S&P Global Ratings

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Summary:

San Francisco City and County; Appropriations; CP; General Obligation; Joint Criteria

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Credit Profile		
US$189.735 mil GO bnds (Earthquake Safety And Emergency Reponse) ser 2018C due 06/15/2038		
Long Term Rating	AA+/Positive	New
US$142.255 mil GO bnds (Affordable Hsg) ser 2018D due 06/15/2038		
Long Term Rating	AA+/Positive	New
US$50.085 mil GO bnds (Public Health And Safety) ser 2018E due 06/15/2038		
Long Term Rating	AA+/Positive	New

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to San Francisco City and County's series 2018C-E general obligation (GO) debt. At the same time, S&P Global Ratings affirmed its 'AA+' long-term rating on the city and county's GO debt, and its 'AA' long-term rating and underlying rating (SPUR) on the city and county's appropriation obligations. The outlook on these ratings is positive. S&P Global Ratings also affirmed its 'AAA/A-1+' joint-support rating on the city and county's series 2008 variable-rate lease revenue obligations, and its 'A-1+' short-term rating on the series 1, 1-T, 2, 2-T, 3, and 3-T commercial paper (CP).

Revenue from unlimited ad valorem taxes levied on all taxable property, without limitation as to rate or amount, secures the series 2018C-E GO bonds as well as previously issued GO bonds. Lease payments by the city and county for the use of capital facilities secure the appropriation obligations. Our joint rating on the city and county's lease revenue bonds, which have received joint credit support (series 2008-1 and 2008-2), reflects our application of joint support criteria as well as a letter of credit from State Street Bank and Trust Co. Last, the rating on the CP reflects our view of the city and county's covenant to appropriate quarterly rental payments and credit agreements with State Street Bank and Trust (series 1 and 1-T) and U.S. Bank N.A. (series 2 and 2-T).

The city and county will use proceeds from this issuance to fund:

- Infrastructure and facility improvements to aid emergency response to earthquakes, focusing on water supply and fire and police stations (2018C);
- Low- and middle-income housing programs, including those that promote the preservation of existing housing, development of new housing, and rental and down payment assistance (2018D); and
- Program and facility improvements to aid emergency response capacity, focusing on medical and mental health (2018E).

The ratings reflect our view of the city and county's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Very strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 46% of operating expenditures;
- Very strong liquidity, with total government available cash at 122.8% of total governmental fund expenditures and 16x governmental debt service, and access to external liquidity we consider exceptional;
- Weak debt and contingent liability position, with debt service carrying charges at 7.7% of expenditures and net direct debt that is 85.8% of total governmental fund revenue, and a large pension and other postemployment benefit (OPEB) obligation and the lack of a plan to sufficiently address the obligation, but low overall net debt at less than 3.0% of market value; and
- Strong institutional framework score.

Very strong economy

We consider the city and county's economy very strong. San Francisco, with an estimated population of 874,228, is located in the San Francisco-Oakland-Hayward MSA, which we consider broad and diverse. The city and county has a projected per capita effective buying income of 200% of the national level and per capita market value of $267,750. Overall, the city and county's market value grew by 10.7% over the past year to $234.1 billion in 2018. The county unemployment rate was 3.3% in 2016.

During the current economic expansion, San Francisco has been rivaling Silicon Valley cities as a locus of growth in high-paying information technology jobs. The Salesforce Tower, which in January 2018 ended the Transamerica Pyramid's 45-year reign as the city's tallest structure, physically exemplifies this dynamic. The tower's eponymous owner--a customer relationship management service provider--now has more employees than San Francisco stalwarts such as Wells Fargo, Gap, and Kaiser Permanente. The city's South of Market (SOMA) district, where the tower is located, has seen several other major private commercial and residential projects in recent years, and is receiving public investment in the form of a new subway line and rebuilds of its transit hub and convention center. This has extended the city's downtown southward, and is contributing to the city and county's efforts to address a long-term shortfall in housing production relative to job growth. At the same time, San Francisco faces multiple market, regulatory, and capital challenges related to housing affordability and transportation capacity. Should the regional and national economic expansion continue, we think the city and county's ability to address these challenges will play an outsized role in San Francisco's long-term economic growth.

For now, assessed value (AV) growth, which was already proceeding at a brisk pace from a large base, crested above 10% in fiscal 2018. This reflects a mix of new construction and property ownership turnover in one of the U.S.' strongest real estate markets. Consistent with our expectation of real GDP growth in the western U.S. states, and San Francisco's positive momentum, we anticipate that AV growth will continue through fiscal 2020, although at a moderating pace.

Very strong management

In December 2017, Mayor Ed Lee died unexpectedly. After a short period in which the office was held by London Breed, who is a candidate for the June 2018 election that will determine who will serve out the remainder of the term that runs through 2020, the board in January 2018 appointed supervisor Mark Farrell, who we understand is not running, as mayor for the interim period. We have identified no major operational or policy changes resulting from the transition, but we anticipate that a new administration could have differing policy priorities. We will monitor the situation for any shifts in budgeting approach and debt management, which we view as being cautious during the current economic expansion given the city and county's capital backlog and other spending options.

The potential for continuity, in our view, is supported by 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, who could institutionalize them with a two-thirds vote. An example of a change that has borne fruit during the current economic expansion is 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, are at their peak. We think this has both added to the city and county's financial cushion 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.

We view the city and county's management as very strong, with strong financial policies and practices under our FMA methodology, indicating our view that financial practices are strong, well embedded, and likely sustainable. Highlights include:

- A charter-required biennial budget draws on an extensive analysis of revenue and expenditure trends.
- Within the fiscal year, the controller's office issues formal six- and nine-month budget updates, but doesn't regularly update the board on financial performance early in the fiscal year.
- The city and county's charter requires management to annually prepare a five-year financial plan to identify structural budgetary challenges.
- Capital spending is informed by a 10-year plan updated for each biennial budget that identifies funding sources.
- An internal policy governs the city and county's investment decisions, and management provides reports monthly on the investment pool's holdings and performance.
- A formal debt policy provides guidelines for specific areas such as refunding savings thresholds, private placement obligations, and principal outstanding relative to AV.
- The city and county's minimum general fund reserve rules are set by ordinance, which provides for a gradual increase to 3.0% of budgeted general fund revenue by fiscal 2021 from 1.5% in fiscal 2015. 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.

Strong budgetary performance

San Francisco's budgetary performance is very strong, in our opinion. The city and county had operating surpluses of 10.9% of expenditures in the general fund and of 12.3% across all governmental funds in fiscal 2017.

With the possible exception of lodging taxes, which dropped slightly in fiscal 2017 and could fall further in fiscal 2018 as San Francisco rebuilds its convention center, the city and county's budgetary performance is running from strength to strength on robust tax performance and careful management of spending growth. In our view, this is largely due to the mayor's office's recommendations to deploy much of the city's recent revenue growth to address a backlog of capital needs with one-time spending and largely avoiding recurring spending.

As much of this revenue growth is related to economically sensitive real property transfer taxes, the strength of which has triggered formula-driven contributions to a rainy day reserve and a budget stabilization reserve, we expect general fund performance has peaked with the fiscal 2017 result--one of the strongest results among its peers last year. In addition, the city and county's March 2018 forecast shows a baseline general fund gap equivalent to 1% fiscal 2017 adjusted expenditures in the upcoming fiscal year. However, based on a record of conservative budgeting and no signs of an economic slowdown, we anticipate that general fund net results will exceed 5% of expenditures through fiscal 2019.

The longer view appears more challenging. The city and county's March 2018 forecast, which covers the period ending 2022, shows slight improvements in net operations from the city and county's December 2017 forecast as a result of stronger experience- and external forecast-driven tax revenue assumptions and lower projected pension contribution rates. But the report also concludes that that much of the budgetary relief in the upcoming biennium will be one-time in nature and does not incorporate risks such as an economic downturn or curtailment in federal grants. Even with these medium-term benefits, baseline spending outpaces revenue growth in each year, resulting in a cumulative four-year shortfall equivalent to 16% of fiscal 2017 adjusted expenditures. Therefore, we anticipate that a continued economic expansion might delay, but is unlikely to remove, the need for spending reductions if San Francisco City and County is to maintain structurally balanced operations in the long term.

Our assessment of the city and county's budgetary performance profile also takes into account our view that deferred capital investment masks long-term operating costs and will likely lead to higher spending. The capital plan, which covers the period ending 2027, shows considerable capital investment tied to GO and other funding, doesn't anticipate reaching a sustainable match between funding and costs for repair and renewal needs until fiscal 2032, based on current trends. Street maintenance is the largest single cost, and the city and county also intends to move utility infrastructure below streets and sidewalks and improve streetscapes.

Very strong budgetary flexibility

San Francisco's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 46% of operating expenditures, or $1.9 billion. We expect the available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

Our calculation of available reserves includes general fund balances that are unassigned, assigned, and committed for budget stabilization, as well as certain portions of the rainy day reserve for economic stabilization, which we believe the city and county would be able to use during periods of economic stress. We have adjusted general fund expenditures upward for recurring transfers that, in our view, function like ongoing expenditures. The city and county makes these transfers regularly to San Francisco General Hospital, Laguna Honda Hospital, and the Municipal Transportation Agency. We believe rising baseline costs, such as those for pensions and voter-approved baseline expenditures, could eventually weaken budgetary flexibility, especially if they coincide with a major recession. However, we anticipate that San Francisco City and County's available general fund balance fund will remain well above our 15%-of-expenditures minimum threshold for very strong financial flexibility.

The city and county's December 2017 and March 2018 budgetary updates suggest continued strengthening in reserves for fiscal 2018. Consistent with our expectation of positive general fund performance for fiscal 2019, we anticipate the city and county's available fund balance will reach and exceed 50% of expenditures during our two-year outlook horizon.

Very strong liquidity

In our opinion, San Francisco's liquidity is very strong, with total government available cash at 122.8% of total governmental fund expenditures and 16x governmental debt service in 2017. In our view, the city and county has exceptional access to external liquidity if necessary. We anticipate that the city and county's liquidity profile will remain very strong for the foreseeable future, partly as a result of our very strong financial performance assessment, and we view its frequent debt issuances, across a range of securities during the past 15 years, as evidence of its exceptional access to external liquidity.

The city and county has an internal investment policy that complies with state guidelines, and it holds the bulk of its liquid assets in an investment pool, which it manages on behalf of itself and other agencies, such as the school district. As of March 2018, the pool held most of its liquid assets in U.S. Treasuries and agencies, representing 58% of assets by market value, followed by certificates of deposit (22%) and CP (7%).

Partly as a result of the city and county's growing operations and reserves and a lack of need, in practice, to support its contingent liability agreements, we no longer view the city and county as having a material nonremote contingent liability exposure. The largest potential exposure, in our view, consists of an agreement to make payments on as much as $260 million in potential variable-rate notes associated with the Transbay Joint Powers Authority Transbay Transit Center project. These obligations stand at $103 million and are supported by tax increment and special assessment revenue that the authority receives. The second major exposure is an agreement to step in to obviate missed payments on a $97 million loan supported by the Asian Art Museum Foundation. Should the city and county be required to support either obligation, we anticipate that its exposure, in practice, would likely be much less than the full balance of the obligations in any given year.

Weak debt and contingent liability profile

In our view, the city and county's debt and contingent liability profile is weak. Total governmental fund debt service is 7.7% of total governmental fund expenditures, and net direct debt is 85.8% of total governmental fund revenue. Overall net debt is low at 2.8% of market value, which is, in our view, a positive credit factor.

Our calculation of net direct debt excludes self-supporting revenue obligations but includes the city and county's former redevelopment agency debt, which represented 21% of net direct debt at the end of fiscal 2017. The city and county has $24 million in alternative financing--variable-rate GO bonds issued in August 2015--that we don't consider a source of material contingent liquidity risk. Variable-rate debt supported by governmental funds represents about 3% of net direct debt.

After the issuance of the series 2018C-E, the city and county will have $742 million in voter-authorized, unissued GO debt for various projects, including $259 million in GO bonds for transportation (approved in 2014), about $127 million for public health and safety (after the series 2018E), and about $93 million for affordable housing (after the series 2018D). We further anticipate that San Francisco City and County will ask voters for additional GO authorization in the next several years--the board of supervisors will consider placing a $425 million authorization on the November 2018 ballot next month--to meet identified capital needs, particularly if AV growth continues. At the same time, the city and county's intention to conform to a policy levy rate ceiling outlined in its 2017 capital plan leads us to expect muted growth in its debt ratios in the medium and likely long term.

San Francisco City and County's large pension and OPEB obligations, without a plan in place that we think will sufficiently address them, is a credit weakness, in our opinion. The city and county's combined required pension and actual OPEB contributions totaled 13.7% of total governmental fund expenditures in 2017, with 10.3% representing required contributions to pension obligations and 3.5% representing OPEB payments. The city and county made its full annual required pension contribution.

The city and county and its employees participate in a few cost-sharing, multi-employer retirement plans: the San Francisco City and County Employees Retirement System (SFERS), and the California Public Employees Retirement System's (CalPERS) safety and miscellaneous plans. The funded ratio, as measured by the plan fiduciary net position as a percentage of the total pension liability of the largest plan, SFERS, was 77.6%, which we view as low, in 2017.

The city provides OPEB in the form of health care. The unfunded actuarial accrued liability stood at $4.2 billion as of the end of fiscal 2014, after deduction of assets of $49.0 million.

Although the creation of new, lower-cost pension benefit tiers should bend the cost curve in the very long term, actuarial calculations suggest higher contributions are likely into the next decade, and with a virtually unfunded OPEB liability we anticipate that these already large costs will represent increasing budgetary challenges.

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.

Outlook

The positive outlook reflects our view that San Francisco City and County's new mayoral administration, which will take office starting fiscal 2019, and board of supervisors could continue budgeting practices that have helped the city and county significantly strengthen reserves during the current economic expansion. We see at least a one-in-three chance that we could raise our rating during the next two years because of our expectation that the city and county will be able to build on, or at least consolidate, recent financial gains. Although flagging tax revenue growth could make it more difficult for the city and county to sustain very strong performance, we anticipate the decisive factor in whether to raise the rating to 'AAA' will be our view of the likelihood that the city and county can sustain long-term structural balance, despite challenges such as rising pension and OPEB costs.

Consistent with our expectation of good-to-strong economic growth during our two-year outlook horizon, we anticipate that the city and county will continue to make formula-driven deposits into its rainy day and budget stabilization reserves, such that they will approach their 10%-of-revenue combined maximum. In addition, we believe our calculation of the city and county's overall financial position will rise in some form during the two-year outlook horizon, albeit likely at a slower pace. We further anticipate that a new mayoral administration will initially follow the policy goals of the 2017 capital plan, which we think puts the city and county on a path to start making progress on its projects and maintenance backlog, while tailoring debt issuance to the city and county's levy rate goals.

We could revise the outlook to stable if the city and county's financial performance substantially falters, which could result from a sharp downturn in tax revenue without effective budget-balancing actions, or if the city and county accelerates capital spending in response to its identified needs and it draws down available general fund balance.

Related Research

2017 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of April 25, 2018)		
San Francisco City & Cnty certs of part (Hope Sf)		
Long Term Rating	AA/Positive	Affirmed
San Francisco City & Cnty certs of part (Moscone Expansion District Project)		
Long Term Rating	AA/Positive	Affirmed
San Francisco City & Cnty certs of part (Multiple Capital Improvement Projs)		
Long Term Rating	AA/Positive	Affirmed
San Francisco City & Cnty certs of part (Port Facs Proj)		
Long Term Rating	AA/Positive	Affirmed
San Francisco City & Cnty certs of part (Port Facs Proj)		
Long Term Rating	AA/Positive	Affirmed
San Francisco City & Cnty certs of part (War Memorial Veterans Building) ser 2016A due 04/01/2032		
Long Term Rating	AA/Positive	Affirmed
San Francisco City & Cnty lse rev commerical paper certs of part ser 1 due 05/25/2021		
Short Term Rating	A-1+	Affirmed
San Francisco City & Cnty lse rev commerical paper certs of part ser 1-T due 05/25/2021		
Short Term Rating	A-1+	Affirmed
San Francisco City & Cnty lse rev commerical paper certs of part ser 2 due 05/25/2021		
Short Term Rating	A-1+	Affirmed
San Francisco City & Cnty lse rev commerical paper certs of part ser 2-T due 05/25/2021		
Short Term Rating	A-1+	Affirmed

Ratings Detail (As Of April 25, 2018) (cont.)		
San Francisco City & Cnty rfdg certs of part		
Long Term Rating	AA/Positive	Affirmed
San Francisco City & Cnty rfdg certs of part (City Office Buildings)		
Long Term Rating	AA/Positive	Affirmed
San Francisco City & Cnty rfdg certs of part (Juvenile Hall Proj)		
Long Term Rating	AA/Positive	Affirmed
San Francisco City & Cnty rfdg certs of part (Moscone Center North Rfdg Proj)		
Long Term Rating	AA/Positive	Affirmed
San Francisco City & Cnty rfdg certs of part (Moscone Center South Rfdg Proj)		
Long Term Rating	AA/Positive	Affirmed
San Francisco City & Cnty rfdg certs of part (San Francisco Courthouse Proj)		
Long Term Rating	AA/Positive	Affirmed
San Francisco City & Cnty COPs (federally taxable) (War Memorial Vets Building Seismic Upgrade & Imprmts) ser 2015B due 04/01/2030		
Long Term Rating	AA/Positive	Affirmed
San Francisco City & Cnty COPs (War Memorial Vets Building Seismic Upgrade & Improvements) ser 2015A due 10/01/2040		
Long Term Rating	AA/Positive	Affirmed
San Francisco City & Cnty APPROP		
Long Term Rating	AA/Positive	Affirmed
San Francisco City & Cnty APPROP		
Long Term Rating	AA/Positive	Affirmed
San Francisco City & Cnty APPROP		
Long Term Rating	AA/Positive	Affirmed
San Francisco City & Cnty APPROP		
Long Term Rating	AA/Positive	Affirmed
San Francisco City & Cnty APPROP (MBIA of Illinois)		
Unenhanced Rating	AA(SPUR)/Positive	Affirmed
San Francisco City & Cnty GO		
Long Term Rating	AA+/Positive	Affirmed
San Francisco City & Cnty GO		
Long Term Rating	AA+/Positive	Affirmed
San Francisco City & Cnty certs of part (Juvenile Hall Replacement Proj) ser 2003		
Unenhanced Rating	AA(SPUR)/Positive	Affirmed
San Francisco City & Cnty GO		
Long Term Rating	AA+/Positive	Affirmed
San Francisco City & Cnty Fin Corp, California		
San Francisco City & Cnty, California		
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty) lse rev bnds (Equip Prog)		
Long Term Rating	AA/Positive	Affirmed

Ratings Detail (As Of April 25, 2018) (cont.)		
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty) APPROP		
Long Term Rating	AA/Positive	Affirmed
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty) APPROP		
Long Term Rating	AA/Positive	Affirmed
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty) JOINTCRIT		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	AA(SPUR)/Positive	Affirmed
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty) JOINTCRIT		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	AA(SPUR)/Positive	Affirmed
San Francisco City & Cnty Fin Corp lse (Comb Emergency Communications Sys Equip) ser 1998		
Unenhanced Rating	AA(SPUR)/Positive	Affirmed
San Francisco City & Cnty Fin Corp lse (Open Space Fund - Var Pk Projs) ser 2006		
Unenhanced Rating	AA(SPUR)/Positive	Affirmed
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty) (Open Space Fund - Var Pk Projs) ser 2007		
Unenhanced Rating	AA(SPUR)/Positive	Affirmed

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 the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.