S&P Global Ratings

RatingsDirect®

Summary:

San Francisco; Appropriations; CP; General Obligation; Joint Criteria

Primary Credit Analyst:
Chris Morgan, San Francisco + 1 (415) 371 5032; chris.morgan@spglobal.com

Secondary Contact:
Li Yang, San Francisco + 1 (415) 371 5024; li.yang@spglobal.com

Table Of Contents

Summary:

San Francisco; Appropriations; CP; General Obligation; Joint Criteria

Credit Profile		
US$316.195 mil GO rfdg bnds ser 2022R1 due 06/15/2034		
Long Term Rating	AAA/Stable	New
US$50.0 mil taxable lse rev cml pap cops ser 3-T due 05/01/2026		
Short Term Rating	A-1+	New
US$50.0 mil tax-exempt lse rev cml pap cops ser 3 due 05/01/2026		
Short Term Rating	A-1+	New
San Francisco City & Cnty GO		
Long Term Rating	AAA/Stable	Outlook Revised

Rating Action

S&P Global Ratings revised the outlook to stable from negative and affirmed its 'AAA' long-term rating and underlying rating (SPUR) on San Francisco's previously issued general obligation (GO) bonds and its 'AA+' long-term rating and SPUR on the city and county's previously issued appropriation obligations.

At the same time, S&P Global Ratings assigned its 'AAA' long-term rating, with a stable outlook, to San Francisco City and County's expected $316.2 million series 2022-R1 general obligation (GO) refunding bonds and its 'A-1+' short-term rating to San Francisco's expected $100 million series 3 (tax-exempt) and 3-T (taxable) lease revenue commercial paper (CP) certificates of participation.

Last, S&P Global Ratings affirmed the following ratings:

- 'AAA/A-1+' joint support rating on the city and county's previously issued series 2008-1 and 2008-2 variable-rate lease revenue obligations; and
- 'A-1+' short-term rating on the city and county's series 1, 1-T, 2, and 2-T CP.

The outlook revision reflects our view of the city and county's effective budgetary management in the face of the economic and operational stresses of the COVID-19 pandemic that has enabled it to emerge amid improving economic conditions with only a slightly weaker financial position. We continue to view its economic base as among the strongest in the nation despite job losses in the leisure and hospitality industry. The rise in remote work could slow both revenue and economic recoveries but we believe long-term fundamentals provide the conditions for sustained improvement in its most economically sensitive revenue streams, such as sales taxes and lodging taxes.

We calculate that the city and county will have approximately $5.8 billion in governmental debt, including institutionally linked tax increment and special assessment debt, outstanding at the end of fiscal 2022.

Revenue from unlimited ad valorem taxes levied on all taxable property, without limitation as to rate or amount, secures the new and previously issued GO bonds. The city and county will use the proceeds of the series 2022-R1 to achieve interest expense savings by refunding previously issued GO debt.

The series 3 and 3-T CP certificates represent interests in rental payments the city makes, as lessor, for the use of city facilities. The city will enter into a revolving credit agreement with Bank of the West running through May 2026. Under the agreement, the city can draw on a line of credit with repayment periods of the earlier of 270 days or the end of the agreement to fund city capital projects in an aggregate amount of as much as $100 million using either series 3 or series 3-T or in combination. We view the bank's commitment as providing sufficient support for liquidity demands under the program, and the short-term rating reflects mapping from our view of the city and county's long-term appropriation credit profile of 'AA+'.

Credit overview

San Francisco's credit stresses associated with the COVID-19 pandemic and recent recession appear to be receding, with high COVID-19 vaccination rates easing the lifting of most public health controls in March 2022, sales tax revenue surging, and a recent extraordinarily strong investment return in its pension system auguring budget relief in the coming years through lower contribution rates. Plus federal support for local governments under the American Rescue Plan Act has facilitated the city and county's management of one-time costs and revenue losses associated with the pandemic, and its financial cushion remains near its record high relative to expenditures. The main short-term blemish in this picture is the condition of the hospitality and retail industries, which appear to be only limping along given a slow recovery in business travel and suppressed international travel. We also see the potential for institutionalized high remote work rates as potentially holding back the performance of the city and county's recently revamped business tax that depends on office occupancy and, potentially, property tax revenue if office lease demand falls in the coming years.

The rating further reflects our view of the city and county's:

- Extraordinarily strong income profile and resilient residential real estate demand during the past two years despite pandemic conditions' having a negative effect on urban centers;
- Very strong management, with multiple reserve-filling mechanisms and robust financial planning practices; and
- Weak debt and contingent liability profile characterized by a large pension and other postemployment benefit (OPEB) obligation and the likelihood of additional GO issuances under existing authorizations but a levy rate policy constraint on issuance.

Environmental, social, and governance

We see elevated exposure to environmental risks, with earthquakes and sea level rise the most prominent. The city has managed seismic risk through the use of robust building codes, and is managing sea level rise through an assessment of vulnerable areas and capital improvements that have included debt-financed seawall construction.

Social risk is also above average, in our view, with a long-standing significant population of people experiencing homelessness and high housing costs that put more people at risk of homelessness, especially during economic downturns. We expect housing and homelessness services to figure prominently in budget decisions and expect affordable housing to be a common use of debt proceeds for the foreseeable future.

We consider governance risk in line with our view of the sector standard, with strengths in the form of timely and public disclosures regarding policy and budgetary challenges and the use of a well-established financial forecasting practice that uses inputs from an independent economist. We find robust political debate common among stakeholders, but the city and county is able to make timely decisions. The city has seen senior officials charged with public corruption related to city contracts and land use controls in recent years, and we understand that internal and external investigations continue with implications for revisions to internal controls, but based on available information we do not believe these events indicate a below-average governance framework.

Stable Outlook

Downside scenario

We could lower the rating during the next two years if we thought that the city and county were having difficulty responding budgetarily to a resurgence in pandemic conditions or if we thought an institutionalized shift in office occupancy had created a major long-term drag on structural budgetary performance. However, even if we saw evidence of a weakening in reserves, the city and county's institutionalized monitoring and forecasting practices would lead us to take into account the timeliness and effectiveness of any efforts to correct an emerging imbalance.

Credit Opinion

Post-pandemic economic recovery has started but has a distance to go

The city is emerging from the 2020 recession and abating pandemic conditions with a battered hospitality and retail industry, an open question regarding how fast--or even if--office workers will return to highly priced workspaces, but also resiliency in residential real estate values.

Upside in leisure and hospitality in the coming year appears particularly strong, with pandemic conditions particularly harming urban centers and cratering demand for local hotel stays in 2020. A high local vaccination rate and low COVID-19 case rate enabled local officials to lift most public health restrictions in March 2022, helping restaurant dining rooms and retail streets fill up again. Hotel market data provider STR reports the mid-March 2022 occupancy rates in San Francisco were up by half from mid-March 2021, and we think that business travel, including convention attendance, is likely to pick up in the coming year but that restrictions on international travel from Asian countries will represent a drag on the recovery.

We are aware of anecdotal reports of office tenants negotiating lower rates or scaling back square footage needs, but we think the effects of remote work will take time to show up in assessed value given the convention of five-year extendable leases. Data using key card swipes, mobile phone locations, and commuter rail exits all point to a tepid recovery in office occupancy, and a Stanford professor's early 2022 survey of office workers in eight major U.S. cities found that San Francisco employees had the highest affirmative response rate to the question of if they plan to be in the office half as frequently as before the pandemic. But even if employers' demand for office square footage remains intact, lower office attendance rates would have negative implications for local spending and business taxes that are tied to employees working on site.

We don't see signs that residential demand is fading, as real estate broker Zillow's smoothed data found the typical property falling in value by 1% in February 2020 to February 2021 but bouncing back by 11% through February 2022. Apartment List data point to a more sensitive rental market, with a 26% drop and a 16% recovery. We anticipate a similar, if smaller in percentage terms, pattern in the local population, with the U.S. Census estimating that San Francisco saw a 6% population loss in July 2020 to July 2021, the sixth-largest numerical loss in the country among counties.

Robust institutionalized policies and practices help the city identify long-term challenges and appear to have helped the city manage the implications of the pandemic.

Elements of the city and county's policies and practices include:

- A charter-required biennial budget that draws on an extensive analysis of revenue and expenditure trends;
- Formal six- and nine-month budget-to-actual updates but no formal reporting early in the fiscal year;
- Charter-required five-year financial planning each year to identify structural budgetary challenges;
- Comprehensive updates to a 10-year capital plan with each biennial budget that identifies funding sources and smaller updates in off years;
- An internal policy that governs the city and county's investment decisions, with monthly reporting on the investment pool's holdings and performance;
- A formal debt policy that provides guidelines for specific areas such as refunding savings thresholds, private placement obligations, and principal outstanding relative to assessed value; and
- Multilayered minimum general fund reserve rules set by ordinance.

The city and county is planning for a gradual increase in its general fund reserve to 3.0% of budgeted general fund revenue by fiscal 2029 from 1.5% in fiscal 2021. In addition, the city and county in fiscal 2011 created a budget stabilization reserve that, together with the "rainy day" reserve created the previous decade, can equal no more than 10% of general fund revenue. The stabilization reserve is funded through the dedication of 75% of volatile revenue, including real property transfer tax receipts in excess of the five-year annual average, funds from the sale of assets, and year-end unassigned general fund balances not assumed to be appropriated in the subsequent year's budget.

We think that the city and county has positioned itself for policy and administrative continuity when senior political and administrative leadership changes by instituting multiple formal policies that direct financial reserves, capital spending, debt, and investment management, as well as comprehensive budget planning and reporting. Many of these date back to the end of the Great Recession, when voters approved Proposition A (2009), which, among other elements, required the controller to annually recommend financial policies to the mayor and board, which could institutionalize them with a two-thirds vote. An example of a change that has borne fruit during the most recent economic expansion was the acceptance of a recommendation to add a budget stabilization reserve that is designed to grow when some of the city and county's most economically sensitive revenue streams, such as property transfer taxes, surge. We think this both added to the city and county's financial cushion before the recession and reduced the city and county's opportunities to increase expenditures on an ongoing basis in response to what could turn out to be unsustainable revenue growth.

Management reports that the city and county has an established information technology policy and a full-time cybersecurity manager who reports to the chief information officer and controller.

Resilient property values, federal support, helped blunt revenue losses associated with the hospitality and retail sectors

We view San Francisco's budgetary performance profile as adequate, with only slightly negative adjusted general fund net results in fiscal 2021, as federal grants under the American Rescue Plan Act affecting fiscal years 2021 and 2022 and a resurgence in sales tax performance so far in fiscal 2022 suggest that the city and county faces a much easier set of trade-offs as it starts fiscal 2023 budget building and may even see a surplus.

Central to the city and county's budgetary challenge going into the pandemic is a revenue structure with a significant portion of economically sensitive revenue, including business taxes, a portion of which depend on work occurring on site, and lodging taxes. But with activity underlying both tax revenue sources recovering and estimates of a 19% sales tax increase relative to fiscal 2021, officials are increasingly confident in the long-term budgetary outlook. Moreover, a particularly robust 34% return in assets against the pension liability points to long-term relief in (smoothed) contributions in the coming years unless there is a major reversal. Accordingly, we believe it increasingly likely that the city and county will be able to retain adjusted reserves approximating 50% for the foreseeable future, or about 5x the cushion at the end of fiscal 2011 (after the Great Recession). We also anticipate that the city and county's liquidity position, which includes resources associated with its enterprises, is likely to remain very strong for the foreseeable future.

More GO debt is coming, but amortization and debt service policy constraints are likely to keep debt ratios at similar ratios

Our debt ratio calculations include tax increment, hotel tax, and special assessment debt associated with the city and county's redevelopment agency under our debt statement analysis criteria. We think that that new borrowing from GO authorizations outstanding could add to the debt burden in nominal terms during the next five years, but the city and county's intention to conform to policy ceilings on levy rates and general fund debt service leads us to expect muted debt ratio growth. Based on prerecession activity elsewhere in the state and the city and county's most recent needs assessment, we think that the city and county could ask voters for additional authorizations this decade if property values hold up and the economic recovery continues.

Large pension and OPEB liability could have a negative effect on financial performance in the coming years, but robust fiscal 2021 investment could provide contribution relief

The city and county participated in the following plans as of June 30, 2021:

- San Francisco City and County Employees Retirement System (SFERS) multiple-employer plan: $5.1 billion in net liability, and 83% funded
- California Public Employees Retirement System (CalPERS) multiple-employer plan for safety employees: $335 million in net liability, and 78% funded
- CalPERS agent multiple-employer plan for miscellaneous employees: $16 million in net assets, and 75% funded
- CalPERS agent multiple-employer plan for redevelopment successor agency employees: $32 million in net liability,

and 75% funded

- CalPERS agent multiple-employer plan for transportation employees: $3 million in net liability, and 75% funded
- Single-employer OPEB plan: $3.8 billion in net liability, and 11% funded

We view the city and county's pension and OPEB liabilities as large, partly because of the size of combined pension and OPEB carrying charges relative to operations and partly because of the low funded ratio of the OPEB and CalPERS liabilities. Although the city and county makes pension contributions based on actuarial assumptions, it does not make full actuarially based OPEB contributions for a liability closed to new employees since 2009, and we believe that combined contributions are unlikely to decline relative to governmental expenditures for the foreseeable future.

The city and county makes its full annual required contribution to SFERS based on an actuarial study, consistent with the requirements of the city and county charter and level-percentage amortization periods of as long as 20 years, which matches our baseline assumption for pension plans. Payments fell slightly short of actual minimum funding progress but exceeded our calculation of static funding progress in 2020. SFERS more than cleared its 7.2% discount rate that took effect for fiscal 2022 in fiscal 2021, but we view this discount rate as potentially leading to contribution volatility over time as it is above our 6.0% baseline. SFERS projects mortality rates on a generational basis, and this, in our view, reduces the risk of significant upward revisions to liabilities following experience studies--providing more consistency to contribution rates over time.

The city and county provides OPEB in the form of health care. Although charter changes that voters approved have tightened eligibility rules and required employee contributions to the liability, we do not believe the current employee and employer contributions represent a plan that will substantially address this liability.

Strong institutional framework

The institutional framework score for California municipalities required to submit a federal single audit is strong. The city and county is subject to the federal single-audit requirement because it receives federal awards across at least two programs that collectively exceed $750,000 annually. These two conditions trigger enhanced financial reporting requirements under state law.

Issue ratings above the U.S. sovereign rating

The issue ratings associated with the city and county's GO bonds are based on our view that the city and county's general creditworthiness is above that of the U.S. sovereign. We do not expect the city and county to default in a stress scenario likely to accompany a sovereign default given autonomy from sovereign intervention. We view the city as exhibiting relatively low funding interdependency with the federal government, as local taxes represent the vast majority of total governmental funds revenue. However, consistent with our view that U.S. state and local governments are moderately sensitive to country risk, we would be unlikely to set ratings on the city's obligations more than two notches above the U.S. sovereign rating.

San Francisco Key Credit Metrics				
	Most recent	Historical information		
		2021	2020	2019
Very strong economy				
Projected per capita EBI as % of U.S.	239			
Market value per capita ($)	402,355			
Population		815,201	873,965	896,998
County unemployment rate (%)			7.8	
Market value ($000s)	328,000,000	318,846,449	297,057,986	259,329,479
Ten largest taxpayers as % of taxable value	3.3			
Adequate budgetary performance				
Operating fund result as % of expenditures		(0.9)	(0.6)	10.3
Total governmental funds result as % of expenditures		16.2	2.1	20.6
Very strong budgetary flexibility				
Available reserves as % of operating expenditures		48.0	53.0	56.5
Total available reserves ($000s)		2,667,390	2,683,845	2,714,961
Very strong liquidity				
Total government cash as % of governmental funds expenditures		148	140	137
Total government cash as % of governmental funds debt service		2,077	2,153	1,735
Very strong management				
Financial management assessment	Strong			
Weak debt and long-term liabilities				
Debt service as % of governmental funds expenditures		7.1	6.5	7.9
Net direct debt as % of governmental funds revenue	67			
Overall net debt as % of market value	2.3			
Direct debt 10-year amortization (%)	34			
Required pension contribution as % of governmental funds expenditures		11.6		
OPEB actual contribution as % of governmental funds expenditures		3.4		
Strong institutional framework				

Note: Data points and ratios may reflect analytical adjustments. EBI--Effective buying income. OPEB--Other postemployment benefits.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- Medians And Credit Factors: California Municipalities, Jan. 22, 2020
- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

- Pension Spotlight: California, July 13, 2021
- 2021 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of April 7, 2022)		
San Francisco City and County cert of part (Multiple Capital Improvements) ser 2021A due 04/01/2041		
Long Term Rating	AA+/Stable	Outlook Revised
San Francisco City and County taxable lse rev cml pap cops ser 3-T due 05/01/2026		
Short Term Rating	A-1+	Affirmed
San Francisco City and County tax-exempt lse rev cml pap cops ser 3 due 05/01/2026		
Short Term Rating	A-1+	Affirmed
San Francisco City and County GO bnds (Earthquake Safety & Emergency Response) ser E-1/E-2 due 06/15/2046		
Long Term Rating	AAA/Stable	Outlook Revised
San Francisco City and County GO bnds (Health & Recovery) ser D-1/D-2 due 06/15/2046		
Long Term Rating	AAA/Stable	Outlook Revised
San Francisco City and County GO bnds (Transportation & Rd Imp Bnds) ser C-1/C-2 due 06/15/2046		
Long Term Rating	AAA/Stable	Outlook Revised
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Outlook Revised
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Outlook Revised
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Outlook Revised
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Outlook Revised
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Outlook Revised
San Francisco City & Cnty certs of part (49 South Van Ness Proj) ser 2019A due 04/01/2050		
Long Term Rating	AA+/Stable	Outlook Revised
San Francisco City & Cnty rfdg certs of part (multiple cap imp projects) ser 2020-R1 due 10/01/2033		
Long Term Rating	AA+/Stable	Outlook Revised
San Francisco City & Cnty rfdg certs of part (Multiple Cap Imp Proj) due 04/01/2035		
Long Term Rating	AA+/Stable	Outlook Revised
San Francisco City & Cnty taxable GO bnds		
Long Term Rating	AAA/Stable	Outlook Revised
San Francisco City & Cnty CP 1		
Short Term Rating	A-1+	Outlook Revised
San Francisco City & Cnty CP 1-T		
Short Term Rating	A-1+	Outlook Revised
San Francisco City & Cnty CP 2		
Short Term Rating	A-1+	Outlook Revised

Ratings Detail (As Of April 7, 2022) (cont.)		
San Francisco City & Cnty CP 2-T		
Short Term Rating	A-1+	Outlook Revised
San Francisco City & Cnty GO bnds (pub hlth and safety, 2016) ser 2020D-1 due 06/15/2040		
Long Term Rating	AAA/Stable	Outlook Revised
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Outlook Revised
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Outlook Revised
San Francisco City & Cnty (Juvenile Hall Proj)		
Long Term Rating	AA+/Stable	Outlook Revised
San Francisco City & Cnty (Moscone Center South Rfdg Proj)		
Long Term Rating	AA+/Stable	Outlook Revised
San Francisco City & Cnty (Moscone Expansion Dist Proj)		
Long Term Rating	AA+/Stable	Outlook Revised
San Francisco City & Cnty (Multiple Capital Improvement Projs)		
Long Term Rating	AA+/Stable	Outlook Revised
San Francisco City & Cnty (MBIA) (National)		
Unenhanced Rating	AA+(SPUR)/Stable	Outlook Revised
San Francisco City & Cnty (Port Facs Proj)		
Long Term Rating	AA+/Stable	Outlook Revised
San Francisco City & Cnty (Port Facs Proj)		
Long Term Rating	AA+/Stable	Outlook Revised
San Francisco City & Cnty 2020 certs of part (animal care & control proj) ser 2020A due 04/01/2041		
Long Term Rating	AA+/Stable	Outlook Revised
San Francisco City & Cnty Fin Corp, California		
San Francisco City and County, California		
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty)		
Long Term Rating	AA+/Stable	Outlook Revised
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty) rfdg lse rev bnds (Brand Lib Imp Prog)		
Long Term Rating	AA+/Stable	Outlook Revised
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty) rfdg lse rev bnds (Open Space Fund)		
Long Term Rating	AA+/Stable	Outlook Revised
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty) JOINTCRIT		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	AA+(SPUR)/Stable	Outlook Revised
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty) JOINTCRIT		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	AA+(SPUR)/Stable	Outlook Revised

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.