MOODY'S
INVESTORS SERVICE

Rating Action: Moody's revises outlook on San Francisco, CA to negative; affirms outstanding Aaa GO and Aa1 and Aa2 lease-backed ratings

18 Jun 2020

New York, June 18, 2020 -- Moody's Investors Service has revised the outlook on the City and County of San Francisco, CA's long-term ratings to negative from stable. Concurrently, Moody's affirmed the Aaa rating on the city's $2.6 billion in outstanding general obligation (GO) bonds and the Aa1 and Aa2 ratings on the city's $1.5 billion in lease-backed obligations.

RATINGS RATIONALE

The revision of the outlook to negative from stable reflects the likelihood that the pandemic's impact on San Francisco's economy and financial position will be unusually severe, due in part to its revenue mix, which is more exposed to risks than most cities. Not only is the city highly exposed to relatively volatile revenue from tourism and business travel, but it has exposure to volatility in property taxes. A substantial portion of recent rapid tax base growth resulted from newly developed commercial and multi-family residential properties, which are more at risk of downward reassessment. The city also has steeply graduated property transfer taxes, which will be affected by a slowdown in commercial real estate transactions. The combined effects of these exposures could materially weaken the city's fiscal health absent politically difficult, offsetting expenditure adjustments. The timeframe necessary for such adjustments, however, may be extended given the exceptional strength of the city's balance sheet going into this coronavirus recession.

The Aaa rating continues to reflect 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 Aa1 rating on lease revenue bonds and COPs secured by leases of the city's Moscone Convention Center reflects a one-notch distinction from the city's Aaa GO bond rating. This is narrowed from the typical two notches for a standard California abatement lease of an asset we consider less essential, due to the availability of dedicated but unpledged revenues used to make the lease payments. These obligations benefit from hotel gross receipts taxes established specifically to fund improvements to the assets. The annual revenue from this dedicated hotel tax should be sufficient to cover debt service, despite current revenue declines, minimizing the burden on the General Fund. Nevertheless, these abatement lease payments are payable from all available funds, including accumulated prior year hotel tax revenue.

The Aa1 ratings for other lease-backed obligations reflect the standard one notch distinction from the city's Aaa GO bond rating, which we apply to abatement leases secured by more essential assets and to equipment leases where the term matches the useful life of the leased assets. The Aa2 ratings for lease-backed obligations reflect the standard two notch distinction from the city's Aaa GO bond rating, which we apply to abatement leases secured by less essential assets.

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. Today's action reflects the impact of the crisis on San Francisco. While credit risks related to coronavirus are not immediate, given the city's currently very strong balance sheet, significant spending reductions and other measures will be needed for fiscal 2021 and 2022 to match 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 31% of fiscal 2019 revenues, will be most affected in the short term and have varying expected rates of recovery. While 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, the city's largest revenue source, 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. Additionally, the city has been benefited from a change in the apportionment of property taxes away from the Educational Revenue Augmentation Fund (ERAF), based on recalculation of the obligation under a statutory formula requiring counties to shift taxes collected to schools. While the city has conservatively not relied on this revenue for its ongoing operations, it is forecasting a loss of this $200 million annually starting in fiscal 2022, given the state is now disputing the calculation of excess ERAF by San Francisco and other counties amidst its own fiscal challenges.

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, recent forecasts of revenue declines are more severe than initial estimates in March 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 be likely subject to state reductions in health and welfare funding.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATINGS (OR A STABLE OUTLOOK)

- An upgrade is not applicable

- The negative outlook could be revised to stable if the city is able to mitigate its revenue declines to maintain its financial position, or if revenue declines are less severe than anticipated

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS

- 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

- For those obligations secured by convention center assets, protracted loss of hotel tax revenues being used to fund debt service could result in widened notching

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.

The Lease Revenue Bonds Series 2008-1 and 2008-2, Refunding COPs Series 2011A and Certificates of Participation Series 2017B, rated Aa1, are secured by rental payments under standard abatement lease agreements for certain portions of the Moscone Convention Center, assets we consider less essential, and are paid with a demonstrated, stable non-pledged revenue source.

The remaining Aa1-rated obligations are secured by rental payments under standard abatement lease agreements for assets that we view as more essential or for equipment with a strong lease structure where the lease term matches the useful life of the leased assets. The Aa2-rated obligations are secured by rental payments under standard abatement lease agreements for assets that we view as less essential.

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 Wastewater Enterprise (Aa2 stable).

METHODOLOGY

The principal methodology used in the general obligation ratings was US Local Government General Obligation Debt published in September 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBM_1191097 . The principal methodology used in the lease ratings was Lease, Appropriation, Moral Obligation and Comparable Debt of US State and Local Governments published in July 2018 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBM_1102364 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

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.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

These ratings are solicited. Please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website www.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1133569 .

At least one ESG consideration was material to the credit rating action(s) announced and described above.

The Global Scale Credit Rating on this Credit Rating Announcement was issued by one of Moody's affiliates outside the EU and is endorsed by Moody's Deutschland GmbH, An der Welle 5, Frankfurt am Main 60322, Germany, in accordance with Art.4 paragraph 3 of the Regulation (EC) No 1060/2009 on Credit Rating Agencies. Further information on the EU endorsement status and on the Moody's office that issued the credit rating is available on www.moodys.com.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

Lori Trevino
Lead Analyst
Regional PFG West
Moody's Investors Service, Inc.
One Front Street
Suite 1900
San Francisco 94111
US
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

Alexandra Cimmiyotti
Additional Contact
Regional PFG West
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

Releasing Office:
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

MOODY'S
INVESTORS SERVICE

EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS, AND PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS OR PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER.

MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS ARE NOT INTENDED FOR USE BY ANY PERSON AS A BENCHMARK AS THAT TERM IS DEFINED FOR REGULATORY PURPOSES AND MUST NOT BE USED IN ANY WAY THAT COULD RESULT IN THEM BEING CONSIDERED A BENCHMARK.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing its Publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY CREDIT RATING, ASSESSMENT, OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any credit rating, agreed to pay to Moody's Investors Service, Inc. for credit ratings opinions and services rendered by it fees ranging from $1,000 to approximately $2,700,000. MCO and Moody's investors Service also maintain policies and procedures to address the independence of Moody's Investors Service credit ratings and credit rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold credit ratings from Moody's Investors Service and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moodys.com under the heading "Investor Relations — Corporate Governance —

Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any credit rating, agreed to pay to MJKK or MSFJ (as applicable) for credit ratings opinions and services rendered by it fees ranging from JPY125,000 to approximately JPY250,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.