S&P Global Ratings

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Summary:

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

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Credit Profile		
US$168.375 mil GO bnds (taxable) (Social Bonds - Affordable Housing, 2019)) ser 2023C dtd 03/28/2023 due 06/15/2048		
Long Term Rating	AAA/Stable	New
US$75.0 mil taxable lse rev cml pap cops ser 2-T due 05/31/2026		
Short Term Rating	A-1+	New
US$75.0 mil tax-exempt lse rev cml pap cops ser 2 due 05/31/2026		
Short Term Rating	A-1+	New
US$39.095 mil GO bnds (taxable) (Embarcadero Seawall Earthquake Safety,2018) ser 2023B dtd 03/28/2023 due 06/15/2048		
Long Term Rating	AAA/Stable	New
US$28.85 mil GO bnds (tax-exempt) (Health And Recovery,2020) ser 2023A dtd 03/28/2023 due 06/15/2048		
Long Term Rating	AAA/Stable	New

Credit Highlights

- S&P Global Ratings assigned its 'AAA' long-term rating to San Francisco City and County (the city), Calif.'s approximately $236.32 million general obligation bonds ($28.85 million series 2023A, health and recovery; $39.095 million series 2023B Embarcadero seawall earthquake safety; and $168.375 million series 2023C social bonds, affordable housing).
- At the same time, S&P Global Ratings assigned its 'A-1+' short-term rating to the city's expected $150 million series 2 (tax-exempt) and 2-T (taxable) lease revenue commercial paper (CP) certificates of participation (COPs).
- Additionally, S&P Global Ratings affirmed its 'AAA' long-term rating and underlying rating (SPUR) on San Francisco's outstanding GO debt and its 'AA+' long-term rating and SPUR on San Francisco City and County's outstanding appropriation obligations.
- S&P Global Ratings also affirmed its 'AAA/A-1+' joint support rating on the city and county's outstanding series 2008-1 and 2008-2 variable-rate lease revenue obligations.
- Finally, S&P Global Ratings affirmed its 'A-1+' short-term rating on the city and county's series 1, series 1-T, series 3 and 3-T CP COPs.
- The outlook, where applicable, is stable.

Security

Revenue from unlimited ad valorem taxes levied on all taxable property, without limitation as to rate or amount, secures the new and outstanding GO bonds. Bond proceeds will be used to fund various capital projects of the city, including the construction of supportive housing facilities and shelters, construction of a seawall and other infrastructure improvements, and affordable housing projects throughout the city.

The series 2 and 2-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 Wells Fargo Bank, N.A. through March 30, 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 $150 million using either series 2 or series 2-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

The local economy for the city and county of San Francisco remains very strong going into fiscal 2023, evidenced by sustained income and wealth levels at extremely strong levels that reflect a steady recovery since the onset of the COVID-19 pandemic in fiscal 2020. The city's assessed value (AV) has increased continuously during the past several years despite impacts from the recent pandemic due to ongoing housing demand in the region as well as the new construction of both residential and commercial property that underscores future AV growth. However, certain macroeconomic conditions, such as rising mortgage rates and a shift toward 100% remote work/hybrid model for many companies in San Francisco's downtown has resulted in a weaker housing market for the region and the potential for reduced commercial property AV in the near term.

The city maintained a strong financial position with very strong reserve levels reported in its general fund (equal to $2.9 billion, 51% of expenditures), with an operating surplus reflected in its fiscal 2022 audit. We calculate the city's available general fund reserves by combining the committed budget stabilization reserve, assigned, and unassigned general fund balances, plus the city's rainy day reserve that is currently categorized as restricted in the general fund. Most of the city's major revenue streams reported increases in fiscal 2022, including total property tax revenues, sales tax revenues, and hotel room taxes, reflecting a post-pandemic economic recovery going into fiscal 2023. The city's improved tourism, conventions, and business travel trends resulted in increased sales tax and hotel tax revenue streams for the city, a trend that is likely to continue for the next several years.

However, certain macroeconomic weaknesses persist that will likely challenge the city's budgetary performance in the longer term. The shift toward remote work for many companies based in the downtown financial district has resulted in a persistently high downtown office vacancy rate, which management reported was approximately 30% as of December 2022. We believe this trend will likely result in decreased commercial property values in the future that would lead to lower property tax revenues generated by those kinds of properties. Management also reports that business tax revenues, of which a large portion is generated from the payroll for employees who physically work in the city of San Francisco, have declined during the past two years and are likely to continue to decline going forward as the recent work-from-home culture shift is unlikely to change in the near term. Real property transfer taxes have also declined in recent years and are projected to decline again in fiscal 2023, in large part due to the weaker commercial property market in downtown. High mortgage rates that continue rising into fiscal 2023 have also reduced residential property sales leading to lower real property transfer taxes collected by the city.

Departmental costs for the city have not risen substantially in fiscal 2022 and fiscal 2023 and nearly all departments are projected to have an operating surplus in fiscal 2023 except for the police department. City management indicates that the police department is projected to end fiscal 2023 with a net operating deficit, primarily due to overspending from overtime, holiday, and premium pay. Management notes that the city is currently considering adding an additional $25 million in supplemental funding in order to address the police department's overtime deficit. We expect these costs will likely continue to increase going forward, in part due to the mayor's proposal for increasing funding for police to address staffing shortages to increase public safety and improve street conditions. We note that the city's five-year forecast projection includes increases in expenditures that outpace revenue growth, driven by higher salary and benefit costs, high inflation, and voter-mandated funding for certain projects and programs. While we understand that this forecast includes certain conservative assumptions, we believe the city will need to actively manage these costs to avoid a structural imbalance going forward.

Overall, the city's general fund reported an operating surplus in fiscal 2022 based on audited figures and the city's year-to-date actuals for fiscal 2023 point toward generally balanced results. Despite declines in business tax revenues and real property transfer tax revenues in recent years, management reports that continued growth in some of the city's other revenue streams such as property taxes, sales taxes, and hotel taxes outweigh these revenue declines and continue to drive these general fund surpluses in the near-term. However, a likelihood of weaker commercial property values and a persistent decline of business tax revenues generated in the downtown core of San Francisco will likely challenge the city's budgetary operations in the medium term. Additionally, we think S&P Global Economics' expectation that the U.S. will fall into a shallow recession in the first half of 2023 (see "Economic Outlook U.S. Q1 2023: Tipping Toward Recession", published Nov. 28, 2022) could result in weaker revenues such as sales taxes, business taxes, and hotel taxes, which tend to be more volatile in a harsher economic environment. We believe city management will need to manage its expenditures both actively and sufficiently in light of these potential challenges to maintain its current credit quality.

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 negatively affecting urban centers;
- Very strong management, with multiple reserve-filling mechanisms and robust financial planning practices; and
- Very weak debt and contingent liability profile characterized by a large pension and other postemployment benefit (OPEB) obligation and the likelihood of additional GO bonds under existing authorizations but a levy rate policy that constrains issuance. Additionally, we believe pension and OPEB costs are likely to rise in the near-term due to the weaker investment returns recognized by CalPERS and SFERS in fiscal 2022.

Environmental, social, and governance

The city's exposure to environmental risks (in terms of physical risks), primarily from earthquakes and sea level rise, are a key concern for the region. However, the city has managed seismic risk through the use of robust building codes, and is working to mitigate sea level rise through an assessment of vulnerable areas and capital improvements that have included debt-financed seawall construction.

Affordable housing needs and a long-standing significant population of people experiencing homelessness, resulting partly from high housing costs, demonstrates the city's social capital risks. This risk could accelerate as U.S. economic conditions deteriorate. 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 view the transparency and reporting 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 as governance strengths in our credit analysis. 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 weaker governance structure or risk management culture.

Outlook

In light of certain budgetary challenges that the city faces going forward, we believe its very strong reserve levels will be the key in maintaining its current credit quality in the near-term as it weathers the potential shortfalls in some of its general fund revenues. The stable outlook reflects our expectation that the city will maintain its very strong reserves without needing to substantially spend its reserves to materially weaker levels. However, should these revenue challenges persist in the longer-term without sufficient efforts at cost reductions and maintaining budgetary balance in this new economic environment, resulting in continued unmitigated declines in available general fund reserves, then the city's overall credit profile could be pressured.

Downside scenario

We could lower the rating during the next two years if we think that the city is struggling to respond budgetarily to a persistent decline in some of its major revenue streams, resulting in a material reduction in the city's general fund reserve and liquidity position without a reasonable plan to restore reserves back to stronger levels.

Issue ratings above the U.S. sovereign rating

The issue ratings associated with the city'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 City and County, Calif.: Key Credit Metrics

	Most recent	Historical information		
		2022	2021	2020
Very strong economy				
Projected per capita EBI % of U.S.	229.18			

San Francisco City and County, Calif.: Key Credit Metrics (cont.)				
	Most recent	**Historical information**		
		2022	**2021**	**2020**
Market value per capita ($)	369,999			
Population			888,361	873,965
County unemployment rate(%)			5	
Market value ($000)	328,692,976	328,643,733	318,846,449	
Ten largest taxpayers % of taxable value	4.11			
Strong budgetary performance				
Operating fund result % of expenditures		3.40	(0.92)	(0.61)
Total governmental fund result % of expenditures		13.17	16.20	2.08
Very strong budgetary flexibility				
Available reserves % of operating expenditures		51.02	47.99	52.97
Total available reserves ($000) *		2,901,009	2,667,390	2,683,845
Very strong liquidity				
Total government cash % of governmental fund expenditures		153.43	148.19	139.70
Total government cash % of governmental fund debt service		1,865.41	2,076.77	2,153.15
Very strong management				
Financial Management Assessment	Strong			
Very weak debt & long-term liabilities				
Debt service % of governmental fund expenditures		8.23	7.14	6.49
Net direct debt % of governmental fund revenue	77.13			
Overall net debt % of market value	2.36			
Direct debt 10-year amortization (%)	35.06			
Required pension contribution % of governmental fund expenditures		10.37		
OPEB actual contribution % of governmental fund expenditures		3.37		
Strong institutional framework				

EBI--Effective buying income. OPEB--Other postemployment benefits. Data points and ratios may reflect analytical adjustments. * Our total available reserve calculation includes the city's rainy day reserve, categorized as restricted in the audit.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Ratings Detail (As Of March 17, 2023)		
San Francisco City & Cnty GO		
Long Term Rating	AAA/Stable	Affirmed

Ratings Detail (As Of March 17, 2023) (cont.)		
San Francisco City and County cert of part (Multiple Capital Improvements) ser 2021A due 04/01/2041		
Long Term Rating	AA+/Stable	Affirmed
San Francisco City and County taxable lse rev cml pap cops ser 2-T due 05/31/2026		
Short Term Rating	A-1+	Affirmed
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 2 due 05/31/2026		
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	Affirmed
San Francisco City and County GO bnds (Health & Recovery) ser D-1/D-2 due 06/15/2046		
Long Term Rating	AAA/Stable	Affirmed
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	Affirmed
San Francisco City and County GO rfdg bnds ser 2022R1 due 06/15/2034		
Long Term Rating	AAA/Stable	Affirmed
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Affirmed
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Affirmed
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Affirmed
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Affirmed
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Affirmed
San Francisco City & Cnty certs of part (49 South Van Ness Proj) ser 2019A due 04/01/2050		
Long Term Rating	AA+/Stable	Affirmed
San Francisco City & Cnty rfdg certs of part (multiple cap imp projects) ser 2020-R1 due 10/01/2033		
Long Term Rating	AA+/Stable	Affirmed
San Francisco City & Cnty rfdg certs of part (Multiple Cap Imp Proj) due 04/01/2035		
Long Term Rating	AA+/Stable	Affirmed
San Francisco City & Cnty taxable GO bnds		
Long Term Rating	AAA/Stable	Affirmed
San Francisco City & Cnty CP 1		
Short Term Rating	A-1+	Affirmed
San Francisco City & Cnty CP 1-T		
Short Term Rating	A-1+	Affirmed

Ratings Detail (As Of March 17, 2023) (cont.)		
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
San Francisco City & Cnty GO bnds (pub hlth and safety, 2016) ser 2020D-1 due 06/15/2040		
Long Term Rating	AAA/Stable	Affirmed
San Francisco City & Cnty		
Long Term Rating	AA+/Stable	Affirmed
San Francisco City & Cnty (Juvenile Hall Proj)		
Long Term Rating	AA+/Stable	Affirmed
San Francisco City & Cnty (Moscone Center South Rfdg Proj)		
Long Term Rating	AA+/Stable	Affirmed
San Francisco City & Cnty (Moscone Expansion Dist Proj)		
Long Term Rating	AA+/Stable	Affirmed
San Francisco City & Cnty (Multiple Capital Improvement Projs)		
Long Term Rating	AA+/Stable	Affirmed
San Francisco City & Cnty (MBIA) (National)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
San Francisco City & Cnty (Port Facs Proj)		
Long Term Rating	AA+/Stable	Affirmed
San Francisco City & Cnty (Port Facs Proj)		
Long Term Rating	AA+/Stable	Affirmed
San Francisco City & Cnty 2020 certs of part (animal care & control proj) ser 2020A due 04/01/2041		
Long Term Rating	AA+/Stable	Affirmed
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	Affirmed
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty) rfdg lse rev bnds (Brand Lib Imp Prog)		
Long Term Rating	AA+/Stable	Affirmed
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty) rfdg lse rev bnds (Open Space Fund)		
Long Term Rating	AA+/Stable	Affirmed
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty) JOINTCRIT		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
San Francisco City & Cnty Fin Corp (San Francisco City & Cnty) JOINTCRIT		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	AA+(SPUR)/Stable	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

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