proportion of revenues from Social Housing Activity (%)	Annual population growth (%)	Average social rent as % of market rent in the main region of operation	Vacancy rates (three-year average; %)	Average age of the portfolio (years)	EBITDA/revenue (three- or five-year average; %)	Debt/EBITDA (three- or five-year average; x)	EBITDA/ Interest (3yr Average or 5 year ave) (X)	Liquidity ratio (outlook period)
Housing Authority of City of Seattle	aa	71.0	1.4	34.4	3.5	41	29.8%	21.8	17.1	2.7
King County Houing Authority	aa	55.0	1.4	39.0	1.5	28	22.5%	7.7	5.3	3.8
Chicago Housing Authority	aa-	89.0	0.1	19.6	3.3	37	15.9%	1.3	13.1	1.8
Housing Catalyst (formerly Fort Collins Housing Authority)	aa-	61.5	1.5	37.1	6.9	34	24.1%	10.5	6.7	4.3
Philadelphia Housing Authority	a+	87.4	1.8	23.9	6.0	55	10.7%	10.2	13.9	9.3
Boston Housing Authority	a+	84.0	0.4	23.3	2.0	35	8.1%	6.8	4.0	2.0
Housing Authority of the City of Los Angeles	a+	94.6	0.3	15.4	2.6	60	5.7%	30.9	2.2	1.5

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, the SDHC SACP 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 2,500 family and elderly units in 189 sites scattered throughout the city, all of which are public housing units. In addition, SDHC administers more than 15,000 HCVs. SDHC provides housing services for more than 125,000 residents of San Diego and is one of the youngest PHAs 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 17.1%, which is lower than that of most U.S. PHAs we rate.

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 2,500 units in 189 multifamily projects, including 35 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 over 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 95% 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.

Construction has been completed on all fiscal 2018 projects, with no delays observed. Two SDHC properties (the

40-unit Vista Verde [phase I] and the 120-unit University Canyon Apartments [phase 2]) underwent major rehabilitation and interior and exterior work during fiscal 2018. Replacement of the plumbing lines (clean water and sewer) at Hotel Sanford was completed in fiscal 2018 as well.

For fiscal 2019, SDHC expects that phase 2 of the renovation work at Vista Verde will commence. Also, new structural work at Hotel Sanford will commence, and 20 properties composed of duplexes, triplexes, and fourplexes will undergo major rehab during fiscal 2019. Structural repair, kitchen renovation, painting of interiors and exteriors, parking lot resurfacing, and landscaping at La Jolla Marine are also expected to be done in fiscal 2019.

Financial Profile

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

SDHC's score of '5' results from the three-year average EBITDA-to-revenues (E/R) ratio of 15.3%, which has increased since our last review, and remains below average compared to those of similarly rated 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 three-year average debt-to-EBITDA ratio of 4.0x is one of the lowest 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 2012 from $67 million in 2010. Since 2012, the commission's debt has stabilized, growing 10.6% between 2012 and 2017. Total debt increased in 2017 by 7% to $184 million. At the same time, EBITDA increased substantially to $52.8 million in 2017 from $33.5 million in 2016. In addition, the commission's EBITDA-to-interest ratio is extremely strong, in our view, at over 8x at a three-year average. Both measurements lead to a final score of '1'.

Liquidity: Ratios fluctuate but remain extremely strong

SDHC's liquidity ratio remains extremely strong at 4.8x, 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 that of most PHA peers. Due to the strength of its liquidity ratio, we gave a score of '1' to SDHC's liquidity position. We expect a similar liquidity position in fiscal 2019. 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

San Diego Housing Commission Liquidity Sources And Uses

(Mil. $ except in the case of liquidity ratio)

	2018	2019
Liquidity sources		
Forecast cash generated from continuing operations if positive	40.0	40.0

Table 2

San Diego Housing Commission Liquidity Sources And Uses (cont.)		
(Mil. $ except in the case of liquidity ratio)		
	2018	**2019**
Cash and liquid investments (current values)	79.0	79.0
Total sources of liquidity	118.9	118.9
Liquidity uses		
Forecast working capital excluding cash outflows, if negative	11.5	11.5
Expected capital expenditure over the next 12 months	13.2	5.8
Interest and principal payments due on debt over the next 12 months	9.1	9.1
Other payments, if applicable		
Total liquidity uses	33.8	26.4
Liquidity ratio	3.52	4.51

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

San Diego Housing Commission Key Financial Ratios			
	--Fiscal year ended June 30--		
	2015	**2016**	**2017**
EBITDA ($)	28,609,315	33,535,700	52,803,000
Debt ($)	142,418,468	139,975,241	147,552,000
Debt service ($)	8,622,006	8,492,265	8,251,000
Government support percentage (%)	83.3	82.0	82.1
Voids, vacancy (%) of revenue	4.1	1.5	1.5
Market rent in the main region of operation ($)	23,688	23,688	24,665
Average social rent as a percentage of market rent in the main region of operation	21.1	19.3	17.1
Average dwelling price as (%) of national average	157.6	166.0	167.3
EBITDA/revenue (%)	12.4	13.7	19.9
Debt/EBITDA (x)	5.0	4.2	2.8
EBITDA interest coverage (x)	6.2	7.2	11.2

Table 3

San Diego Housing Commission Key Financial Ratios (cont.)

	--Fiscal year ended June 30--		
	2015	**2016**	**2017**
Working capital excluding cash ($)	3,375,862	(5,645,925)	(17,390,000)
Population growth	0.9	0.8	0.7
# of units	2,414	2,422	2,559