FITCH RATES $246.7MM SAN FRANCISCO, CA'S RFDG GOS 'AA'; AFFIRMS OUTSTANDING; OUTLOOK TO POSITIVE

Fitch Ratings-San Francisco-09 January 2015: Fitch Ratings assigns an 'AA' rating to the following City and County of San Francisco, California (the city) general obligation bonds (GOs):

--Approximately $246.7 million GO refunding bonds, series 2015-R1.

Bond proceeds will be used to refund various outstanding GO bonds for debt service savings. The bonds are expected to price via competitive sale the week of Jan. 26th.

In addition, Fitch affirms $2.1 billion in outstanding city GO bonds and San Francisco Finance Corporation (corporation) lease revenue bonds at 'AA' and approximately $1.1 billion in various city and corporation lease obligations at 'AA-'. A full list of ratings and security for lease obligations follows at the end of this press release.

The Rating Outlook on all bonds is revised to Positive from Stable.

SECURITY

The GO bonds are payable from an unlimited ad valorem taxes upon all property subject to taxation by the city.

KEY RATING DRIVERS

STRONG RESERVES/FINANCIAL POLICIES SUPPORT POSITIVE OUTLOOK: The Positive Outlook reflects the city's fiscally prudent institutionalized financial policies which, along with strong economic and revenue growth, have resulted in solid rainy day and budgetary reserves. It further reflects Fitch's expectation for continued improvement in the city's financial flexibility as measured by its fund balances and ability to adjust expenditures.

EXCEPTIONALLY STRONG ECONOMIC BASE: San Francisco's large and dynamic economy has seen continued strong labor force and employment growth rates. Taxable assessed valuation (TAV) growth remains robust. Wealth indicators are very strong and the tax and employment bases are very diverse.

SOUND FINANCIAL OPERATIONS: Four years of operating surpluses have resulted from strong economic and revenue growth, moderate expenditure growth and policies to fund reserves with one time and above average revenues. Reserves now exceed pre-recession levels and new policies are structured to slow their use during the next downturn.

STRONG FINANCIAL MANAGEMENT, OVERSIGHT: The city's charter requires thorough periodic budget monitoring and gives the independent controller strong expenditure control.

MIXED LONG-TERM LIABILITY PROFILE: The city's overall debt is high on a per capita basis, but Fitch considers it affordable given the city's wealth level and strong tax base. Capital needs are large, but above-average amortization and tax base growth should keep the city's debt levels affordable. Carrying costs including debt service, pension and other post-employment benefit (OPEB) costs are moderate but rising despite recent reforms.

RATING SENSITIVITIES

SUSTAINED POSITIVE OPERATIONS: Continued adherence to adopted fiscal policies to build and maintain reserves and curb expenditure growth resulting, in sustained sound financial flexibility would lead to an upgrade.

CREDIT PROFILE

STRONG FINANCIAL OVERSIGHT SUPPORTS ENHANCED FINANCIAL FLEXIBILITY

The city's charter features several conservative requirements that promote financial stability. The budget must be based on revenue projections published by the independent controller. The charter also requires periodic budget status reports and permits the controller to freeze appropriations if actual revenues are less than budgeted.

In April 2010, the board adopted policies including: two-year budgeting, a biennial five-year forecast with balancing strategies, use of one-time revenues for one-time expenditures, and budgetary reserve funding policies and procedures. The budget stabilization account is funded from two of the city's most volatile revenue sources, including real property transfer tax revenues in excess of the five-year average.

The new reserve policies in particular have contributed to the city's improved financial position, helping to rein in expenditure growth during a period of economic expansion. Rainy day and budget stabilization reserves have increased materially since their low point in fiscal 2010; furthermore, the requirement to fund reserves from above average growth in certain cyclical revenues helps curb the city's historical reliance on unsustainable revenue growth for ongoing expenditures. Although most of the city's new mechanisms remain untested by a severe fiscal shock, in Fitch's view they position the city to better absorb any future economic and revenue uncertainty.

In fiscal 2014, the city added another $67 million to its rainy day and budget stabilization reserves, raising the balance to $215.5 million (about 5.9% of general fund spending). This is up from $39 million at fiscal year-end 2010. Furthermore, voters amended the charter to limit the amount of the rainy day reserve available for the separately-managed local school district under the original rainy day fund approved in 2003.

HOSPITAL OPERATIONS REMAIN HEALTHY

San Francisco's public hospital (SFGH) has maintained sound financial operations since implementation of the Affordable Care Act. To date, increased revenue from newly insured patients has exceeded the reductions in state and federal support and the city's general fund transfers to the hospital remain at historical levels. Nonetheless continued reductions in state and federal support for indigent care as well as competition for insured patients will be a challenge going forward. Uncertainties remain in the rapidly changing healthcare environment. Fitch believes the city's hospital is well positioned to address these challenges and that its general fund financial exposure is manageable.

DIVERSE REVENUES; GROWING FUND BALANCES

As both a city and county, San Francisco enjoys a relatively diverse revenue base which performed adequately during the national recession and has shown solid growth over the last several years. Locally generated taxes generate more than two-thirds of general fund revenues, resulting in somewhat less exposure to potential state and federal funding shifts than other California counties. Total tax revenues for fiscal 2014 were 7% above prior year levels and 39% above receipts for fiscal 2010.

General fund balances have improved steadily over the past four years culminating in fiscal 2014 with a $295 million net operating surplus resulting in an unrestricted fund balance of $728 million, equal to a solid 19.8% of spending. General fund cash balances have also strengthened, rising to over $1 billion in fiscal 2014, a four-fold increase from 2010 levels.

LONG TERM BUDGET CHALLENGES REMAIN

The city closed an initial $67 million general fund gap for fiscal 2015, equal to about 2% of fiscal 2014 operations. Department costs, reserve deposits and about $45 million in new labor contracts resulted in a total projected deficit of $140 million. The city closed the gap mostly with improved revenue performance, including better state funding and public health fees for services. Overall, the budget appropriates about $64 million in fund balance though Fitch expects the city to finish the year better than budget.

Management's five-year forecast, which was prepared prior to adoption of the fiscal 2015 budget, projects general fund deficits rising to about $340 million in fiscal 2018 (10% of fiscal 2013 spending), largely due to more rapid growth for personnel expenses than revenues. Suggested solutions to close the projected gap include slowing capital spending and department savings, among other options. Fitch believes the city has sufficient expenditure flexibility to address the forecast deficits, though wage pressure could present a challenge. Notably, the five-year forecast includes a recession scenario allowing the city to begin discussing actions which would be needed to address larger deficits. Fitch views this level of planning positively.

ECONOMIC GROWTH OUTPACES STATE AND NATION

TAV levels rose by 5.4% in fiscal 2015 and maintained a 4.3% compounded annual growth rate over the past six years. Employment growth has been similarly robust and the city's unemployment rate fell to a very low 4.5% in June 2014, well below state and national averages. Job growth continues to exceed state and national averages and wealth and income levels are high.

PENSION AND OPEB COSTS RISING BUT AFFORDABLE

The city is pre-funding a portion of its OPEB costs, aided by charter-required employee contributions, and expects to reach the full actuarially-required contribution (ARC) in approximately 30 years. The pay-as-you-go amount was about $166 million in fiscal 2014, or 3.6% of governmental expenditures and funding at the actuarially required level ($341 million or 7.5% of governmental expenditures) would be challenging. Fitch considers voters' approval of a 2013 ballot measure to prevent future raids on a recently established OPEB trust as a credit positive.

The city's retirement fund is adequately funded at about 76% as of June 30, 2013 using Fitch's 7% return assumption. Pension contributions are expected to flatten as investment losses have been fully smoothed in. In addition, concern about pension contribution trends are offset somewhat by the recent pension reforms that require employees to share responsibility for the rising costs and limit COLAs.

Carrying costs, including pension, OPEB and debt service, consumed about 19% of fiscal 2013 governmental expenditures, a level Fitch believes is manageable. However, as noted, OPEB annual costs are likely to rise somewhat over the medium term which could pressure operations.

AFFORDABLE DEBT AND LARGE CAPITAL NEEDS

San Francisco's debt burden remains affordable despite sizeable recent issuances. Including overlapping entities, debt totals a high $6,400 per capita but a moderate 2.9% of taxable market value. Future debt issuance plans are expected as the city addresses needs identified in its 10-year, $4.7 billion general fund capital improvement plan. This borrowing could raise debt burden above current levels, depending on the timing of issuances and repayment schedules.

In addition, Fitch affirms the following COPs issued by the city at 'AA-':

--$2.6 million series 2013B (port facilities, non-AMT);
--$32.8 million series 2013C (port facilities, AMT);

--$22.1 million series 2013A (Moscone Center Improvements);
--$18.8 million series 2001A (30 Van Ness Ave. Project);
--$47.2 million series 2014R-1 (courthouse project) and 2014R-2 (juvenile hall project);
--$139.9 million series 2007A (city office buildings - multiple properties);
--$143.2 million series 2009A (multiple capital improvement projects);
--$34.3 million series 2009B (multiple capital improvement projects);
--$159.11 million series 2009C and 2009D (525 Golden Gate Avenue);
--$116.2 million refunding series 2010A;
--$40.7 million series 2012A (multiple capital improvement projects);
--$67.8 million refunding series 2011A and 2011B (Moscone Center South refunding project) (underlying rating).

--Fitch also affirms the 'AA-' bank bond rating on the corporation's series 2008-1 and 2008-2 bonds.

Fitch affirms the following lease revenue bonds issued by the City and County of San Francisco Finance Corporation at 'AA-':

--$18.8 million series 2010A, 2011A, 2012A and 2013A (equipment lease program);
--$15.5 million series 2010-R1 (911 information and emergency communications system);
--$30 million series 2009A (branch library improvement project);
--$116 million series 2008-1 and 2008-2 (Moscone Center expansion).

In addition, Fitch affirms $52.8 million of corporation lease revenue bonds, series 2006 and 2007 (open-space fund) at 'AA'.

The Outlook on the COPs and lease revenue bonds is revised to Positive from Stable.

SECURITY

City and corporation COPs and lease revenue bonds are secured by the city's covenant to budget and appropriate lease payments for use and occupancy of city assets that Fitch believes provide a strong incentive to appropriate. Additional security is provided by standard insurance provisions.

Corporation lease revenue bonds (open-space fund) are secured by lease payments made from a voter-approved property tax set-aside for open space. Additional security is provided by 12 months rental interruption insurance and a cash-funded debt service reserve fund.

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In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope.

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

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