City and County of San Francisco, California

New Issue Report

Ratings

Long Term Issuer Default Rating	AA+

New Issue

$75,000,000 (Social Bonds — Affordable Housing, 2016) General Obligation Bonds (Taxable), Series 2019A	AA+

Outstanding Debt

Details on Page 3

Rating Outlook

Stable

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New Issue Summary

Sale Date: Feb. 14, 2019

Series: Series 2019A

Purpose: Affordable housing

Security: The bonds are payable from an unlimited ad valorem property tax on all taxable property in the City and County of San Francisco (the city). In addition, a portion of the loan repayments collected by the city from the affordable housing loans made with the 2019A bond proceeds will be used to pay debt service on the bonds.

Analytical Conclusion

The 'AA+' Issuer Default Rating (IDR) and GO bond rating reflects the city's very strong revenue growth prospects and operating performance, partially offset by limitations in expenditure flexibility and independent revenue-raising ability. Strong budgetary and financial policies provide a foundation for maintaining ample reserves and financial flexibility throughout economic cycles. The long-term liability burden is moderate.

Economic Resource Base: The city is the economic and cultural center of the nine-county San Francisco Bay Area. Despite being essentially built out, population continues to grow, as parts of the city, including former military bases and former industrial areas, are redeveloped with increased density. The city's economic profile benefits from good wealth levels; per capita personal income is almost twice the national average, and market value per capita is over $250,000. The city's largest private employers include Wells Fargo & Co., Salesforce, California Pacific Medical Center, PG&E Corp. and Gap Inc.

Key Rating Drivers

Revenue Framework: 'aa'
Very strong economic growth has been generating revenue growth well in excess of U.S. GDP. This strength is partially offset by the city's limited independent revenue-raising ability.

Expenditure Framework: 'aa'
Recent expenditure growth has lagged the unusually strong revenue growth. However, a relatively restrictive workforce framework, sharply rising retiree costs and a large proportion of minimum funding levels and set-asides limit spending flexibility in a downturn.

Long-Term Liability Burden: 'aa'
Long-term liabilities are moderate relative to the city's personal income. Based on the city's debt issuance plans, its amortization rate and the expected growth of personal income, Fitch Ratings expects the liability burden to remain in the moderate range.

Operating Performance: 'aaa'
The city's gap-closing ability is exceptionally strong, evidenced by robust reserve levels relative to low expected revenue volatility. Furthermore, the city has demonstrated its ability to curb expenditure growth through negotiated labor concessions when necessary. Charter- and

Rating History (IDR)

Rating	Action	Outlook/ Watch	Date
AA+	Affirmed	Stable	3/07/18
AA+	Upgraded	Stable	1/08/16
AA	Affirmed	Positive	1/09/15
AA	Upgraded	Stable	3/28/13
AA–	Downgraded	Stable	4/12/11
AA	Revised	Negative	4/30/10
AA–	Affirmed	Negative	2/24/10
AA–	Affirmed	Stable	3/18/08
AA–	Affirmed	Positive	3/13/06
AA–	Downgraded	Stable	5/18/04
AA	Affirmed	Negative	6/17/03
AA	Assigned	—	4/15/93

ordinance-approved financial policies support maintenance of financial flexibility through economic cycles.

Rating Sensitivities

Financial Flexibility: An unexpected shift in the city's financial flexibility, including a reversal of funding of rainy day reserves as well as inability to manage rising carrying costs, could negatively pressure the rating. Positive rating action is limited by the city's lack of independent revenue-raising capacity, just-adequate spending flexibility and moderate liabilities.

Credit Profile

As the economic and cultural center of the San Francisco Bay area, the city benefits from high wealth levels, low unemployment and strong economic growth. Taxable assessed valuation has increased approximately 57% between fiscal years 2013 and 2019, including about 11% gains in fiscal years 2018 and 2019, based on initial fiscal 2019 assessment values. Technology employment has been especially strong in this economic expansion and now accounts for about 20% of payroll in the city. Recent job growth appears to be slowing, which may be more a result of the limitations of infrastructure and full employment than a sign of a slowing economy. The city's tourism sector has performed exceptionally well during the economic expansion, though hotel taxes have moderated recently in part due to the partial year closure of the convention center. Property and business taxes more than offset softness in budgeted hotel and real property transfer taxes.

Revenue Framework

As a city and county, San Francisco benefits from a wide variety of revenues, with the vast majority coming from local taxes and the remainder from state and federal subventions as well as local fees, charges and fines. Revenue growth has been robust, reflecting the rapid economic growth and strong job gains, and largely offsets the city's limited ability to independently raise revenues.

The city's tax structure captures the diverse and growing economic activity with a variety of taxes, led by property (about 32% of fiscal 2017 total general fund revenues) as well as business (15%), real property transfer taxes (9%) and hotel taxes (8%). Recent revenue gains have comfortably exceeded national GDP growth even when adjusted for increases to the real property transfer tax rate. The locally generated taxes yield almost three-quarters of general fund revenues, resulting in somewhat less exposure to potential state and federal funding shifts than is the case for other California counties.

The fiscal 2018 audit is not yet available, but total tax revenues for that year are estimated at about 8.1% higher than fiscal 2017. Growth is led by very strong property tax performance due to underlying value increases as well as the city working through a large backlog of assessments, partially offset by a large decline in real property transfer taxes from an exceptionally high level in fiscal 2017. Fitch expects the pace of tax and overall revenue growth to slow as the economic expansion matures and the backlog of assessments is worked through over the medium term.

Like all local governments in California, the city's independent legal ability to raise its revenues is constrained by various voter-approved initiatives. However, Fitch assesses the city's revenue-raising ability as moderate due to its historically very low revenue volatility coupled with some ability to increase fees, charges for services, rents and concessions.

Related Research
Fitch Rates City & County of San Francisco, CA's $75MM GO Bonds; Outlook Stable (February 2019)

Related Criteria
U.S. Public Finance Tax-Supported Rating Criteria

Outstanding Debt

San Francisco (City & County) (525 Golden Gate Avenue- SFPUC Office Project) (Federally Taxable-Build America Bonds Direct Payment) Certificates of Participation	AA
San Francisco (City & County) (525 Golden Gate Avenue- SFPUC Office Project) Certificates of Participation	AA
San Francisco (City & County) (Affordable Housing, 2015) General Obligation Bonds (Taxable)	AA+
San Francisco (City & County) (Branch Library Facilities Improvement Bonds, 2000) General Obligation Bonds	AA+
San Francisco (City & County) (City Office Buildings-Multiple Properties Project) Refunding Certificates of Participation	AA
San Francisco (City & County) (Clean and Safe Neighborhood Parks Bonds, 2008) General Obligation Bonds	AA+
San Francisco (City & County) (Clean and Safe Neighborhood Parks Bonds, 2012) General Obligation Bonds	AA+
San Francisco (City & County) (Clean and Safe Neighborhood Parks Bonds, 2008) General Obligation Bonds (Federally Taxable-Build America Direct-Payment)	AA+
San Francisco (City & County) (Earthquake Safety and Emergency Response Bonds, 2010) General Obligation Bonds	AA+
San Francisco (City & County) (Earthquake Safety and Emergency Response Bonds, 2014) General Obligation Bonds	AA+
San Francisco (City & County) (Earthquake Safety and Emergency Response) General Obligation Bonds	AA+
San Francisco (City & County) (Earthquake Safety and Emergency Response, 2014) General Obligation Bonds	AA+
San Francisco (City & County) (Hope SF) Certificates of Participation (Taxable)	AA
San Francisco (City & County) (Juvenile Hall Project) Refunding Certificates of Participation	AA
San Francisco (City & County) (Moscone Center South Refunding Project) Refunding Certificates of Participation	AA
San Francisco (City & County) (Moscone Convention Center Expansion Project) Certificates of Participation	AA
San Francisco (City & County) (Multiple Capital Improvement Projects) Certificates of Participation	AA
San Francisco (City & County) (Port Facilities Project) Certificates of Participation (AMT/Private Activity)	AA
San Francisco (City & County) (Port Facilities Project) Certificates of Participation (Non - AMT)	AA
San Francisco (City & County) (Road Repaving and Street Safety Bonds, 2011) General Obligation Bonds	AA+

Expenditure Framework

As a city and a county, San Francisco provides a wide variety of services, with the majority of expenditures focused on public health and social services, followed by public safety.

Given the city's very rapid revenue growth and the nature of its spending responsibilities, Fitch expects that growth in major spending areas is likely to be in line with revenue growth on average over time. Salary increases have been 3% per year for several years, below the city's revenues growth rate; however, retiree benefit costs are increasing sharply.

Carrying costs for direct debt service and retiree benefits are elevated (21% in fiscal 2017), though excluding various enterprise departments reduces them to more moderate levels. Fitch's supplemental pension metric, which assumes a 20-year level payoff of the Fitch-adjusted liability, indicates that contributions at the actuarial level are likely be insufficient to reduce pension liabilities over time.

The city's workforce framework is somewhat restrictive, including 37 bargaining units, binding arbitration for most contracts, salary surveys and some staffing minimums in public safety. The city charter includes binding arbitration for essentially all employees and minimum staffing levels for the police and fire departments. Formulaic funding requirements for several departments or functions based on aggregate discretionary revenues or assessed valuation further restrict discretion. About 30% of the spending in fiscal 2018 was formulaic, up from about 15% in fiscal 1995. These formulaic funding requirements will limit options to cut spending in an economic downturn, though the formulaic funding amount would decline commensurately when revenues fall.

Nonetheless, the city maintains an adequate ability to cut spending as needed. This assessment is supported by employee groups' history of negotiating furloughs and other cost saving measures during economic downturns as well as contracts that delay salary increases in the event of sizable projected budget deficits.

Most contracts are settled through fiscal 2019, with the police and fire contracts settled through fiscal 2021 through binding arbitration. These police and fire contracts include wage increases of 3% in fiscal years 2019, 2020 and 2021, with the final increase subject to delay depending on the size of the projected deficit for fiscal 2021.

Long-Term Liability Burden

The city's combined debt and pension liability is moderate at about 18% of personal income. The liabilities include direct debt, overlapping debt and direct net pension liabilities (NPLs).

The city has about $2.5 billion in voter-approved GO bonds outstanding and another $1.3 billion in lease obligations paid from the general fund. Total direct debt equals about 4% of personal income. Given the city's policies, which limit lease obligation debt service to 3.25% of general fund discretionary revenues and maintain the GO bond debt service levy within the fiscal 2006 property tax rate, Fitch expects the direct debt burden to grow roughly in line with the city's resource base as measured by resident personal income. The city's fiscal years 2018–2027 general fund capital improvement plan totals about $35 billion and is expected to be funded from a variety of sources, including GO bonds and lease revenue bonds, as policies permit.

Overlapping debt issuers include the San Francisco Unified School District (with nearly $1 billion in outstanding GO bonds), the San Francisco Community College District, the former Redevelopment Agency and the San Francisco Bay Area Rapid Transit District (BART). Overlapping debt totals about $2.9 billion, or 3.0% of personal income.

Outstanding Debt

San Francisco (City & County) (Road Repaving and Street Safety) General Obligation Bonds	AA+
San Francisco (City & County) (San Francisco Courthouse Project) Refunding Certificates of Participation	AA
San Francisco (City & County) (San Francisco General Hospital) General Obligation Bonds	AA+
San Francisco (City & County) (San Francisco General Hospital) General Obligation Bonds (Federally Taxable-Build America Direct-Payment)	AA+
San Francisco (City & County) (San Francisco General Hospital) General Obligation Improvement Bonds	AA+
San Francisco (City & County) (Transportation & Road Improvement Bonds, 2014) General Obligation Bonds	AA+
San Francisco (City & County) (War Memorial Veterans Building Seismic Upgrade & Improvements) Certificates of Participation	AA
San Francisco (City & County) (War Memorial Veterans Building Seismic Upgrade & Improvements) Certificates of Participation (Taxable)	AA
San Francisco (City & County) General Obligation Bonds	AA+
San Francisco (City & County) General Obligation Refunding Bonds	AA+
San Francisco (City & County) Refunding Certificates of Participation	AA
San Francisco (City & County) Finance Corp. (911 Information and Communications System) Lease Revenue Refunding Bonds	AA
San Francisco (City & County) Finance Corp. (Branch Library Improvement Program) Lease Revenue Bonds	AA
San Francisco (City & County) Finance Corp. (Branch Library Improvement Program) Refunding Lease Revenue Bonds	AA
San Francisco (City & County) Finance Corp. (Equipment Program) Lease Revenue Bonds	AA
San Francisco (City & County) Finance Corp. (Moscone Center Expansion Project) Lease Revenue Bonds	AA
San Francisco (City & County) Finance Corp. (Open Space Fund - Various Park Projects) Lease Revenue Bonds	AA+
San Francisco (City & County) Finance Corp. (Open Space Fund - Various Park Projects) Refunding Lease Revenue Bonds	AA+

San Francisco maintains its own pension system, the San Francisco Employees' Retirement System, which has both a public safety and a miscellaneous plan. In addition, a small portion of employees participate in CalPERS. The city funds the pensions at the actuarially determined contribution (ADC), although potentially with liberal assumptions as indicated by Fitch's supplemental pension metric (which assumes a 20-year level payoff of the Fitch-adjusted liability), indicating that contributions at the actuarial level are likely be insufficient to reduce pension liabilities over time.

The most recent reported combined NPL is about $5.7 billion, which is an increase of more than $3 billion from the prior year. This increase is due primarily to investment returns below the assumed rate (7.5%), a court decision requiring COLAs for certain retirees that had not been included in the previous study and changes to the mortality assumptions. Combined plan assets cover roughly 78% of liabilities at the plan's assumed rate of return.

Fitch estimates the city's combined NPL at a much higher $11 billion (11.5% of personal income) when using a more conservative 6% investment return assumption, reducing the ratio of assets to liabilities to about 64%. As with carrying costs, a material portion of the NPL is attributable to enterprises, reducing the liability burden somewhat.

The city's net other post-employment benefits (OPEB) liability is sizable at more than 4% of personal income even after several charter amendments lowered the liability and resulted in contributions from employees and the city being deposited into an OPEB trust that may not be drawn upon until it is fully funded. The city expects the combination of these sources of OPEB contributions to reach the actuarially required contribution (ARC) in about 30 years.

Operating Performance

The city's historically low revenue volatility and large reserves offset limited budget flexibility, based on moderate ability to raise revenues and adequate spending flexibility. For details, see scenario analysis, page 6.

The city's available fund balance (including rainy day funds) at the end of fiscal 2017 totaled $1.9 billion, a 31% increase over the fiscal 2016 available fund balance. The fiscal 2017 unrestricted balance equaled a very high 40% of spending, and fiscal 2018 estimates point to an increase to fund balance. According to the city's nine-month budget status report, fiscal 2018 revenues exceeded budget by $80 million, and budgetary and economic reserves (not including unassigned and assigned fund balances) will have increased by about $64 million. The fiscal 2019 general fund budget totals $5.52 billion, a 6.6% increase over the fiscal 2018 budget, and the city closed the $38 million shortfall identified in the March 2018 Five Year Financial Plan. Fitch expects that the city would maintain reserves throughout a downturn at a level above the 8% minimum reserve safety margin consistent with a 'aaa' operating performance assessment.

Budget management is conservative, and the city 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.

A 2009 voter-approved charter amendment led to the adoption of various financial policies, including: two-year budgeting, a biennial five-year forecast with balancing strategies, limiting use of one-time revenues for one-time expenditures and budgetary reserve funding policies and procedures. Importantly, one of the budgetary reserves, 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. This feature reduces volatility in the city's budgeted revenues and limits the reliance on unsustainable revenue growth for ongoing expenditures.

The reserve policies have contributed to the city's improved financial position, helping to rein in expenditure growth during an extended period of economic expansion. Rainy day and budget stabilization reserves increased materially to $449 million in fiscal 2017 from their low point of $39 million in fiscal 2010. Although most of the city's mechanisms remain untested by a severe fiscal shock, in Fitch's view, the city is now well-positioned to absorb future economic and revenue uncertainty.

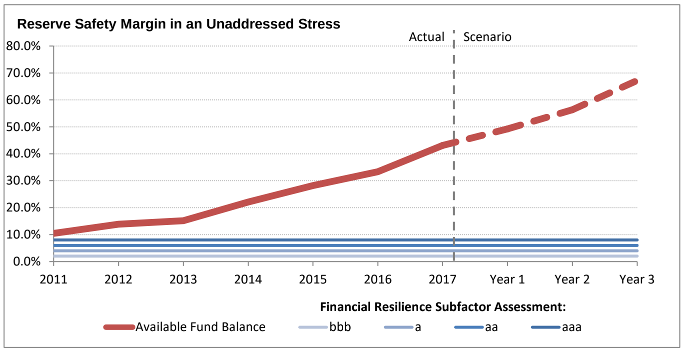
Recent Developments

In November, the city announced an update to its current year revenue projections based on the reallocation of property tax revenue in its educational revenue augmentation fund (a shift of revenues established by state law in 1992). The city will recognize an additional $208 million in fiscal 2018 and $207 million in fiscal 2019, with $156 million of the total automatically allocated to rainy day reserves, $78 million to be allocated to various baselines and the remaining $188 million will be available for appropriation, about which the city is currently debating. The additional $156 million will add to reserves Fitch viewed as already very high.

The city's most recent Five-Year Financial Plan, published in January 2019, projects a $107 million deficit in fiscal 2020, rising to $644 million in fiscal 2024; however, the forecasts are based on conservative assumptions, and Fitch expects the city to take action to address underlying structural deficits.

San Francisco (City & County) (CA)

Scenario Analysis



Analyst Interpretation of Scenario Results:

The city's historically low revenue volatility and large reserves offset limited budget flexibility, based on moderate ability to raise revenues and adequate spending flexibility. As a result, Fitch expects the city to retain superior financial flexibility through economic cycles. Charter- and ordinance-approved financial policies require formulaic deposits to various budgetary and fiscal reserves based on revenue performance, and likewise their use during downturns is limited by formula. The city's solid history of negotiating concessions with labor groups during downturns somewhat offsets constrained labor agreements.

Other available fund balance in the chart below includes the city's rainy day reserves which are included in the audited restricted fund balance.

Scenario Parameters:	Year 1	Year 2	Year 3
GDP Assumption (% Change)	(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)	2.0%	2.0%	2.0%
Revenue Output (% Change)	(1.0%)	3.1%	5.7%
Inherent Budget Flexibility		Limited	

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2011	2012	2013	2014	2015	2016	2017	Year 1	Year 2	Year 3
Total Revenues	2,964,249	3,153,115	3,327,036	3,747,361	4,112,644	4,356,916	4,636,787	4,590,419	4,733,227	5,002,122
% Change in Revenues	-	6.4%	5.5%	12.6%	9.7%	5.9%	6.4%	(1.0%)	3.1%	5.7%
Total Expenditures	2,440,017	2,595,522	2,764,692	2,954,898	3,099,553	3,324,512	3,479,654	3,549,247	3,620,232	3,692,637
% Change in Expenditures	-	6.4%	6.5%	6.9%	4.9%	7.3%	4.7%	2.0%	2.0%	2.0%
Transfers In and Other Sources	114,374	124,131	199,714	223,034	170,284	213,905	142,037	140,617	144,991	153,228
Transfers Out and Other Uses	502,378	553,190	646,912	720,806	873,741	962,343	857,629	874,782	892,277	910,123
Net Transfers	(388,004)	(429,059)	(447,198)	(497,772)	(703,457)	(748,438)	(715,592)	(734,165)	(747,286)	(756,895)
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	136,228	128,534	115,146	294,691	309,634	283,966	441,541	307,007	365,709	552,590
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	4.6%	4.1%	3.4%	8.0%	7.8%	6.6%	10.2%	6.9%	8.1%	12.0%
Unrestricted/Unreserved Fund Balance (General Fund)	274,066	402,018	490,678	728,346	1,005,441	1,308,534	1,744,489	2,051,496	2,417,205	2,969,796
Other Available Funds (GF + Non-GF)	33,439	34,109	26,339	83,194	114,969	120,106	125,689	125,689	125,689	125,689
Combined Available Funds Balance (GF + Other Available Funds)	307,505	436,127	517,017	811,540	1,120,410	1,428,640	1,870,178	2,177,185	2,542,894	3,095,485
Combined Available Fund Bal. (% of Expend. and Transfers Out)	10.5%	13.9%	15.2%	22.1%	28.2%	33.3%	43.1%	49.2%	56.4%	67.3%

Reserve Safety Margins	Inherent Budget Flexibility				
	Minimal	Limited	Midrange	High	Superior
Reserve Safety Margin (aaa)	16.0%	8.0%	5.0%	3.0%	2.0%
Reserve Safety Margin (aa)	12.0%	6.0%	4.0%	2.5%	2.0%
Reserve Safety Margin (a)	8.0%	4.0%	2.5%	2.0%	2.0%
Reserve Safety Margin (bbb)	3.0%	2.0%	2.0%	2.0%	2.0%

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's downturn scenario assumes a -1.0% GDP decline in the first year, followed by 0.5% and 2.0% GDP growth in Years 2 and 3, respectively. Expenditures are assumed to grow at a 2.0% rate of inflation. Inherent budget flexibility is the analyst's assessment of the issuer's ability to deal with fiscal stress through tax and spending policy choices, and determines the multiples used to calculate the reserve safety margin. For further details, please see Fitch's US Tax-Supported Rating Criteria.

The ratings above were solicited and assigned or maintained at the request of the rated entity/Issuer or a related third party. Any exceptions follow below.