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City of San Antonio, Texas

Primary Credit Analyst(s): Horacio Aldrete-Sanchez, Dallas (1) 214-871-1426; horacio_aldrete@standardandpoors.com
Secondary Credit Analyst(s): Theodore Chapman, Dallas (1) 214-871-1401; theodore_chapman@standardandpoors.com

Credit Profile
US$32.955 mil General Improvement Forward Refunding Bonds, Series 2006 dtd 12/01/2004 due 02/01/2016
AA+
Sale date: 01-DEC-2004

AFFIRMED
Outstanding GO Bonds, Various Series
AA+

Outstanding GO Bonds, Various Series
AAA / AA+ (SPUR)

OUTLOOK:
STABLE

Rationale

Standard & Poor's Ratings Services assigned its 'AA+' rating, and stable outlook, to San Antonio, Texas' series 2006 general improvement forward refunding bonds.

The rating reflects the city's:

- Continued strong economy;
- Strong management with a comprehensive long-term capital program;
- Strong financial performance and position; and
- High debt burden, coupled with manageable capital needs.

The city's full faith and credit pledge secures the bonds.

San Antonio, with about 1.2 million residents, is Bexar County's seat and the nation's ninth-largest city. The designation of San Antonio as the site for a new Toyota Motor Corp. truck manufacturing facility, which is scheduled to be complete by the end of 2005, has brought substantial growth to the south portion of the San Antonio MSA. The plant should generate about 2,100 jobs and a total capital investment of roughly $800 million from Toyota. Assessed valuation (AV) growth remained strong in fiscal 2005, increasing by 4.9% over fiscal 2004. Total AV is now nearly $47 billion. The residential and services and trade sectors continue to experience the strongest growth. The medical and biomedical industries, which contributed an estimated $11.9 billion to the area as a whole in 2003, now account for the largest part of the city's economy. Expansions continue at South Texas Medical Center, which is the city's leading employer with nearly 29,000 employees. San Antonio's unemployment, which has decreased to about 4.8%, remains below state and national levels. San Antonio's management policies and controls are very strong and include a comprehensive long-term capital program, as well as several transparency and accountability initiatives.

Following a fiscal 2002 deficit that reduced the general fund balance to $55.0 million, San Antonio's financial performance significantly improved in fiscal 2003 with a $19.2 million operating surplus that restored the general fund balance to $81.6 million, or 14.2% of expenditures. Management expects fiscal 2004 to reflect similar fund balance levels. The city's fiscal 2005 budget is balanced. The city continues to substantially exceed its goal of maintaining at least 5% of expenditures in the general fund, and management's dedication of $23 million of general fund reserves in case of potential revenue declines provides additional flexibility; these reserve funds did not decline during fiscal 2003.

Overall net debt is high at roughly $2,549 per capita and nearly 7% of market value. To some extent, these figures are elevated because they include the city's overlapping debt, which is substantially comprised of school district debt that receives significant support for debt service payments from the state's instructional facilities allotment program. In November 2003, the electorate approved a $115 million bond package to finance improvements to the city's street and drainage infrastructure and library system, parks and recreation facilities, and public health and safety facilities. In March 2005, city officials plan to issue a second installment of nearly $32.0 million in conjunction with roughly $5.4 million of certificates of obligation.

Outlook

The stable outlook reflects the expectation that the city will continue to take the necessary actions to keep its budget balanced and work to build reserves.

Economy

San Antonio is in south-central Texas, about 75 miles south of Austin, Texas and 150 miles north of the Mexican border. According to U.S. Census estimates for 2002, San Antonio is the nation's ninth-largest city and the state's third-largest city. Although military and tourism have long been the driving forces in the city's economy, medical and biomedical companies are now the leading force, contributing an estimated $11.9 billion to the area's economy. The city has worked hard to build this component of its economy, which is evidenced by South Texas Medical Center's status as its leading employer. In all, the medical and biomedical fields account for nearly 106,000 jobs, or about 13% of total city employment. Despite the slowing economy and cutbacks of some employers, San Antonio added about 26,000 jobs overall during 2003. Although wealth levels remain below the national average, they have consistently increased at a faster rate than the nation's levels. Growth in median household effective buying income from 1998-2003 reached 9.4% compared with the state's 4.5% and the nation's 1.1%. Therefore, median household effective buying income levels are now at 97% of the nation's average, up from 89% in 1998. To support this upward trend in income growth, management has focused its economic development efforts to attracting industries in the biotechnology and health care, aerospace, telecommunications, IT, logistics and transportation, tourism, and automotive manufacturing sectors. City officials estimate that total employment in these targeted industries will be about 275,000.

San Antonio's property tax base is diversified: The 10 leading property taxpayers account for about 5% of total AV. H.E. Butt Grocery Co., the leading taxpayer, accounts for just 1.2% of total AV. Tourism and convention traffic remain strong. Hotel room nights have increased by a cumulative 12% over the past five years.

San Antonio's access to Mexico promotes strong international trade and tourism, creating further economic diversity. Government, specifically the military, continues to be a large component of the economy with five military bases in the city. Although Kelly Air Force Base officially closed as a military installation in July 2001, city officials have worked at privatizing the base to prevent job losses. To date, 7,400 military jobs have been retained and 5,200 private sector jobs have been created. The city's goal is to create 21,000 jobs at the Kelly installation by 2006, which would more than offset the estimated 12,000 jobs lost due to the base closing. Boeing Co. and Lockheed Martin Corp. are the leading employers at the Kelly installation, and management expects the two companies to spur further privatization and allow the retention of several aircraft repair operations. Total capital investment in this project has reached $191 million: $172 million of which has come from private investors. Subsequent phases of the Kelly-USA initiative include the development of a Class A business park with rail, air, and highway access for an estimated investment of $364 million in capital projects. City officials expect this second phase of development to generate an additional 6,400 jobs and increase Kelly's economic effect on the local economy to $4.3 billion annually.

Similarly, San Antonio is working with Brooks Air Force Base to retain jobs there should future base closures be considered nationally. In July 2002, Brooks Air Force Base transferred ownership of all its land to the city. Part of the city's involvement includes the development of Brooks Technology & Business Park, where the U.S. Air Force will be the city's major tenant; city officials are also planning the development of additional health services and biotechnology companies. Brooks City-Base is the only project of its kind in the nation. In summer 2003, University of Texas at San Antonio opened a bioprocessing training center at Brooks City-Base. In addition, Brooks City-Base already has lease agreements with nine tenants; and the facility has also been designated as a center for homeland security and city and county emergency operations.

In September 2003, the U.S. Army designated Fort Sam Houston in San Antonio as the new location for the U.S. Army's Southern Command Center, creating about 500 jobs and an annual economic effect of roughly $200 million. In light of the upcoming base realignment and closure round scheduled for 2005, city officials have established a task force to implement a strategy to avoid base closures.

San Antonio won its bid for a new Toyota truck plant to be built on land south of the downtown area. The plant is scheduled to begin operations at the end of 2005. The city's economy will benefit from various aspects of the project, including roughly $800 million of capital investment from Toyota. City management expects this project to create about 2,100 construction jobs. Toyota's management is projecting the plant, once at full operation, will produce 150,000 units of its Tundra truck annually. City officials are forecasting the project to create about 2,000 manufacturing jobs and an additional 5,300 spin-off jobs in the area. The city recently issued contract revenue bonds through its Starbright Industrial Development Corp. to finance the acquisition of land and fund other costs associated with the project; San Antonio will pay debt service on the bonds solely through revenues the city pledges from the funds it receives from city public services. City management will create a three-year limited-purpose district for the site with the expectation that the district will annex this land at the end of that period. The city is also planning a new site for Texas A&M University as part of its southside initiative.

To encourage the redevelopment of San Antonio's inner-city neighborhoods, management has implemented eight neighborhood commercial revitalization programs, which have attracted an estimated $54 million of private investment and 1,741 new jobs.

Finances

San Antonio's financial performance remains strong. In fiscal 2003, the city reported an ample $19.2 million surplus, which restored, in part, a $33.9 million decrease in the unreserved general fund balance from fiscal 2002. The city's fiscal year-end 2003 $74.4 million unreserved general fund balance accounted for a healthy 13% of operating expenditures, which substantially exceeded the city's goal of maintaining at least 5% of expenditures in the fund. A significant 23% increase, or $38.9 million, in city public service payments to San Antonio accounted for much of the city's revenue growth in fiscal 2003. In addition, cost-containment measures provided city officials with additional flexibility to achieve a year-end operating surplus. Management is projecting fiscal 2004 unaudited figures to reflect similar general fund balance levels to those of fiscal 2003. Early projections indicated a $23.1 million general fund shortfall for fiscal 2005. The fiscal 2005 budget eliminates this projected shortfall through a combination of revenue enhancements and expenditure controls, resulting in an overall balanced budget.

The general fund continues to rely on city public service revenues, which account for about 30% of total general fund revenues. While city public services have moved into a deregulated environment, its favorable and competitive position limits or mitigates concerns. The city's fiscal 2003 sales tax revenues were slightly below the fiscal 2002 level. Unaudited fiscal 2004 sales tax revenues reflect a significant 5.8% increase in sales tax collections.

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FitchRatings
Rating Action Commentary

Contact
Jose Acosta +1-512-322-5324
Mark Campa +1-512-322-5316

Fitch Rates San Antonio, Texas Gen Improv Forward Rfdg Bonds 'AA+'

Fitch Ratings-Austin-November 29, 2004: Fitch Ratings assigns the rating of 'AA+' to San Antonio, Texas' (the city) approximately $33 million general improvement forward refunding bonds, series 2006. The bonds are expected to price Dec. 1 via a syndicate led by First Southwest Co. In addition, Fitch affirms the 'AA+' rating on the city's approximately $634 million in outstanding general improvement bonds and $219.1 million in outstanding certificates of obligation. The Rating Outlook is Stable.

The high-grade rating reflects the city's positive overall economic performance, strong financial practices and satisfactory results, and well-managed debt position. Finances stabilized in fiscal 2003 primarily due to increased utility transfers to the general fund. Unaudited fiscal 2004 results point to a modest operating surplus. Economically, the city managed well during the most recent recession, despite job losses in the manufacturing sector. Direct debt levels remain manageable and principal amortization is rapid.

San Antonio is the third-largest city in the state and ninth largest in the U.S. according to census information, with an estimated population of approximately 1.3 million. The city's south-central location in the state makes it one of the major U.S. gateways to Mexico. Although there is vulnerability associated with some of the city's key employment sectors such as defense, telecommunication services, and tourism, growth in the labor force and employment levels outperformed most metropolitan areas in the state during the most recent recession. The latest monthly unemployment rate remains below the state-wide average. While there were job losses in manufacturing, Toyota Motor Manufacturing's recent announcement to build an $800 million manufacturing facility in San Antonio plus anticipated attendant businesses are expected to add a significant number of new manufacturing jobs. Taxable assessed valuations also continue to show steady annual gains.

After posting a significant operating deficit in fiscal 2002, the city's financial position recorded marked improvement in fiscal 2003, primarily due to a nearly $40 million increase in electric utility revenue transfers. Equal to 14% of its electric utility (City Public Service, or CPS) annual gross revenues, transfers spiked during fiscal 2003 due to increased electric sales associated with rising fuel costs, which were exacerbated by a four-month repair of one reactor at the South Texas Nuclear Project, part of which is owned by CPS (whose electric and gas systems revenue bonds are rated 'AA+' by Fitch). Despite the fact that sale tax receipts were below budget, the additional electric transfers contributed to an undesignated general fund balance representing 7% of expenditures and transfers out. Unaudited results for fiscal 2004 indicate a modest operating surplus.

The city's direct debt load is moderate. Annual general obligation debt issuances are expected to support the city's capital plan through fiscal 2006. A $115 million general obligation bond referendum was approved last year. The debt service portion of the tax rate is not expected to require significant adjustment to accommodate future borrowing. Principal amortization is rapid at over 70% in 10 years. The overall debt ratio is above average, primarily reflecting substantial borrowings by several area school districts. However, adjusting for state support for a sizable portion of school district debt reduces the overall debt level considerably.