

Rating Action: Moody's assigns Aaa to San Francisco, CA's 2020B GO bonds

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New York, August 06, 2020 -- Moody's Investors Service has assigned a Aaa rating to the City & County of San Francisco, CA's \$135.8 million General Obligation Bonds (Transportation & Road Improvement, 2014) Series 2020B (Tax-Exempt). Moody's maintains a Aaa rating on the city's \$2.2 billion in outstanding general obligation (GO) bonds and Aa1 and Aa2 ratings on the city's \$1.5 in lease-backed obligations. The outlook is negative.

RATINGS RATIONALE

The Aaa rating reflects the city's large and diverse tax base and unusually strong socioeconomic profile, which has improved in tandem with the economy and tax base over the last decade. The rating further reflects the city's robust financial profile, which prior to the coronavirus outbreak had reached its strongest level in the past decade. The city's long-term projections indicate that expenditures will outpace revenues, though this fits an historic pattern and actual results have been favorable, owing to conservative budgeting and sound financial management. The current downturn will likely challenge that favorable record. City charter provisions governing pension and health care benefits and funding in particular are critical tools for San Francisco to maintain its current financial position. While the city's 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 rapid and widening spread of the coronavirus outbreak, deteriorating global economic outlook, falling oil prices, and financial market declines are creating a severe and extensive credit shock across many sectors, regions and markets. The combined credit effects of these developments are unprecedented. We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. While credit risks related to coronavirus are not immediate, given the city's currently very strong balance sheet, significant spending reductions and other balancing measures will be needed for fiscal 2021 and 2022 to offset expected lower revenue. The longer-term impact will depend on both the severity and duration of the crisis.

RATING OUTLOOK

The negative outlook reflects the forecasted material, multi-year declines for the city's largest tax revenue streams due to effects of the coronavirus outbreak and the potential for deterioration of the city's tax base. Hotel, business, and real property transfer taxes, which combined represented an unusually high 28.4% of fiscal 2019 general fund revenues, will be most affected in the short term and have varying expected rates of recovery. The city is currently projecting recovery of business taxes to prior levels in the near term and no material loss of ad valorem property tax revenue, which represents the city's largest revenue source. However we view any prolonged reduction in business activity due to changes in commuting patterns or potential business relocation, as well as declining rents and likely increases in valuation appeals, as material downside risks to those revenues.

The city has identified large annual funding gaps in its most recent five-year forecast, requiring significant actions to balance the budget in the next two fiscal years, in addition to significant possible additional spending on its coronavirus response. While the city is better positioned than most to meet the challenges of declining revenue and increased expenditures resulting from this public health emergency, current forecasts of revenue declines are severe and identify material longer term risks to the city's economy. As a county, San Francisco has higher than average exposure to expenditure cutting pressures, as it will likely be subject to state reductions in health and welfare funding.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATING

- Not applicable

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATING

- Deterioration of the city's financial position to a materially weaker level
- Prolonged weakening of the city's economy
- Material increase in debt, pension or OPEB liabilities

LEGAL SECURITY

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

USE OF PROCEEDS

Proceeds of the bond issuance will be used for transportation and road improvements, as authorized by a GO bond measure approved by voters in 2014.

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 890,000.

San Francisco's combined city-county organization is unique in California. The city is 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 Airport Commission (A1 stable), San Francisco Municipal Transportation Agency (Aa2 stable), San Francisco Port Commission (Aa3 negative), and San Francisco Public Utilities Commission Water Enterprise (Aa2 stable) and San Francisco Public Utilities Commission Wastewater Enterprise (Aa2 stable).

METHODOLOGY

The principal methodology used in this rating was US Local Government General Obligation Debt published in July 2020 and available at https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBM_1230443. Alternatively, please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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