FitchRatings

FITCH RATES SAN ANTONIO (TX) PFC LEASE REV BONDS 'AA'; OUTLOOK STABLE

Fitch Ratings-Austin-03 October 2012: Fitch Ratings assigns an 'AA' rating to the following San Antonio, Texas bonds:

--$519.5 million Public Facilities Corporation (PFC) improvement and refunding lease revenue bonds, series 2012 (Convention Center Refinancing and Expansion Project).

The bonds are scheduled to sell via negotiation during the week of Oct. 8, 2012. Bond proceeds will be used to refund all outstanding hotel occupancy tax (HOT) bonds and finance the expansion costs of the convention center.

In addition, Fitch affirms the following ratings:

--$1.018 billion limited tax bonds at 'AAA';
--$334.6 million combination tax and revenue certificates of obligation (COs) at 'AAA';
--$32 million tax notes at 'AAA';
--$21.3 million (Starbright Industrial Development Corp.) contract revenue bonds, series 2003 at 'AA+';
--$35.8 million municipal facilities corporation (MFC) lease revenue bonds affirmed at 'AA+';

The Rating Outlook is Stable.

SECURITY

The PFC lease revenue bonds are secured by annually appropriated lease payments made by the city to the PFC. The limited tax bonds, COs, and tax notes are secured by an annual property tax levy, limited to $2.50 per $100 taxable assessed valuation (TAV). The COs are additionally payable from a limited pledge of net revenues of the city's municipal parks system. The MFC lease revenue bonds are secured by annually appropriated lease payments made by the city to the MFC. The contract revenue bonds are special obligations of the San Antonio Starbright Industrial Development Corporation and are payable from pledged contract payments from the city containing payments from its electric and gas utility, Central Public Service (CPS).

KEY RATING DRIVERS

STRONG FINANCIAL RESERVES: San Antonio'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 enhanced financial reserve policies during the economic slowdown. Fitch favorably views the city's two-year budget strategy, which has expanded its planning horizon.

LARGE CAPITAL PLANS: The city's debt profile is mixed, characterized by its above-average overall debt burden, balanced against rapid limited tax bond amortization 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.

CONVENTION CENTER NOT ESSENTIAL TO CORE OPERATIONS: Although important to the city's economy, the leased asset (convention center) is not considered essential to the city's core governmental operations according to Fitch published rating criteria, leading to a two-notch distinction between the PFC lease revenue bonds and the city's limited tax bonds. However, Fitch does note the statutory requirement that convention center expansion costs are the sole eligible use of 2% expansion HOT receipts, which provide an incentive to the city to make full and timely annual appropriations.

CONVENTION CENTER DEBT: HOTs, the planned source of repayment for the PFC convention center project lease revenue bonds, are subject to economic volatility but benefit from the city's large convention and visitor industry which markets to both regional and national audiences. The inventory of hotel rooms grew by a notable 26% from 2007-2011 and additional hotels are under construction (although the city's conservative forecast points to modest future growth, which Fitch views favorably).

HIGH STARBRIGHT DEBT SERVICE COVERAGE: Electric and gas utility payments to the city provide very high debt service coverage for the Starbright Industrial Development Corporation's contract revenue bonds. Additionally, the bonds' contract terms and legal covenants are sound and no additional leveraging is planned.

MILITARY REMAINS KEY SECTOR: Although the local economy has diversified notably, the military remains a major economic factor. This is evidenced by very large ongoing investments and planned additions to troop strength resulting from base realignment and closure decisions that have benefited the city.

STABLE ECONOMY: The recessionary contraction of the local economy has begun to reverse course, enabling the city's unemployment rate to remain well below state and national averages. The city's population growth remains rapid, aided by affordable home prices and ample developable land.

CREDIT PROFILE

Large Financial Reserves
The city's financial profile remains solid as evidenced by the maintenance of unreserved fund balances in excess of 20% of spending since fiscal 2006, well above its 9% fund balance policy level. Additions to fund balance had been enabled by previously strong sales tax growth and positive CPS (electric and gas utility rated 'AA+' by Fitch) payment trends, along with management's aggressive cost controls mainly in the form of annual personnel reductions.

Two-Year Budget Strategy
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. A sizeable $83.4 million of such reserves was budgeted for use in fiscal 2011, although greater than projected sales tax receipts and CPS transfers precluded the need for using any of the reserve and led to a modest increase in the fund balance.

Sales tax receipts grew by 6.1% in fiscal 2011, exceeding the budget's modest 1% growth estimate, and CPS payments increased moderately due to a very hot summer and a rate hike. As a result, the unrestricted fund balance totaled a strong $226.6 million or 25.1% of operating expenditures and transfers out. A portion of this fund balance, $83.4 million, is designated as the city's 9% reserve.

Current Year's Progress and Fiscal 2013 Budget
Due to conservative revenue projections and continued cost controls, projected fiscal 2012 results are also favorable. Despite a projected $26.8 million operating deficit (equal to 2.8% of spending), the planned drawdown is well below the $76.9 million two-year budget reserve allocated to close the fiscal 2012 budget gap. As a result, the two-year budget reserve will remain mostly intact for fiscal 2013 at $66.4 million. The resulting projected unrestricted fund balance for fiscal 2012 equals a still strong $200 million or 21.2% of spending, notably better than the budgeted level of 15.9%.

The proposed fiscal 2013 budget, aided by the appropriation of $66.4 million of the two-year budget reserve (equal to 6.8% of appropriations), is balanced at a level property tax rate and assumes a reasonable sales tax growth projection of 3%. The budget also allocates a more modest $6.6 million of reserves for fiscal 2014, reducing the projected budget gap to $36 million, equal to a modest 3.6% of planned fiscal 2014 expenditures.

Large Capital Needs

This summer, the city issued the first installment of the $596 million general obligation bond authorization approved by voters in May 2012. As the largest bond authorization in the city's history, it is intended to address the city's substantial deferred capital needs. According to the management, all future debt will be sized and timed to maintain the city's current debt service tax rate assuming modest tax base growth.

Manageable Debt Profile

The impact of the 2012 bond program on the city's direct debt profile should be manageable given its low current levels, favorable pay-out rate, and expansive tax base. The rapid pay-out rate, at 65% of limited tax bond principal in ten years, is reflected in sizable annual debt payments, which in fiscal 2011 were above average at 18.5% of general government spending. Including the current offering, the city's overall debt burden is above average at $3,251 per capita and 5.3% of market value after adjusting for substantial state support of local school district debt.

Convention Center Expansion Project

The current offering will finance the expansion of its convention center and refund all of the city's outstanding HOT debt issued to finance previous improvements to the facility. Although secured by an annual appropriation of all legally available funds, the city plans to fund lease payments primarily with HOT receipts.

Fitch notes that the refunding represents a substantial restructuring of HOT debt in which the final maturity is extended by eight years, principal payments are deferred for the first four years, and principal payments are heavily back-loaded. As a result, principal amortization is negligible in the first 10 years at only 2.6%, which Fitch views negatively. The structure allows debt service carrying costs to rise to manageable levels during the first 10 years, providing ample time for HOT receipts to grow in the interim.

In the absence of a debt service reserve fund, the city council approved the funding of two contingency funds as part of its HOT financial policy. The funds consist of a $47 million lease payment contingency fund and a $15 million operating contingency fund for the convention center, both considered important features by Fitch.

Appropriation Risk Affected by Nature of Leased Asset

The leased asset, the convention center, is not considered essential to core governmental operations by Fitch and serves as the basis for the two-notch distinction from the city's 'AAA' rating on its limited tax bonds. Also, the bonds' somewhat weak legal provisions do not include a mortgage interest for the trustee in the event of non-appropriation.

The non-appropriation of base rental payments requires the city to vacate the leased asset by the end of the last fiscal year for which lease payments were funded. Fitch notes that the principal planned repayment source, the 2% expansion HOT, can only be used for convention center expansion costs by state statute, minimizing the incentive for the city to withhold any annual appropriation.

HOT Growth Projection Reasonable

In addition to the 2% expansion HOT, the plan of finance also relies on a portion of the annual growth in the city's 7% general HOT. The city's 30-year projection of HOT receipts forecasts long-term annual HOT growth of 3.37% based on modest annual increases in new hotel room additions, available room nights, and daily room rates.

The 7% general HOT revenues fund the city's community and visitor's facility fund, which includes the operations of the convention center facilities, the convention and visitor's bureau, the Alamodome, international affairs, cultural affairs, outside arts agencies, and other convention/tourist-related activities. Aided by the two HOT contingency funds, Fitch notes that the two HOT sources are sufficient to withstand considerable economic impact, including another deep recession in the early years followed by a slower economic recovery.

Military Still Key Within Broad Economy

San Antonio is the second largest city in the state and seventh largest in the U.S., with an estimated population of 1.3 million for 2012. 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. Aided by considerable growth in energy sector jobs, the city's unemployment rate declined to 7.3% in July 2012, down from the 8.1% level recorded in July 2011.

The city's unemployment rate compares favorably to state and national averages of 7.5% and 8.6%, respectively, for the same period. The city's construction sector has benefited from several large projects, including the recent completion of the $3.2 billion San Antonio Military Medical Center, which was accompanied by approximately 12,500 additional military personnel to the city. After posting strong annual gains through fiscal 2009, the city's taxable values have flattened through fiscal 2013 as new improvement values have been offset by reappraisal losses in existing values.

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Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

In addition to the sources of information identified in the Tax-Supported Rating Criteria, this action was informed by information from CreditScope, University Financial Associates, S&P/Case Shiller Home Price Index, HIS Global Insight, Zillow.com, and National Association of Realtors.

Applicable Criteria and Related Research:
'Tax-Supported Rating Criteria', Aug. 14, 2012;
'U.S. Local Government Tax-Supported Rating Criteria', Aug. 14, 2012.

Applicable Criteria and Related Research:
Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. Local Government Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314

STANDARD & POOR'S
RATINGS SERVICES

RatingsDirect®

San Antonio Public Facilities Corporation, Texas
San Antonio; Appropriations; General Obligation

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Table Of Contents

San Antonio Public Facilities Corporation, Texas
San Antonio; Appropriations; General Obligation

Credit Profile		
US$585.0 mil imp and rfdg lse rev bnds (Convention Center Refinancing and Expansion Proj) ser 2012		
Long Term Rating	AA+/Stable	New
San Antonio GO		
Long Term Rating	AAA/Stable	Affirmed
San Antonio GO		
Unenhanced Rating	AAA(SPUR)/Stable	Affirmed
San Antonio Mun Facs Corp, Texas		
San Antonio, Texas		
San Antonio Mun Facs Corp (San Antonio) (Pub Safety Answering Point Proj)		
Long Term Rating	AA+/Stable	Affirmed
San Antonio (Mun Facs Corp) (Dev and Bus Svcs Ctr Proj)		
Long Term Rating	AA+/Stable	Affirmed
San Antonio Mun Fac Corp lse rev bnds		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Starbright Indl Dev Corp, Texas		
San Antonio, Texas		
Starbright Indl Dev Corp (San Antonio) (Starbright Proj)		
Long Term Rating	AA+/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services assigned its 'AA+' long-term rating to San Antonio Public Facilities Corporation, Texas' series 2012 improvement and refunding lease revenue bonds, issued for San Antonio. At the same time, Standard & Poor's affirmed its 'AAA' underlying rating (SPUR) on the city's general obligation (GO) debt outstanding and its 'AA+' rating and SPUR on the city's appropriation debt outstanding. 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 maintain stable financial operations through recessionary cycles;
- Very strong financial performance and position;
- Strong financial management policies, which include a comprehensive long-term financial and capital program; and
- Moderately high overall debt burden as a percent of market value.

The 'AA+' rating on the series 2012 improvement and refunding lease revenue bonds also reflects our opinion of:

- The general creditworthiness of the city as obligor, and
- The appropriation risk associated with lease revenue bonds.

The city and the corporation will enter into a lease agreement dated Oct. 1, 2012. Under this lease agreement the corporation will obtain a leasehold interest in the city's convention center facilities and immediately sublease the facilities back to the city through the sublease agreement. The bonds are then secured by and payable from the trust estate, which consists primarily of lease payments to be made by the city to the corporation pursuant to the sublease. The obligation of the city to make lease payments is a current expense, payable solely from funds annually appropriated by the city for such use. The sources of payment for the lease payments include to hotel occupancy tax receipts, sales and use tax collections that are not for a dedicated purpose, utility transfers, ad valorem tax collections not levied for GO debt payments, and any other lawfully available funds. Lease payments are due each March 5 and Sept. 5 (or the next business day thereafter if the due date is not a business day). Bond proceeds will be used primarily to refund all outstanding city indebtedness issued to finance or refinance the existing convention center, and to finance the acquisition, construction, and equipping of the proposed expansion of the existing convention center.

San Antonio, with approximately 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 expansion of the production capacity at 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. In addition, continued drilling activity at the Eagle Ford Shale has also resulted in increased economic activity in San Antonio, as several energy companies have established satellite operations in the city. The increased economic activity is also reflected in the improvement of two factors that we consider key from an economic standpoint: First, according to the Federal Reserve Bank of Dallas, the San Antonio metropolitan area had an unemployment rate of 6.8% as of July 2012, which was below both the state's and national rates of 7.2% and 8.3%, respectively. Second, the city's taxable assessed valuation experienced a modest, 1.6% increase in fiscal year 2013, growing to approximately $71.84 billion.

We believe that San Antonio's financial performance and position remain very strong. In fiscal year 2011, the city reported an operating surplus in the general fund of $26.3 million and an overall surplus (after $40.9 million in net transfers out to other funds) of $1.8 million. In our view, the fiscal year end 2011 total available general fund balance of $178 million is very strong, at 21% of operational expenditures. For fiscal year 2012 city officials estimate an ending fund balance equal to about 22% of operational expenditures. The city has adopted a balanced budget for fiscal 2013. City officials expect to maintain available reserves well in excess of the formally approved budget reserve minimum of 9% of expenditures. We believe that the city's policy of producing five-year financial forecasts and maintenance of a comprehensive two-year balanced budget strategy have enhanced officials' ability to anticipate and address potential budget gaps on a timely basis.

The general fund continues to rely on contributions from the city's electric utility (San Antonio Public Service Authority, AA/Stable), which are the largest source of general fund revenue and are projected to account for about 31% of total general fund revenues in fiscal year 2012. While the utility has moved into a deregulated environment, we believe that its favorable and competitive position mitigates the risks with 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 its street lighting system.

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. Highlights of the city's practices include the city's use of extensive long-range financial and capital planning, as well as the adoption of strict reserve and expenditure control measures.

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, 2011 was $242.7 million, which represented a 90.6% funded ratio. The city's UAAL related to the TMRS was $95.1 million as of Dec. 31, 2011, equivalent to a 91.6% funded ratio, which is significantly higher than the 73.3% funded ratio identified in the Dec. 31, 2009 actuarial valuation. An improving investment portfolio performance and the elimination of annual repeating cost-of-living adjustments are some of the reasons for the reduction in the city's unfunded pension liability. According to the TMRS' latest actuarial valuation, the city's expected contributions for fiscal year 2012 will be reduced to 10.05% of covered payroll from 12.6% in fiscal year 2011.

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

The first program provides benefits for all nonuniformed 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 to approximately $400 million from $581.3 million. Based on a recently completed actuarial valuation, performed Jan. 1, 2011 the UAAL was projected at $324.5 million.

The second program provides retirement health care 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 prefunded basis. After legislative changes were made to the plan in 2007, the estimated UAAL as of Oct. 1, 2011 was $403.6 million.

While House Bill 2365 gives local governments in Texas the option to not comply with GASB 45, management decided to adopt GASB 45 and reported the unfunded other postretirement employee benefits liability as part of its financial reports.

We consider the city's overall net debt levels moderate at approximately $4,725 per capita and moderately high at 9.0% 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. In our opinion, the city's debt service carrying charges are moderate, at 13% of total governmental funds expenditures. On May 12, 2012 the voters authorized a bond program, totaling $596 million, to fund improvements to streets, bridges, drainage and flood control systems, parks and recreation, libraries and museums, and public safety facilities. The city currently has approximately $523.8 million of authorized and unissued bonds, which management plans to issue in various installments during the next few years. City officials expect that the current authorization will meet the city's capital needs through 2017.

Outlook

The stable outlook reflects our view of San Antonio's deep and increasingly diverse property tax base, solid financial performance, and very strong level of general fund reserves, which will likely allow management to successfully develop its capital program and meet growing service delivery needs. We do not expect to change the ratings within the next two years given our view of the continued diversification of the city's economic and employment base, and of management's strong financial management practices.

Convention Center Expansion Project

San Antonio's convention center facilities were first constructed in 1968 as part of the HemisFair World's Fair. Since then the facilities have undergone three expansions. Currently the facilities host more than 300 events per year with an estimated 750,000 delegates annually. The city's rationale for the current expansion has several key components: There is strong market demand for space, the expansion will create uniform quality throughout the facilities, it will create contiguous exhibit halls and optimally distribute meeting space, the facilities will be modernized to meet the market's future needs, and it will enhance the convention district as a whole. A key enhancement from the expansion will be the extension of the contiguous exhibit space to 521,308 square feet from about 426,600 square feet. Construction is currently estimated to be completed by April 2016.

Related Criteria And Research

- USPF Criteria: GO Debt, Oct. 12, 2006
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007
- State And Local Government Ratings Are Not Directly Constrained By That Of The U.S. Sovereign, Aug. 8, 2011

MOODY'S INVESTORS SERVICE

New Issue: Moody's Investors Service has assigned a Aa2 rating to the City of San Antonio (TX) Public Facilities Corporation's $519.5 million Improvement and Refunding Lease Revenue Bonds Series 2012 (Convention Center Refinancing and Expansion Project)

Global Credit Research - 03 Oct 2012

NOTE: On October 5, 2012 the report was revised as follows: Correction to text: Under the Solid Financial Operations... section, in the second paragraph, second sentence. The sentence has been corrected to reflect the amount CPS Energy accounts for of the total utility system revenues. The amount was changed to $298 million from $204 million. The sentence now reads, "The city's electric utility, CPS Energy (Aa1 revenue rating) accounted for a majority of the utility system revenues with $298 million (total revenue from utilities was $308.4 million)." Revised release follows.

Outlook remains negative

SAN ANTONIO (CITY OF) TX
Cities (including Towns, Villages and Townships)
TX

Moody's Rating

ISSUE		RATING
Public Facilities Corporation Improvement and Refunding Lease Revenue Bonds, Series 2012 (Convention Center Financing and Expansion Project)		Aa2
Sale Amount	$519,510,000	
Expected Sale Date	10/10/12	
Rating Description	Lease Rental: Appropriation	

Moody's Outlook NEG

Opinion

NEW YORK, October 03, 2012 --Moody's Investors Service has assigned a Aa2 rating to the City of San Antonio (TX) Public Facilities Corporation's $519.5 million Improvement and Refunding Lease Revenue Bonds Series 2012 (Convention Center Refinancing and Expansion Project). The outlook is negative. A portion ($253.1 million) of the proceeds of the sale will be used to refund the city's existing hotel occupancy tax (HOT) debt. The remaining portion ($325 million) will be used to fund the expansion of the existing Convention Center.

SUMMARY RATING RATIONALE

The lease revenue bonds are secured by lease payments which will be made by the city to the trustee for the benefit of the corporation. The obligation of the city to make the lease payment is a current expense of the city, payable solely from legally available funds subject to annual appropriation.

The City of San Antonio (TX) is rated Aaa/negative outlook. Assignment of the Aa2 ratings reflect the sizeable regional economy that is driven by diverse industries and anchored by an expanding military presence but challenged by somewhat depressed socio demographic indicators. The ratings also reflect a history of surplus operations that have bolstered reserves, expectations for moderate draws on reserves largely for operational needs, strong fiscal management practices that include multi-year forecasting and conservative budgeting practices. The Aa2 rating considers the general fund appropriation risk, the essentiality of the project to the city's economy and the limited impact of debt service payments on the general fund. The rating assignment also incorporates the city's plan to make lease payments specifically from hotel occupancy tax (HOT) revenues and the city's contingency to manage volatility in the revenue stream.

Moody's negative outlook on San Antonio's Aaa rating is due to its indirect linkages to the weakened credit profile of the U.S. government. The negative outlook relates to Moody's August 2, 2011 decision to confirm the Aaa government bond rating of the United States and assign a negative outlook, and to our December 7, 2011 assessment of San Antonio's exposure to indirect linkages to the federal government. Moody's has determined that issuers with indirect linkages, such as San Antonio, have some combination of economies that are highly dependent on federal employment and spending, a significant healthcare presence in their economies, have direct healthcare operations, or high levels of short-term and puttable debt. Please see the special comment from December 7, 2011 entitled "Most Aaa-Rated State and Local Governments Revert to Stable Outlooks, Despite Negative Pressure on U.S. Government Rating" for more information.

STRENGTHS

Sizeable regional economy that remained relatively stable through economic downturn

Strong financial management practices demonstrated by a history of surplus operations and adequate reserves

CHALLENGES

Somewhat depressed socio demographic indicators

Operating pressures associated with large population and demand for services

Dependence on potentially volatile revenue streams such as utility transfer and sales tax

DETAILED CREDIT DISCUSSION

LEASE REVENUE PAYMENT WILL BE A CURRENT EXPENSE OF THE CITY

The current issue is secured by lawfully available revenues of the city subject to annual appropriation. Debt service will be paid by the city in the form of lease payments that will be remitted to the trustee for the account of the corporation. Lease payments will be paid on March 5th and September 5th in anticipation of the March 15th, and September 15th debt service payment dates. The pro forma includes an ascending debt service schedule with the maximum annual debt service (MADS) of $67.2 million scheduled for fiscal year 2042. Based on fiscal year 2011 audited numbers, MADS would account for 7.4% of revenues. On an average annual basis, the debt service payment is $39.3 million (4.3% of fiscal year 2011 General Fund revenues). We believe the lease revenue payment is a limited portion of the city's budget. Failure of the city to appropriate revenues to make debt service payment will result in a loss of the operations of the convention center, the impact of which will be detrimental.

Although debt service is secured by available General Fund revenues, the city intends to make debt service payments through hotel occupancy tax (HOT) revenues. Currently, the city levies a total of 9% hotel occupancy tax, which includes the 7% general HOT and the 2% expansion HOT, on every hotel room city wide. HOT taxes have historically grown an annual average of 4.7% between 1995 and 2011. For the debt service purposes, the city intends to cap the base HOT year as fiscal year 2012, where debt service will be paid from a combination of a portion (about 1/3) of incremental 7% general HOT revenues in each year following the base year, and the entire 2% HOT revenues. With projections including a 3% assumption in HOT, revenues are excepted to be sum sufficient. In the event revenues decline, the city has set aside a contingency which includes two funds that totaled $61.6 million at fiscal year-end 2011. The funds are made up of $46.6 million in lease payment contingency and $15 million in operating fund contingency. The two funds have largely been accumulated with excess HOT revenues in prior years years. Although the bonds are still ultimately secured by lawfully available revenues, maintenance of the contingency fund demonstrates prudent financial management.

DIVERSE ECONOMY WITH TOURISM BEING A MAIN STAPLE OF THE ECONOMY; TAXABLE VALUES APPEAR TO BE ON A SLOW REBOUND FOLLOWING THE ECONOMIC DOWNTURN THAT RESULTED IN MODEST CONTRACTION

Per the 2010 U.S. Census, the City of San Antonio is the seventh largest city in the United States and the second largest city in the state following the City of Houston (GO Aa2 Stable). In the last ten years the population increased by 16% to 1.3 million. San Antonio's economy is diverse with a mix of military, hospitality, financial, healthcare and aerospace industries. The hospitality industry which includes a mix of tourism and conventions remains a staple of the economy with officials estimating that the industry accounts for approximately 16% of the city's General Fund revenues. Per officials, the hospitality industry also employs 106,311 individuals (about 16.8% of the total labor force) with an annual economic impact of $11 billion, a 71.8% increase over the previous 10 years. The Henry B.

Gonzalez Convention Center (the existing convention center) is located in the downtown area of the city, on the River Walk adjacent to the tourism district and HemisFair Park. Currently, the amount of prime contiguous space in the center makes it the 23rd ranking facility in the nation. The city proposed expansion will enable the city to become more attractive in competing for convention packages. With the expansion, the city expects to rank 9th in the nation in amount of prime contiguous space.

San Antonio's unemployment has historically tracked well below the state and nation. As of June 2012, the unemployment rate of 7.3% was below the state's 7.6% and the nation's 8.4% taken during the same time period. Socioeconomic indicators within the city remain below national averages reflecting institutional presence by way of the military and higher education. The Moody's Economy.com July 2012 report also notes, "The San Antonio economy will continue to advance in the near term, supported by expansion of the Eagle Ford shale energy industry and gradual gains in the national economy. The drag from local government cutbacks will dissipate. Additionally, the concentration of military cyber security and medical activity, growth in commercial aerospace, and above-average population gains will contribute to above average performance."

Prior to the economic downturn, taxable values grew by double digits between fiscal years 2007 and 2009. Since then, taxable values have exhibited slowed growth, growing by a modest 0.3% in fiscal year 2010, before contracting by 2.4% and 0.4% respectively in 2011 and 2012. However, taxable values appear to be on the rebound with fiscal year 2013 recording modest growth of 1.6% to $71.8 billion. The increase of $900 million in new construction as well as an increase of $238 million in reappraisals. Given the nature and diversity of the economy, we expect that taxable values will continue to grow, albeit at modest levels over the near to medium term.

SOLID FINANCIAL OPERATIONS CONTINUE WITH PRUDENT FISCAL MANAGEMENT; OPERATING DEFICITS EXPECTED IN THE NEAR TERM

The city's management team has developed and implemented strong financial management practices demonstrated by long-term planning, financial reserve policies, and a two year balanced budget approach strengthened by an annual mid-year budget review process. These practices have resulted in a positive historical financial trend. With the exception of fiscal year 2007 when a slight deficit of $1.8 million was posted, the city has operated in a surplus position adding a net of $72.9 million to reserves between fiscal years 2007 and 2011. On a GAAP basis, fund balances have ranged from 20.7% at FYE 2007 to FYE 2011's fund balance of 25.7%. Cash balances have been weaker, with an 11.2% of General Fund revenues ($100.9 million) cash position recorded at FYE 2011. Of the $232.6 million reported as the total General Fund balance at fiscal year end 2011, $84.7 million fulfills the city's 9% reserve policy, while $87.3 million was available for appropriation, and $60.6 million was for encumbrances. Preliminary estimates for fiscal year 2012 include a draw that will reduce the total General Fund balance to $205.8 million (22.7% of fiscal year 2011 General Fund revenues), with $84 million fulfilling the reserve policy and $68.6 million available for appropriation. Through the two year budget planning exercise, the city has incorporated the use of the $68.6 million set aside for future budgets to balance the budget. With the current plan, officials expect to use a little over $60 million to balance the fiscal year 2013 budget, with the remaining portion (about $6.6 million) to balance the fiscal year 2014 budget. The city has a history of budgeting with draws from reserves, although revenues have typically outpaced expenditures and expenditures have been tightly monitored, resulting in favorable operations. However, pressured operations resulting in significantly lower reserve levels is a credit weakness and will place downward pressure on the rating. Additionally, even though the city has consistently maintained reserves at or above its current 9% policy, we note that the policy remains weaker for similarly rated Aaa credits.

The city's general fund operations are supported primarily by revenues from the city's utility systems which contributed approximately 34.1% of the revenue mix in fiscal year 2011. The city's electric utility, CPS Energy (Aa1 revenue rating) accounted for a majority of the utility system revenues with $298 million (total revenue from utilities was $308.4 million). CPS revenues are based on a percent of CPS returns which can fluctuate due to weather patterns and energy prices. The city takes measures to smooth revenue projections and match potential non-recurring spikes to one-time capital projects. Ad valorem revenues comprised an additional 26.8% while sales taxes (including general and selective sales tax) comprise 22.8% of total General Fund revenues. In fiscal year 2011, utility system revenues and sales tax revenues were up 5.4% and 5.9% respectively due to high natural gas prices, and an improved economy. However, ad valorem taxes were down 1.9% reflecting declined taxable values. The fiscal year 2013 budget includes modest decline of 2.6% in utility revenues, and increases of 1.6% and 3% in ad valorem and sales taxes respectively.

The 2011 CAFR reflects a pension liability of $231.1 million for the Police and Fire pension plan and a $100.4 million unfunded liability for the civilian plan funded through the Texas Municipal Retirement System (TMRS). The public safety and TMRS plans have solid funding levels of 90.7% and 90.6% respectively. The city has met 100%

of the annual required contribution (ARC) for both plans. The combined FY 2011 ARC payments were a manageable 11.2% of fiscal year 2011 general fund revenues. In 2010 the city took measures to reduce the TMRS pension liability and "turned off" the funding of the automatic cost of living increase to current retirees. The city also has OPEB liabilities for both civilian and uniform of a combined total of approximately $712 million. The city has also implemented cost-reducing measures to manage the unfunded OPEB liability. In addition, to establishing a 30 year amortization schedule and fully fund the ARC, the city plans to increase their contributed portion in 2018. The estimated increases are manageable and do not pose a significant impact to city finances. We view the city's actions to address the long-term liabilities as favorable and demonstrative of strong fiscal management practices. Additionally, the funding levels appear to be consistent with other highly rated cities.

The city's strong fiscal management is a key factor in the high quality rating. Management continues to demonstrate a willingness and ability to implement budget adjustments necessary to maintain solid reserves consistent with the rating. Additionally, the long term financial planning reflects management's commitment to remain fiscally sound despite challenges to key revenues.

DEBT PLANNING DESIGNED FOR THE LONG TERM

The City's management team has designed a long term capital improvement planning (CIP) program that is updated annually. The CIP includes plans for future debt issuances in order to meet ongoing capital needs. The current debt plan forecasts future bond elections for ongoing capital needs. The debt plan also includes the annual issuance of Certificates of Obligation for public safety improvements, streets, drainage, parks, and other city improvements. Currently, the city has no immediate plans for additional lease revenue debt, and expect the current proceeds will complete the convention center project.

Inclusive of the current issue, the city's direct debt burden remains moderate at 3% (10.2% overall) on a fiscal year 2012 valuation. Much of this overlapping debt is from several school districts in the city that have issued large amounts of debt to keep up with student enrollment growth and / or aging facilities. Many of these school districts receive as much as 60% to 80% of funding from the State to pay for debt service; therefore, the overall debt burden is somewhat inflated when taking this into consideration. Principal payout of the current issue is sluggish with less than 10% of principal retired in 10 years, given the ascending debt service schedule. However, principal payout on the city's total indebtedness is approximately 60%. Typically, the city's practice is to schedule debt retirement within 20 years of the issuance. We note that this practice is favorable and consistent with the Aaa rating. Ongoing conservative debt management should allow the City to layer in future debt without negatively impacting the direct debt burden.

Outlook

Moody's negative outlook on San Antonio's Aaa rating is due to its indirect linkages to the weakened credit profile of the U.S. government.

WHAT COULD MAKE THIS RATING GO UP

Enhanced legal security

WHAT COULD MAKE THIS RATING GO DOWN

Change in the US rating that results in pressure on the city's Aaa rating

Failure to maintain balanced operations

Trend of declining reserves

Indications of unwillingness or inability to budget for the annual appropriation on the lease payments

KEY STATISTICS:

2010 Population: 1,327,407

2013 full valuation: $71.8 billion

2013 full value per capita: $54,118

Direct debt burden: 3%

Overall debt burden: 10.2%

2011 General Fund balance: $232.6 million (25.7% of General Fund revenues)

Current PFC lease revenue issue: $519.5 million

Post sale GO parity debt (Aaa): $1.4 billion

RATING METHODOLOGY

The principal methodology used in this rating was General Obligation Bonds Issued by U.S. Local Governments published in October 2009. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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