

**Rating Action: Moody's upgrades San Francisco's (CA) GOs to Aaa and assigns Aaa to 2018A and 2018B GOs; lease-backed obligations upgraded to Aa1 and Aa2; outlook is stable**

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Global Credit Research - 06 Mar 2018

**Post-issuance, Aaa applies to \$2.3B GO bonds; Aa1 and Aa2 apply to \$1.4B in lease-backed obligations based on asset essentiality**

New York, March 06, 2018 -- Moody's Investors Service has upgraded the City and County of San Francisco's GO rating to Aaa from Aa1 and lease-backed obligation ratings to Aa1 from Aa2 or to Aa2 from Aa3, depending on the essentiality of the assets securing the obligations. Concurrently, Moody's also assigned a Aaa rating to the city's \$76.71 million General Obligation (GO) Bonds (Clean & Safe Neighborhood Parks, 2012), Series 2018A and \$174.59 million GO Bonds (Transportation & Road Improvements, 2014), Series 2018B.

**RATINGS RATIONALE**

The upgrade to Aaa reflects the material strengthening of San Francisco's credit, underscored by its effective management of pension and retiree health liabilities, particularly in contrast to other large cities. Recent charter amendments have controlled benefit growth while bolstering funding which, in combination with San Francisco's strong operating revenue growth have kept fixed cost at a moderate level. The upgrade further reflects long-term strengthening in the city's economy, tax base and socioeconomic profile consistent with Aaa-rated cities and counties, but which could have been negated without effective liability management. The upgrade further incorporates our recognition of San Francisco's role as a regional economic center.

The Aaa GO rating reflects the city's large and diverse tax base with strong long-term growth resulting from commercial and residential development, as well as an unusually strong socioeconomic profile, which has improved in tandem with the economy and tax base. The rating further reflects the city's very strong financial profile, which has greatly benefited from the economic expansion and is stronger than any point in the past decade. Long-term projections indicate that expenditure growth will outpace revenue growth, but this is mitigated by the city/county's demonstrated record of conservative budgeting and financial management practices; here in particular, the charter amendments governing pension and health care benefits and funding are critical tools that should enable San Francisco to maintain its currently very strong credit position. While the city net direct debt level is typical of a California city, an above-average portion of the debt is GO bonds, which is a positive. The city maintains a moderate combined pension, OPEB, and lease burden. The GO rating incorporates 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.

The Aa1 lease-backed ratings are one notch lower than the Aaa GO rating, reflecting a standard California abatement lease legal structure and leased assets that we view as "more essential." These include the Certificates of Participation (COPs) Series 2009, Series 2009B, Series 2009C, Series 2009D, Series 2012A, Series 2017A, Refunding Series 2010A, Series 2013B, Series 2013C, Refunding Series 2014-R1, Refunding Series 2014-R2, Refunding Series 2015-R1; Lease Revenue Bonds (LRBs) Series 2009A; and Lease Revenue Commercial Paper COPs Series 1, Series 1-T, Series 2, Series 2-T, Series 3 and Series 3-T.

Certain Aa1 lease-backed ratings are also one notch lower than the GO rating, despite being secured by less essential assets, reflecting uplift given the demonstrated, stable non-pledged revenue source that provides strong coverage of debt service payments. These include COPs Refunding Series 2011A, Refunding Series 2011B, Series 2017B; LRBs Refunding Series 2008-1 (LOC) and the associated bank bond rating; and LRBs Refunding Series 2008-2 (LOC) and the associated bank bond rating.

The city's equipment leases also have an Aa1 rating because of the strong lease structure where the lease term matches the useful life of the leased assets. These include the LRBs Series 2010-R1, Series 2012A, and Series 2013A.

The Aa2 lease-backed ratings are two notches lower than the Aaa GO rating, reflecting a standard California

abatement lease legal structure and leased assets that we view as "less essential." These include COPs Series 2015A, Series 2015B, and Series 2016A; and LRBs Series 2006 and Series 2007.

#### 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 very strong financial position, which should remain stable given the financial policies implemented by city management.

#### FACTORS THAT COULD LEAD TO AN UPGRADE

- Not applicable

#### FACTORS THAT COULD LEAD TO A DOWNGRADE

- Deterioration of the city's financial position
- Unanticipated and material weakening of the city's economy for a prolonged period of time
- Material increase in debt, pension or OPEB liabilities consistent with a lower rating level

#### LEGAL SECURITY

The GO bond offering is secured by a voter-approved, unlimited ad valorem property tax pledge of all taxable property within the city boundaries.

#### USE OF PROCEEDS

Proceeds of Series 2018A will be used to fund projects authorized by the voters who approved Proposition B in 2012, including improving the safety and quality of neighborhood parks and waterfront open spaces, enhancing water quality and cleaning up environmental contamination along the Bay, replacing unsafe playgrounds, fixing restrooms, improving access for the disabled, and ensuring the seismic safety of park and recreation facilities.

Proceeds of Series 2018B will be used to fund projects authorized by the voters who approved Proposition A in 2014, including construction, redesign, rebuild and repair of streets, sidewalks, infrastructure and improvements that increase Muni service reliability, ease traffic congestion, reduce vehicle travel times, enhance pedestrian and bicycle safety, and improve disabled access.

#### PROFILE

The City and County of San Francisco is the economic, employment and cultural center of the San Francisco Bay Area and northern California. The city encompasses 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 Napa/Sonoma wine country is about an hour drive to the north. The city's population is an estimated 877,000 as of 2016.

San Francisco's city-county organization is unique in California, governed by a board of supervisors, elected from eleven districts, and a mayor who serves as chief executive officer, elected citywide. The city has over 32,000 employees and operates the San Francisco International Airport, San Francisco Municipal Transportation Agency, Port Commission, and Public Utilities Commission.

#### METHODOLOGY

The principal methodology used in the general obligation was US Local Government General Obligation Debt published in December 2016. An additional methodology used in rating the lease-backed obligations was Lease, Appropriation, Moral Obligation and Comparable Debt of US State and Local Governments published in July 2016. Please see the Rating Methodologies page on [www.moodys.com](http://www.moodys.com) for a copy of these methodologies.

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