MOODY'S
INVESTORS SERVICE

CREDIT OPINION
6 January 2016

New Issue

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San Francisco (City and County of), CA

New Issue - Moody's assigns Aa1 to San Francisco, CA's GO Bonds, Ser. 2016A&B

Summary Rating Rationale

Moody's Investors Service has assigned an Aa1 rating to the City and County of San Francisco, CA's General Obligation Bonds (Clean and Safe Neighborhood Parks Bond, 2008), Series 2016A totaling approximately $8.7 million and the General Obligation Bonds (Clean and Safe Neighborhood Parks Bonds, 2012), Series 2016B totaling approximately $43.4 million. We have also affirmed the Aa1 rating on the City and County's outstanding general obligation bonds totaling approximately $2.0 billion and the Aa3 rating on the city's outstanding lease revenue bonds and certificates of participation totaling approximately $1.1 billion. Additionally, we have affirmed the A1 rating on the City and County's Lease Revenue Bonds, which are part of the equipment program.

The Aa1 rating reflects the strength of the City and County's (city's) tax base, which remains strong and stable. We expect continued modest growth in the city's tax base in the near-term, largely fueled by continued growth in the technology sector, which has promoted growth in the city's other economic sectors as well. Even in the likely event that the city's tech sector growth were to cool, the city's large tax base would still support the current rating assignment. The city's credit profile also benefits from an above-average socioeconomic profile of area residents and strong economic metrics in median home value and a low unemployment rate. The financial profile of the city has greatly benefited from the recent economic expansion and is currently at its strongest position than at any time in the past decade. Long-term projections reflect expenditures increasing faster than revenues, which will likely limit the city's reserve growth, but established financial policies should help to keep the city's reserves stable. The city has a typical debt profile with a substantial portion of its outstanding debt in unlimited ad valorem property tax general obligation bonds, but the city maintains a somewhat elevated combined pension, OPEB, and lease burden.

The general obligation rating reflects the strength of the voter-approved, unlimited property tax pledge securing the bonds and the well-established levy and collection history for the debt service payment. In this instance, the city levies, collects, and disburses the property taxes constitutionally restricted for debt service on general obligation bonds directly to the paying agent.

The Aa3 lease supported obligations are secured by standard, California abatement leases. The two notch distinction between the general obligation ratings represents the weaker security pledge for lease-backed obligations and the additional risk to creditors from the city's financial, operational, and economic conditions compared to the more secure general obligation pledge.

The A1 equipment lease revenue bonds are secured by a typical abatement lease between the city and its finance corporation. The three notch distinction between the general obligation ratings represents the weaker security pledge for these leased assets, which include a wide range of equipment and vehicles for various city departments, principally Police, Fire, Public Works, and Recreation & Parks. The city has pledged to budget and appropriate lease payments for these bonds as long as it has use and possession of the leased assets.

Credit Strengths

» Large, diverse, and growing tax base that will remain strong even in the face of an economic cooling

» Above-average resident economic profile

Credit Challenges

» Long-term projections reflect expenditures growing faster than revenues

» Somewhat elevated combined pension, OPEB, and lease burden expenditures

» Recent growth fueled by the technology sector, which is historically a volatile economic sector

Rating Outlook

The outlook on the city's long-term ratings is stable. The outlook recognizes the city's large and diverse tax base, which is fundamentally sound, and the city's financial position, which should remain stable given the financial policies implemented by city management.

Factors that Could Lead to an Upgrade

» Significantly improved and/or sustained financial profile at currently strong levels

» Sustained economic strengthening

Factors that Could Lead to a Downgrade

» Deterioration of the city's fiscal position

» Unanticipated and material weakening of the city's economy for a prolonged period of time

Key Indicators

San Francisco (City and County of) CA		2011		2012		2013		2014		2015
Economy/Tax Base										
Total Full Value ($000)	$	166,414,083	$	158,649,887	$	165,043,120	$	172,489,208	$	181,809,981
Full Value Per Capita	$	208,543	$	196,408		N/A	$	210,996	$	210,326
Median Family Income (% of US Median)		135.8%		137.1%		139.2%				
Finances										
Operating Revenue ($000)	$	3,150,565	$	3,366,251	$	3,537,941	$	3,984,387	$	4,366,817
Fund Balance as a % of Revenues		11.0%		14.3%		17.6%		21.5%		25.8%
Cash Balance as a % of Revenues		15.1%		18.6%		24.6%		30.0%		32.8%
Debt/Pensions										
Net Direct Debt ($000)	$	2,352,329	$	2,334,044	$	2,713,049	$	2,703,945	$	2,583,175
Net Direct Debt / Operating Revenues (x)		0.7x		0.7x		0.8x		0.7x		0.6x
Net Direct Debt / Full Value (%)		1.4%		1.5%		1.6%		1.6%		1.4%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)		1.7x		1.7x		1.9x		0.0x		1.4x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)		3.2%		3.6%		4.1%		0.0%		0.0%

Source: Moody's Investors Service

Detailed Rating Considerations

Economy and Tax Base: Exceptionally Large Economy Continues to Improve

San Francisco's economy continues to exhibit notable strength and size compared to other large U.S. cities and we expect continued growth. The local economy is one of the strongest in the nation. The city's exceptionally low unemployment rate of 3.4% as of October 2015 is indicative of a labor market at full employment. The technology sector continues to fuel the local economy and provide plentiful job opportunities in both tech and other economic sectors, which is increasing the city's population growth, which is near a 45-year high. Technology will continue to drive strong wage growth, even as job gains cool and approach the national rate over the next couple of years. Now that the area has reached full employment, employees are more difficult to find and expensive to hire. Moving forward, the demand for talent, coupled with the fast-rising cost profile of the city, will likely cool the rate of economic growth in the next few years. Even with possible economic cooling, the city's local economy will continue to exhibit notable strength and support the city's high credit quality.

The city's assessed value (AV) increased by 6.9% in fiscal 2016 to $194.4 billion, which is more than double the median for Aa1-rated cities with populations greater than 500,000. Growth has largely been driven by the strength of local housing and commercial prices, which are not showing signs of slowing down and will likely continue to increase. The median home value for the city was 421.4% of the US average as of 2013 estimates. Single-family housing prices are 35% above their 2007 peak, and rents are rising by 7%-13% per year. Homebuilding will likely set another record year in 2016.

The city's tax base is also highly diverse with the ten largest taxpayers representing only 2.6% of the city's total 2016 AV. The median family income for the city was 139.2% of the US average as of 2013 estimates, while per capita income was 172.2% of the US average. These figures have improved since the last census review in 2000.

Financial Operations and Reserves: Improving Financial Profile; Long-term Expenditures Outpace Revenues

The city's economic strength has resulted in a currently strong financial position, which we expect will remain strong for the next few years with the city's continued economic strength. In the long-term, the city projects expenditures increasing faster than revenues, which will likely limit the upward growth of the city's ending reserve levels. The city maintains strong financial policies, however, and has several financial tools available to curb expenditures in the event of an economic downturn. Additionally, the city consistently plans for the long-term with its five-year financial plan, five-year information and communication technology plan, and ten-year capital plan. Management has proven that expenditure adjustments will be made annually to these long-term plans to adjust for any unanticipated economic or financial changes. These policies and practices should help to keep the city's financial profile stable in the long-term and appropriate for the rating category.

The city's economically sensitive revenues, such as property, hotel, sales, and business taxes, will continue to grow for the next few years along with the strong economy. The above-mentioned tax revenues all increased in fiscal 2015 from the previous year and are showing signs of continued growth in fiscal 2016. Current projections show revenues increasing by $75.6 million in fiscal 2017 and increasing by $152.5 million in fiscal 2018. Revenue growth for the city should remain strong in the near-term, but expenditure growth still outpaces strong revenues. Major drivers for the city's expenditure growth projections are an unexpected increase in employer retirement contributions to the employee pension and voter-approved propositions and set-asides.

Fiscal 2015 was the city's strongest financial year in recent history. Available operating general fund reserves (unassigned, assigned, committed, and restricted debt service reserves) increased to $1.1 billion (25.8% of revenues). Outside of this balance is an additional $115.0 million in the city's Rainy Day Reserve, which balance should continue to increase in the near-term. Operating revenues will continue to increase in fiscal 2016 given the strong growth trends of the city and will likely continue through fiscal 2020.

To minimize expenditures in the next few fiscal years, management has given budget instructions to each department to reduce ongoing expenditures by 1.5% of adjusted general fund support in fiscal 2017 and by an additional 1.5% in fiscal 2018. These policies should help to slow the pace of expenditure growth in the out years.

LIQUIDITY

The city's general fund liquidity continues to be exceptionally strong. The ending general fund cash balance for fiscal 2015 was $1.4 billion (32.8% of revenues) and city liquidity will likely remain exceptionally strong for the projection period.

Debt and Pensions: Manageable Debt Levels with Small Variable Rate Debt Exposure; Slightly Elevated Combined Pension, OPEB, and Lease Burden

The city has an average 1.4% of AV net direct debt burden as of fiscal 2015 that should remain stable as AV growth offsets anticipated general obligation bond issuances. In the long-term, we anticipate the city's direct debt burden will remain low given a city charter provision that prohibits bond indebtedness greater than 3.0% of AV. The city has a low fiscal 2015 general fund lease burden of 1.4% of general fund operating revenues, which will likely increase to 2.6% of revenues at maximum annual debt service in fiscal 2017. The city has pension costs that equaled 13.4% of operating general fund revenues in fiscal 2015 and OPEB contributions that equaled 8.3% of operating general fund revenues in the same year. The combined general fund-supported debt, together with the city's pension and OPEB costs, bring the total general fund fixed-obligations to a material, but still manageable, 23.1% of fiscal 2015 general fund operating revenues. These obligations are slightly elevated compared to other cities nationwide, but not overly burdensome given the strength of San Francisco's general fund revenues.

DEBT STRUCTURE

We feel the city's exposure to variable rate debt is minimal and manageable given the size of the city's general fund cash position. Outstanding variable rate debt, including the Series 2008-1 and 2008-2 revenue bonds and the city's commercial paper program, was only 11% of the city's total debt portfolio as of the 2015 audit. The variable rate debt outstanding represents 21% of the city's available general fund cash for the same fiscal year, suggesting that the general fund could effectively absorb any unanticipated costs associated with its variable rate debt.

The commercial paper program is supported by three letters of credit: JP Morgan Chase and US Bank provide two letters of credit (LOCs) that both expire on June 10, 2016 and State Street Bank and Trust provides a third LOC that expires on February 26, 2019. The city is in the process of renewing the JP Morgan Chase and US Bank LOCs before expiration in June 2016.

The city also has two LOCs for its Series 2008-1 and 2008-2 revenue bonds. On October 8, 2014, State Street Bank provided LOCs for a five-year term for the Series 2008-1, replacing Bank of America after a mandatory tender. State Street extended the existing LOC for Series 2008-2 (no mandatory tender). The current par outstanding for each series is $52.5 million. The city optionally redeemed $3.0 million from each series in October 2014.

DEBT-RELATED DERIVATIVES

The city has no debt-related derivatives. One interest rate swap is associated with the San Francisco International Airport and the risk of this swap is incorporated in the analysis of the airport ratings.

PENSIONS AND OPEB

Moody's adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, is $6.7 billion, or a moderate 1.4 times three-year average operating revenues using fiscal 2013 reporting. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace the district's reported liability information, but to improve comparability with other rated entities. The city's large pension liability will continue to be a long-term challenge and budgetary pressure point, but should not affect the city's rating in the near-term given the strength of the local economy and its positive effect on the city's financial profile.

The city's unfunded OPEB liability remains large at $4.0 billion, which was 161.9% of the city's covered payroll as of July 1, 2012. Changes to the city's OPEB plan should result in significantly lower costs by fiscal 2035, but OPEB costs will continue to remain a near-term budgetary challenge.

Management and Governance

The city will continue to benefit from its strong, professional management team and management's ability to carefully make skillful economic and financial projections. Management also maintains a healthy degree of flexibility to adjust expenditures in the face of changes to economic and financial projections.

California cities have an institutional framework score of "A," or moderate. Revenue predictability is moderate, because the primary sources are property taxes and sales taxes. Property taxes are very predictable, given the state's constitutional formula, known as Proposition 13, while sales taxes are economically sensitive. Revenue-raising ability is moderate because increases almost always require voter approval. Expenditure reduction ability is moderate, because of collective bargaining and growing pension and OPEB pressures. Expenditure predictability is high, as police and fire typically make up 60% of discretionary spending in full-service cities.

Legal Security

The legal security for the current issuance is an unlimited property tax level on all property subject to taxation within the boundaries of the city.

Use of Proceeds

Proceeds from the current issuance will be used to finance the construction and modernization of the city's parks and recreational facilities authorized by voters under an election held in 2008 and an election held in 2012.

Obligor Profile

The city is the economic and cultural center of the San Francisco Bay Area and northern California. The limits of the city encompass over 93 square miles, of which 49 square miles are land, with the balance consisting of tidelands and a portion of the San Francisco Bay. Silicon Valley is about a 40-minute drive to the south, and the wine country is about an hour's drive to the north. The city's fiscal 2015 population was approximately 864,400.

Methodology

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. The additional methodology used in the lease-backed rating was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in December 2011. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

Ratings

Exhibit 2

SAN FRANCISCO (CITY & COUNTY OF) CA

Issue	Rating
General Obligation Bonds (Clean and Safe Neighborhood Parks Bonds, 2008), Series 2016A	Aa1
Rating Type	Underlying LT
Sale Amount	$8,695,000
Expected Sale Date	01/20/2016
Rating Description	General Obligation

General Obligation Bonds (Clean and Safe Neighborhood Parks Bonds, 2012), Series 2016B	Aa1
Rating Type	Underlying LT
Sale Amount	$43,415,000
Expected Sale Date	01/20/2016
Rating Description	General Obligation

Source: Moody's Investors Service

REPORT NUMBER 1012115

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