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$75.0 mil taxable GO bnds (social bnds affordable hsg 2016) ser 2019A due 06/15/2059		
Long Term Rating	AAA/Stable	New
San Francisco City & Cnty GO		
Long Term Rating	AAA/Stable	Upgraded
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Upgraded
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Upgraded
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Upgraded
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Upgraded
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Upgraded
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Upgraded
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Upgraded
San Francisco City & Cnty GO		
Long Term Rating	AAA/Stable	Upgraded
San Francisco City & Cnty GO		
Long Term Rating	AAA/Stable	Upgraded
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Upgraded
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Upgraded
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Upgraded
San Francisco City & Cnty (Juvenile Hall Proj)		
Long Term Rating	AA+/Stable	Upgraded
San Francisco City & Cnty (Moscone Center South Rfdg Proj)		
Long Term Rating	AA+/Stable	Upgraded
San Francisco City & Cnty (Moscone Expansion Dist Proj)		
Long Term Rating	AA+/Stable	Upgraded

Credit Profile (cont.)		
San Francisco City & Cnty (Multiple Capital Improvement Projs)		
Long Term Rating	AA+/Stable	Upgraded
San Francisco City & Cnty (National)		
Unenhanced Rating	AA+(SPUR)/Stable	Upgraded
San Francisco City & Cnty (Port Facs Proj)		
Long Term Rating	AA+/Stable	Upgraded
San Francisco City & Cnty (Port Facs Proj)		
Long Term Rating	AA+/Stable	Upgraded
San Francisco City & Cnty (San Francisco Courthouse Proj)		
Long Term Rating	AA+/Stable	Upgraded
San Francisco City & Cnty certs of part (Juvenile Hall Replacement Proj) ser 2003		
Unenhanced Rating	AA+(SPUR)/Stable	Upgraded
San Francisco City & Cnty Fin Corp, California		
San Francisco City & Cnty, California		
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty)		
Long Term Rating	AA+/Stable	Upgraded
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty)		
Long Term Rating	AA+/Stable	Upgraded
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty) rfdg lse rev bnds (San Francisco City & Cnty) (Brand Lib Imp Prog) ser 2018B due 06/15		
Long Term Rating	AA+/Stable	Upgraded
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty) rfdg lse rev bnds (San Francisco City & Cnty) (Open Space Fund) ser 2018A due 07/01/20		
Long Term Rating	AA+/Stable	Upgraded
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty) JOINTCRIT		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	AA+(SPUR)/Stable	Upgraded
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty) JOINTCRIT		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	AA+(SPUR)/Stable	Upgraded
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty) (MBIA) (National)		
Unenhanced Rating	AA+(SPUR)/Stable	Upgraded

Rationale

S&P Global Ratings raised its long-term rating to 'AAA' from 'AA+' on San Francisco City and County's general obligation (GO) debt and raised its long-term rating and underlying rating to 'AA+' from 'AA' on the city and county's appropriation obligations. S&P Global Ratings also assigned its 'AAA' long-term rating to the city and county's series 2019A taxable GO bonds. Finally, S&P Global Ratings affirmed its 'AAA/A-1+' joint-support rating on the city and county's series 2008-1 and 2008-2 variable-rate lease revenue obligations, and its 'A-1+' short-term rating on the city and county's series 1, 1-T, 2, and 2-T commercial paper (CP). We calculate that the city and county will have approximately $4.5 billion in governmental debt outstanding at the end of fiscal 2019. The outlook, where applicable, is stable.

The rating action reflects our view of continuity in the city and county's cautious budgeting approach across changes in political leadership during a prolonged economic expansion. While interrelated strengthening in real estate values, employment, hotel stays, and retail activity have brought surging tax receipts, the city and county has repeatedly budgeted its revenue conservatively, which has led to spending discipline and a seven-year streak of positive general fund results. We view this pattern as likely to continue through fiscal 2019, even if the city and county's very low unemployment rate and housing affordability might be constraining medium term economic growth. We think San Francisco's ample reserves and voter-approved reserve contribution mechanisms position it to continue to manage challenges such as long-term growth in pension and other postemployment benefits (OPEB) costs during the next economic downturn but we expect to monitor the degree to which the city and county can maintain spending discipline.

Security and use of proceeds

Revenue from unlimited ad valorem taxes levied on all taxable property, without limitation as to rate or amount, secures the series 2019A GO bonds and the city and county's previously issued GO bonds.

Lease payments by the city and county for the use of capital facilities secure or represent an interest in its previously issued appropriation obligations, with some having additional nuances. Payments are subject to abatement in the event of damage or destruction, but the city and county has covenanted to maintain rental interruption insurance of at least two years and the properties meet our criteria for seismic risk during the life of the obligations. Our rating on the city and county's series 2008-1 and 2008-2 lease revenue bonds reflects our application of joint support criteria, which takes into account the city and county's appropriation credit profile and a letter of credit from State Street Bank and Trust Co. expiring in October 2019. The CP ratings reflect 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, 1-T) and U.S. Bank N.A. (series 2 and 2-T). Finally, for its previously issued series 2018A lease revenue refunding bonds, the city and county has covenanted to use a voter-approved property tax set-aside of its regular property tax revenue at a rate of 2.5 cents per $100 of assessed value (AV) for parks and recreation services and capital projects to make lease payments. The city and county reports that it does not consider its general fund obligated to make debt service payments, but, consistent with our "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" criteria, we maintain a rating one notch below our view of the city and county's general creditworthiness to take into account the combination of our view that ad valorem property tax revenue and collections are linked to an obligor's general creditworthiness and appropriation risk inherent to the lease structure. The 2018A represents the only debt obligations payable from this property tax revenue, which totaled a preliminary $46.9 million, or about 11x annual debt service, in fiscal 2018.

The city and county will use proceeds from the series 2019A for local loans to finance affordable housing improvements, including rehabilitation and seismic retrofitting.

Credit overview

San Francisco is running from strength to strength, with a robust employment market buoyed by its role as a rival for Silicon Valley as a locus for the information technology industry's employment growth during this economic expansion. This has translated into rising housing prices, ample real estate transfer tax revenue as commercial property turns over, and a likely resurgence in hotel tax revenue in 2019 as its renovated and expanded convention center reopens. At the same time, the city and county is managing the complex and costly long-term challenges, including homelessness and other social problems; infrastructure deferred maintenance; and pension and OPEB costs. We anticipate that the city and county will continue to post strong results through fiscal 2019 and potentially build up its general fund position to a multiyear high in excess of 50% of expenditures. We think the city and county is well prepared for the next down-cycle partly as a result of voter-approved changes in 2009 to financial management that require set-asides to a rainy day reserve and budget stabilization reserve.

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 methodology;
- Very strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2017;
- 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 75.2% 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

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 and county'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 and county'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. Notwithstanding the discovery of structural defects in the transit center that forced its temporary closure, we see the city and county's downtown as likely to continue expanding southward.

Overall, we view new market-rate and affordable housing construction as helping to address a long-term shortfall in housing production relative to job growth but that multiple market, regulatory, and capital challenges related to housing affordability and transportation capacity are likely to constrain economic growth in the long term. For now, most economic indicators are trending strongly positive, with unemployment averaging a preliminary 2.4% for 2018 and market value increasing a second consecutive year, by 11% for 2019, to $259.3 billion. The city and county's projected 198% 2022 per capita effective buying income is among the highest among large U.S. cities.

Very strong management

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

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 AV; and
- Multilayered minimum general fund reserve rules set by ordinance. These provide 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.

After the passing of Mayor Ed Lee in December 2017, Mayor London Breed was elected in June 2018 for a term that runs from July 2018 to January 2020. We are seeing continuity in the finance and budget functions and a deliberative approach with the most prominent evidence the mayor's proposal to deploy the bulk of an unexpected $181.1 million in unplanned for fiscal 2019 property tax revenue discovered in November 2018 for homelessness and housing services, which also were priorities of the prior administration, rather than to inaugurate new services.

The potential for management 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.

As with its peers in California--and the state itself--San Francisco's policy framework is subject to change under an initiative and referendum system, but we find that the city and county's local political culture can lead to a large number of ballot measures, particularly in general elections. Voters in November 2018 approved:

- GO authorization for $425 million for seawall improvements to address seismic and flooding risk;
- Allocation of 1.5% of the city and county's existing 14.0% lodging tax to cultural organizations and arts programs;
- Imposition of an additional gross receipts tax to pay for specific services to address homelessness;
- Imposition of an additional gross receipts tax on cannabis business activities, the proceeds of which can be expended for any purpose; and
- Establishment of a "privacy first" policy for the use of personal information by the city and county.

Very strong budgetary performance

San Francisco and County'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, the latest year for which reliable information is available. We have removed our adjustment for deferral of significant expenditures, which we no longer think inflates the city and county's budgetary results in the short term but remains a long-term challenge.

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 decisions to deploy much of the city and county's recent revenue growth to address a backlog of capital needs with one-time spending, and largely avoiding recurring spending. Even hotel taxes, which dropped by 5% in fiscal 2017, when the city and county's convention center was largely taken offline for a renovation and expansion, grew in fiscal 2018, by a preliminary 3%, and management reports that hotels were effectively at full occupancy even before the convention center fully reopened in January 2019. Available fiscal 2018 data suggest that the city and county's general fund revenue came in approximately 5% above budget last year, mostly on the strength of property tax and business tax revenue growth.

With no signs of an economic slowdown, we anticipate that general fund net results will exceed 5% of expenditures through fiscal 2019, but this masks longer-term challenges. 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 that general fund performance has peaked with the fiscal 2017 result--one of the strongest results among peers--and, based on the city and county's biennial budget and forecast, we anticipate that performance will moderate. The city and county's January 2019 forecast is the most favorable to date but still anticipates cumulative shortfalls on the assumption that recent revenue growth will slow without a recession scenario. Baseline spending outpaces revenue growth each year, resulting in a cumulative three-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 discipline if the city and county is to maintain structurally balanced operations in the long term.

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 clear 50% of expenditures by fiscal 2019 based on preliminary indicators of continued strong tax revenue performance.

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 the city and county's available general fund balance fund will remain well above our 15%-of-expenditures minimum threshold for very strong financial flexibility through fiscal 2020.

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 December 2018, the pool held most of its liquid assets in U.S. Treasuries and agencies, representing 57% of assets by market value, followed by certificates of deposit (18%) and CP (9%).

Weak debt and contingent liability profile

In our view, San Francisco'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 75.2% of total governmental fund revenue. Overall net debt is low at 2.4% of market value, which is, in our view, a positive credit factor. The net direct debt, direct debt amortization and overall net debt ratios include tax increment, hotel tax, and special assessment debt associated with the city and county's redevelopment agency under our debt statement analysis criteria. Variable-rate debt supported by governmental funds represents about 2% of net direct debt.

The city and county has about $1.1 billion million in voter-authorized, unissued GO debt for various projects and about $396 million in board-approved appropriation borrowings that management anticipates being at least partly exercised in summer and fall of 2019. We think that that new borrowing could add to the city and county's debt burden in nominal terms and our assessment could move to very weak in the long term, but the city and county's intention to conform to a policy levy rate ceiling leads us to expect muted debt growth. Based on experience elsewhere in the state, we see the potential for the city and county to request GO authorization to catch up on street resurfacing and reconstruction, for which the city and county doesn't expect to reach a sustainable match between annual funding and spending until fiscal 2032 based on trends.

We do not view the city and county's nonremote contingent liability exposure to material given their small size relative to the city and county's operations and reserves and the lack of need, in practice, as supportive of the contingent agreements. 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's Salesforce 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.

The city and county provides OPEB, and its employees participate in a several cost-sharing, multiple-employer defined benefit 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. Pension and actual OPEB contributions total 13.7% of total governmental fund expenditures in 2017.

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 the city and county's operations and partly because of the low funded ratios of its largest plans. In addition, although the city and county makes pension contributions based on actuarial assumptions, it does not make full actuarially based OPEB contributions, and we believe the city and county lacks a plan that will address its combined liabilities because we believe that combined contributions are unlikely to decline for the foreseeable future.

Pension obligation payments represented 10.3% of total governmental fund expenditures in fiscal 2017. The largest plan, SFERS, had a funded ratio of 77.6%, which we consider low, as measured by the plan fiduciary net position as a percentage of the total pension liability of the largest plan. The city and county makes its full annual required contribution based on an actuarial study, consistent with the requirements of the city and county charter. SFERS uses a 7.5% discount rate, which is slightly above average by national standards, and level-percentage amortization periods of up to 20 years. 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. Its smaller CalPERS liability had a funded ratio of 74.1% as of the end of fiscal 2017. Based on the funded ratios of these plans and CalPERS' planned methodological revisions to achieve full funding in the long term, we anticipate that contributions to both plans will rise relative to the city and county's total governmental funds expenditures during the next five fiscal years. Helping to bend the cost curve in the long run has been the creation of lower-cost benefit tiers for new employees in recent years.

The city and county provides OPEB in the form of health care, and OPEB payments stood at 3.5% of total governmental fund expenditures in fiscal 2017. Payments are made on a pay-as-you-go basis. The unfunded actuarial accrued liability stood at $4.2 billion as of the end of fiscal 2014 (the latest valuation date), after deduction of assets of $49.0 million.

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 stable outlook reflects our view that the city and county is likely to continue to post strong-to-very-strong financial performance as tax revenue grows and will be able to identify and respond to a revenue slowdown, should one occur. Although we don't think funding challenges related to addressing deferred maintenance, rising pension and OPEB costs, and social service needs related to housing and homelessness will go away, we think that the city and county will continue to show spending discipline during our two-year outlook horizon, potentially leading to its rainy day and budget stabilization reserves reaching their 10%-of-revenue combined maximum. Our outlook takes onto account the likelihood of GO and appropriation debt issuance in the next year that could move our assessment of its debt and contingent liability profile to very weak, but we don't expect that the city's medium-term issuance will create a major addition to its aggregate debt burden given its levy rate goals or create a payment structure that will take its operations out of balance.

We could lower the rating if the city and county's financial performance substantially falters, which could result from a sharp downturn in tax revenue, new policy initiatives, or accelerated capital spending, particularly if we viewed the city and county has having difficulty achieving structural operating balance.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Oct. 24, 2018
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- 2018 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of February 5, 2019)		
San Francisco City & Cnty CP 1		
Short Term Rating	A-1+	Affirmed

Ratings Detail (As Of February 5, 2019) (cont.)		
San Francisco City & Cnty CP 1-T		
Short Term Rating	A-1+	Affirmed
San Francisco City & Cnty CP 2		
Short Term Rating	A-1+	Affirmed
San Francisco City & Cnty CP 2-T		
Short Term Rating	A-1+	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 S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.