FITCH RATES SAN ANTONIO, TX'S $250MM BONDS 'AAA'; OUTLOOK STABLE

Fitch Ratings-Austin-11 June 2010: Fitch Ratings assigns an 'AAA' rating to the following San Antonio, TX bonds:

--$201.9 million aggregate par in;
--general improvement bonds, series 2010A;
--general improvement bonds, taxable series 2010B (Direct Subsidy-Build America Bonds);
--$39.4 million combination tax and revenue certificates of obligation (COs), series 2010;
--$9.5 million tax notes, series 2010A.

The offerings are expected to sell via negotiation during the week of June 14, 2010.

In addition, Fitch affirms the following ratings:

--$1.1 billion in outstanding San Antonio, TX limited tax bonds at 'AAA'.

The Rating Outlook is Stable.

RATING RATIONALE:

--The city's favorable financial performance has been aided by management's focus on increasing efficiency and conservative budgeting, enabling the city to preserve its progress in implementing its enhanced financial reserve policies during the economic slowdown.
--The city's two-year budget strategy, in which a portion of reserves in excess of its fund balance policy are internally designated for next year's spending, has expanded its planning horizon.
--The city's solid debt profile is characterized by its low direct debt burden, moderately rapid payout, and ample debt service capacity within the current tax rate.
--The city's capital plan is aggressive but will allow the city to address its sizeable deferred capital needs.
--The city's population growth remains rapid, aided by affordable home prices and ample developable land, which until recently was fueling solid property tax base growth.
--Although the local economy has diversified notably, the military remains a major economic factor as evidenced by very large ongoing investments and planned additions to troop strength resulting from base realignment and closure decisions that have benefited the city.
--The contraction of the local economy has moderated somewhat, enabling the city's unemployment rate to remain well below state and national averages.

RATING DRIVER:

The maintenance of solid financial reserves, aided by the continued attention to cost controls, is key to preserving credit quality.

SECURITY:

All of the offerings are secured by an annual property tax levy, limited to $2.50 per $100 taxable assessed valuation (TAV). Additionally, the COs are also secured by a limited pledge of surplus net revenues from the city's municipal park system.

CREDIT SUMMARY:

The city's financial profile remains solid as evidenced by the maintenance of unreserved fund balances in excess of 20% since fiscal 2006, enabled by previously strong sales tax growth and positive City Public Service (CPS - electric and gas utility rated 'AA+' by Fitch) payment trends, along with management's aggressive cost controls in the form of annual personnel reductions. After growing by a five-year annual average of over 7%, sales taxes declined by 4.5% in fiscal 2009 due to the economic slowdown. Similarly, CPS transfers decreased by 9.6% in the same period due to the substantial decline in natural gas prices, which impacted CPS' gross revenues and payment amounts. Management's prompt mid-year budget adjustment enabled the city to close the resulting $49 million budget gap and actually post a modest surplus. Notably, in fiscal 2009, the city also added $11 million to its dedicated cushion, the reserve for revenue loss, increasing it to $80 million or 9% of appropriations. The city's goal to increase its dedicated reserves to 10% of spending by fiscal 2010 has been delayed due to current economic conditions. Apart from its reserve for revenue loss, the city has internally designated part of its fund balance as a two-year balanced budget reserve; for fiscal 2010, the city will use $27 million of this reserve to balance its operations. As a result, its remaining unreserved fund balance will total a still strong $152 million, equal to 17.3% of spending. Preliminary fiscal 2011 budget considerations include the use of $38 million in additional budgetary reserves, based on reasonable assumptions of sales tax and CPS payment trends, and keeping the 9% reserve fully funded. Additional budget reduction proposals, totaling $11 million, may reduce the level of budgetary reserves needed in fiscal 2011.

After growing by a five-year annual average of 10.3%, taxable values grew by under 1% in fiscal 2010, the result of declines in base valuations totaling 1.9%, netted against a 2.7% increase resulting from $1.8 billion in new improvements. Preliminary projections indicate fiscal 2011 may post a decline in base valuations, totaling 2.5% at most, as new improvement values are more than offset by losses in base values. The city's top 10 taxpayers comprise a modest 5% of TAV.

The current general improvement bond offerings represent the third installment of a $550 million authorization approved by voters in May 2007, the largest in the city's history. Intended to address the city's large deferred capital needs, the administration is proposing to seek voter authorization for a similar-sized program in fiscal 2012. All future debt will be sized to maintain the city's current debt service tax rate assuming modest tax base growth.

In a departure from its practice to issue 20-year debt, the 2010 BABs are structured with a 30-year maturity to maximize the amount of subsidies to the city. For this offering, the tax rate will be set to cover the BABs' debt service net of the direct subsidy. Credit concern over the potential for delayed or reduced BAB subsidies is offset by the modest amount of the subsidy ($2.8 million annual average), equal to 1.6% of total debt service expenditures, the large amount of reserves in the debt service fund balance ($84 million), and conservative TAV growth assumptions. In any case, the city plans to draw down its large debt service fund balance to maintain level tax rates as part of its overall capital plan, with a target of $25 million-$30 million for its debt service fund balance. With the longer maturity of the current offering, the principal payout rate will decline to 59% in 10 years, just modestly above average.

The impact of the proposed debt plans on the city's direct debt profile should be manageable given its low current levels, moderately above average payout rate, and expansive tax base. However, the city's already high overall debt burden may become burdensome, even after adjusting for state support of local school district debt. Debt service payments represent an above average 17% of combined general and debt service fund expenditures in fiscal 2009.

San Antonio is the second largest city in the state and seventh largest in the U.S., according to census information, with an estimated population of 1.4 million for 2010. Prominent sectors in the local economy are military and government employment, domestic and international trade, convention and tourism, medical and health care, financial services, and telecommunications. The economic slowdown has impacted local employment levels as evidenced by a growing unemployment rate that totaled 6.9% in April 2010. Nevertheless, the city's unemployment rate still compares favorably to state and national averages of 8.1% and 9.5%, respectively, for the same period. Major near-term job growth is expected from the relocation of Toyota's Tacoma production from California and the construction of the $2.2 billion San Antonio Military Medical Center which will bring 12,500 additional personnel to the city. As such, the demand for housing is expected to reduce the city's large inventory of existing homes for sale and fuel new construction as well.

Local Government General Obligation Bonds

The unlimited taxing power of most local government general obligation pledges is the broadest security a U.S. local government can provide to the repayment of its long-term borrowing and, therefore, is the best indicator of its overall credit quality. The average local government general obligation rating is 'AA', with approximately 85% rated at or above 'AA-' and 1% rated 'BBB+' or below. The relatively high ratings reflect local governments' inherent strengths: the authority to levy property taxes, nonpayment of which can result in property foreclosures; additional taxing power that can include sales, utility, and income taxes; and essentiality of and lack of competition for services provided by local governments. Those with low investment-grade or below-investment-grade ratings generally have a combination of a limited or highly volatile economic base, high levels of long-term liabilities, including debt and post-employment benefits, and/or unusually limited financial flexibility. For additional information on these ratings, see 'U.S. Local Government General Obligation Rating Guidelines,' dated Dec. 21, 2009 and available on Fitch's website at 'www.fitchratings.com'.

Applicable criteria available on Fitch's website at 'www.fitchratings.com' include:
'Tax-Supported Rating Criteria,' dated Dec. 21, 2009.
'U.S. Local Government Tax-Supported Rating Criteria,' dated Dec. 21, 2009.

Contact: Jose Acosta +1-512-215-3726 or Rebecca Moses +1-512-215-3739, Austin.

Media Relations: Brian Bertsch, New York, Tel: +1 212-908-0549, Email: brian.bertsch@fitchratings.com; Cindy Stoller, New York, Tel: +1 212 908 0526, Email: cindy.stoller@fitchratings.com.

Additional information is available at 'www.fitchratings.com'.

City of San Antonio, Texas

Primary Credit Analysts:
Kate Choban
Dallas
(1) 214-871-1420
kate_choban@
standardandpoors.com
Secondary Credit Analysts:
Horacio Aldrete-Sanchez
Dallas
(1) 214-871-1426
horacio_aldrete@
standardandpoors.com

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Credit Profile		
US$9.5 mil Tax Notes, Series 2010A, dated 6/01/2010, due 8/01/2013		
Long Term Rating	AAA / Stable	New
US$201.9 mil General Improvement Bonds, Taxable, (Direct Subsidy-Build America Bonds) Series 2010B, dated 6/01/2010, due 8/01/2040		
Long Term Rating	AAA / Stable	New
US$39.36 mil Combination Tax and Revenue Certificates of Obligation, Series 2010, dated 6/01/2010 due 8/01/2019		
Long Term Rating	AAA / Stable	New
US$. mil General Improvement Bonds, Series 2010A, dated 6/01/2010, due 8/01/2030		
Long Term Rating	AAA / Stable	New

Rationale

Standard & Poor's Ratings Services assigned its 'AAA' long-term rating to San Antonio, Texas' series 2010A general improvement bonds, taxable series 2010B general improvement bonds (direct subsidy- Build America Bonds), series 2010 combination tax and revenue certificates of obligation, and series 2010A tax notes. In addition, Standard & Poor's affirmed its 'AAA' long-term and underlying rating (SPUR) on the city's outstanding general obligation (GO) debt. The outlook on all ratings is stable.

The ratings reflect our view of the city's:

- Deep and increasingly diverse economy, which has allowed management to successfully manage the city's operations through previous economic cycles;
- Strong financial management policies, which include a comprehensive long-term financial and capital program;
- Very strong financial performance and position; and

- Moderately high overall debt burden.

The series 2010A and series 2010B general improvement bonds, the series 2010 certificates of obligation, and the series 2010A tax notes are secured by an annual ad valorem tax that the city will levy and collect within the limitations prescribed by law against all taxable property located within the city. The certificates are additionally secured by a lien on and pledge of a portion of the net revenues the city receives from its ownership and operation of its municipal parks system in an amount not to exceed $1,000. In addition, the city intends to issue the series 2010B general improvement bonds as federally taxable Build America Bonds (BABs), in which the city will receive a subsidy from the U.S. Treasury equal to 35% of the stated interest paid. The U.S. Treasury subsidy for BABs, if issued, will be paid directly to the city, and does not constitute security for the payment of principal or interest on the series 2010B bonds.

The general improvement bonds will be used to finance improvements to streets, bridges and sidewalks, drainage, libraries, parks, recreation, open space and athletics, and public health facilities. The certificates will be used to finance permanent public improvements and for other public purposes, to include improvements for police and fire, municipal facilities, parks and recreation, streets, drainage, riverwalk, libraries and golf courses. The tax notes will be used to finance projects related to infrastructure and information security, public safety and service systems, and finance and inspection compliance.

San Antonio, with almost 1.4 million residents, is Bexar County's seat and the nation's seventh-largest city. San Antonio continues to experience sustained growth in the manufacturing, tourism, and services sectors. While the military continues to be a key sector of the local economy, the opening of a Toyota Corp. manufacturing plant, along with several facilities in the information technology and health care sectors, has contributed to a growing diversity in employment opportunities and a significantly deeper economic base. Despite a slowdown in new construction, assessed valuation (AV) growth remained healthy in fiscal 2010, increasing by 0.9% from fiscal 2009's AV. The city's total AV is now slightly above $73 billion, up roughly 46.7% in the past five years. The city's employment base has exhibited, in our opinion, significant stability throughout the current recession, as evidenced by its 7.5% unemployment rate in March 2010, which remained significantly below the state and national averages.

We believe that San Antonio's financial position remains very strong. In fiscal 2008, the city reported an operating surplus of roughly $120.2 million, and an overall surplus (after $93.7 million in transfers to other funds) of $45.2 million. The unreserved general fund balance reached $190.7 million, or a very strong 25.8% of expenditures, at fiscal year-end 2008. Audited figures for fiscal 2009 reflect a year-end unreserved general fund balance of $190 million, or what we consider a very strong 24.9% of expenditures. For fiscal 2010, city management was able to close a projected $11 million revenue short-fall by implementing a 5% budget reduction and eliminating roughly 330 positions from the budget.

San Antonio's financial management practices are considered 'strong' under Standard & Poor's financial management assessment (FMA) methodology, indicating practices are strong, well embedded, and likely sustainable. The city's use of extensive long-range financial and capital planning, coupled with the adoption of strict reserve and expenditure control measures, is key to the 'strong' assessment.

Overall net debt is moderate at roughly $4,287 per capita and moderately high at 8.1% of market value. These figures include the city's overlapping debt, which consists primarily of school district debt that receives significant support for debt service payments from the state's supplemental aid programs. Debt service carrying charges are moderately high at 14.4% of total governmental funds expenditures. In May 2007, the electorate approved the city's $550 million bond program, which is the largest bond program the city has managed to date. The bulk of the bond program will address street and drainage needs. After these issuances, the city will have approximately $163 million of authorized and unissued bonds, which management plans to issue in various installments during the next few years.

Outlook

The stable outlook reflects San Antonio's expanding and increasingly diverse property tax base, solid financial performance and growing level of general fund reserves, which should allow management to successfully develop its capital program, and growing service delivery needs. The continued diversification of the city's economic and employment base, coupled with a steady increase in household wealth and income levels provides additional stability to the rating.

Finances: Strong Performance, Growing Reserves

San Antonio's financial performance remains strong, despite an anticipated revenue shortfall in fiscal 2010. In fiscal 2010, city management successfully closed a projected $11 million budget shortfall by reducing the overall budget by 5% relative to the fiscal 2009 budget. The cuts implemented included the elimination of 330 positions in the budget; however, no employee was laid off as a result of these cuts. The city was able to adopt a balanced 2010 budget while reducing the property tax rate by 2/10ths of 1 cent. For fiscal year 2010, the city forecasted growth in sales tax revenue of 1.2% above the fiscal year 2009 re-estimate. For the first quarter of fiscal 2010, sales tax collections were $900,000 (6.9% on average) below fiscal 2009 levels.

As it has been management's practice for the past two years, city staff prepared a two-year budget outlook, which includes fiscals 2010 and 2011. The projections for fiscal 2011 include another anticipated gap of roughly $11 million, which the city council will need to address once the budget is adopted later this year. However, management has already identified potential reductions to address the anticipated budget gap. Both the fiscal 2010 budget and the projected fiscal 2011 budget maintain the city's contingency reserves at the adopted policy of 9% of budget.

The general fund continues to rely on contributions from the city's electric utility (San Antonio City Public Service, 'AA/Stable'), which is the largest source of general fund revenue, and accounted for about 33% of total general fund revenues in fiscal 2009. While the utility has moved into a deregulated environment, its favorable and competitive position mitigates concerns on the city's dependence on these transfers. The maximum amount in cash to be transferred to the city's general fund from the net revenues of CPS Energy cannot exceed 14% of the gross revenues of the utility, less the value of gas and electric services used by the city for municipal purposes and street lighting system.

Capital Improvement Program: Needs Are Significant

Management has identified roughly $2.2 billion in capital needs to be funded in the next 15 years. The $550 million bond program authorized by the voters in May 2007 will address a portion of these needs without requiring a tax rate increase. Management intends to fund the remainder of its identified capital needs through a combination of non-voter authorized certificates of obligation, and future potential bond elections.

The 2007 bond program will fund the following capital projects:

- $306.9 million for streets, bridges and sidewalk improvements (43 projects);
- $152 million for drainage improvements (26 projects);
- $79.1 million for parks, recreation, open space and athletics improvements (69 projects);
- $11 million for library improvements (11 projects); and
- $800,000 for public health facilities (2 projects).

City management anticipates issuing its remaining GO authorization in the summer of 2011. In addition, city officials plan to continue to supplement its bond program with the issuance of tax notes and certificates of obligation, including roughly $179 million to be issued in the summer of 2012 for capital projects. Future bond elections are planned for fall 2012 (approximately $596 million), and fall 2017 (approximately $370 million).

Financial Management Assessment: Strong

San Antonio's financial management practices are considered 'strong' under Standard & Poor's FMA methodology, indicating practices are strong, well embedded, and likely sustainable.

State statutes and internally developed policies guide long-term financial and capital planning, debt management, and investing. In addition to its internal resources, San Antonio's revenue estimates for budget forecasting have been based on a number of outside data sources and economic forecasting firms. In addition, budget priorities incorporate considerable input from the city's residents, developed through open-budget sessions. Officials prepare monthly revenue and expenditure reports measured against the budget. In addition, city officials are implementing a new budget and financial operating system that will allow a more timely and efficient tracking of the city's financial operations. Management annually prepares a five-year financial forecast that is linked to the annual operating and capital budget. Investment of city funds is based on the city's investment policy, which complies with stringent state statutes. Dedicated staff monitor investments and generate reports quarterly.

While the city's goal is to achieve and maintain a budgetary reserve of approximately 10% of general fund appropriations, the reserve has been maintained at 9% given economic conditions. While the city does not have a formal debt management policy, officials closely evaluate and monitor debt issuance. Management evaluates several key variables that guide its issuance of debt, including the tax rate's stability, a 20-year maturity profile, and an average life of between seven and nine years for debt.

The city has not entered into derivatives to hedge its GO debt outstanding, and management plans to develop a swap management policy before considering the use of derivatives.

Pension And Other Post-Employment Benefit (OPEB) Liabilities

San Antonio provides two pension benefit plans to its employees: the Texas Municipal Retirement System (TMRS) and the Fire and Police Pension Fund. The city conducts an annual actuarial valuation on both funds. Based on these actuarial valuations, the unfunded actuarial accrued liability (UAAL) of the fire and police pension plan as of Oct. 1, 2009, was $275.7 million. The Texas Municipal Retirement System's UAAL as of Dec. 31, 2009, was $188.0 million.

In addition to pension benefits, the city provides all retired employees with certain health benefits under two post-employment retirement benefit programs.

The first program provides benefits for all non-uniformed city retirees, and for all pre-Oct. 1, 1989, uniformed (fire and police) retirees. Based on a review, certain changes were made to the retirement health plan and were approved on Sept. 7, 2006, as a component of the city's fiscal year 2007 adopted budget. These changes resulted in a reduction of the UAAL from $581.3 million to approximately $400.0 million. Based on a recently completed actuarial valuation, as of Jan. 1, 2009, the UAAL was projected at $342.0 million.

The second program provides retirement healthcare benefits to the city's fire fighters and police officers who retired on or after Oct. 1, 1989. The benefits of this plan are financed on a pre-funded basis. After legislative changes were made to the plan in 2007, the estimated UAAL as of Oct. 1, 2009 was $349.1 million. The program does not have a short-term financing problem.

While House Bill 2365 gives local governments in Texas the option to not comply with GASB 45, management has decide to adopt GASB 45 and reported the unfunded OPEB liability as part of its fiscal 2008 audit report.

Related Criteria And Research

USPF Criteria: GO Debt, Oct. 12, 2006

Ratings Detail (As Of 14-Jun-2010)		
Outstanding General Obligation Bonds, Various Series		
Long Term Rating	AAA / Stable	Affirmed
Outstanding General Obligation Bonds, Series 2004, 2006		
Unenhanced Rating	AAA (SPUR) / Stable	Affirmed
Many issues are enhanced by bond insurance.		