Rating Action: Moody's revises outlook on City of San Francisco to negative; affirms outstanding ratings

05 Jul 2023

New York, July 05, 2023 -- Moody's Investors Service has revised the outlook on the City and County of San Francisco, CA's long-term ratings to negative from stable. Concurrently, Moody's affirmed the Aaa ratings on the city's issuer rating and on approximately $2.6 billion in outstanding general obligation (GO) bonds. Moody's also affirmed the Aa1 and Aa2 ratings on the city's approximately $1.4 billion in lease-backed obligations. The city also has approximately $19.5 billion in additional debt outstanding across its governmental and enterprise activities unaffected by this rating action.

RATINGS RATIONALE

The Aaa issuer rating incorporates the city's currently robust financial profile, strong management practices, and diverse revenue sources supported by a favorable property tax structure. These credit qualities position San Francisco well to manage its near-term post pandemic challenges, including changes in employment conditions, tourism patterns, and retail behavior. These shifts present moderately elevated uncertainty about the city's ability to adjust to an evolved economic environment, but the city's enduring credit factors give it the time and resources to adapt. The rating also incorporates the city's exceptionally large tax base, its status as a premier technology and innovation ecosystem, and a very strong property wealth and resident income profile which balances the city's elevated leverage and fixed costs.

The Aaa rating on the city's GOULT bonds incorporates the city's general credit characteristics and the unlimited ad valorem property tax pledge supporting the bonds.

The Aa1 rating of the city's outstanding lease-backed obligations reflects the standard one notch distinction from the city's Aaa issuer rating, which we apply to abatement leases secured by more essential assets and to equipment leases where the term matches the useful life of the leased assets.

The Aa2 lease-backed obligation ratings reflect the standard two notch distinction from the city's Aaa issuer rating, which we apply to abatement leases secured by less essential assets.

The Aa2 rating on the Cal HFA Revenue Bonds (San Francisco Supportive Housing - 833 Bryant Apartments) 2020 Issue N - Social Bonds also reflects a two-notch distinction from the city's Aaa issuer rating. A standard one-notch rating distinction is applied to abatement leases secured by more essential assets. An additional notch has been applied to account for several factors, including the absence of creditor recourse to the leased asset, the city's inability to substitute in an asset during an abatement situation, the risks associated with reliance on the performance of a third party for use and occupancy of the asset, the lack of a debt service reserve fund, and the risks associated with seismic conditions given only one year of business interruption insurance.

RATING OUTLOOK

The revision of the outlook to negative primarily reflects the various near term financial and economic headwinds facing San Francisco. After a period of stable financial performance through the pandemic the city expects draws on reserves in fiscal 2023 and across budget years 2024 and 2025. The city also projects out-year deficits through 2028,
although the city regularly identifies future budget gaps as part of the forecasting process. The deficits largely reflect the underlying sluggish performance of the city’s economic recovery, particularly its downtown. Prolonged weakness in the city’s commercial real estate market, stubbornly slow to rebound office worker attendance, and low downtown utilization continue to weigh on the broad economic vitality of San Francisco’s core business, retail, and tourism districts. The tepid post-pandemic economic progress informs a sluggish forecast for core revenue performance outpaced by expenditure growth in the coming years.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATINGS (OR REMOVAL OF NEGATIVE OUTLOOK)

- Greater certainty regarding long-term economic recovery or reinvention
- Meaningful financial outperformance relative to expectations
- Reduction of long-term liabilities or fixed cost burdens

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS

- Meaningful fund balance and reserve drawdowns consistent with forecast
- Inability to develop long-term solutions for the city’s most pressing economic challenges
- Material growth to long-term liabilities

LEGAL SECURITY

The GO bonds are paid from a voter-approved, unlimited ad valorem property tax pledge of all taxable property within the city boundaries.

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

The Aa2-rated obligations are secured by rental payments under standard abatement lease agreements for assets that we view as less essential.

The Cal HFA Revenue Bonds 2020 Issue N issued on behalf of the city are secured by lease payments made by the city under an abatement lease so long as the city has use and occupancy of an affordable housing project at 833 Bryant Street.

USE OF PROCEEDS

Not applicable

PROFILE

The City and County of San Francisco is the economic, employment and cultural center of the San Francisco Bay Area and Northern California (Aa2 negative). The city encompasses over 93 square miles, of which 49 square miles are land, with the balance consisting of tidelands and a portion of the San Francisco Bay. Silicon Valley is about a 40-minute drive to the south, and the Napa/Sonoma wine country is about an hour drive to the north. The city has approximately 831,000 residents.

San Francisco’s combined city-county organization is unique in California. The City is governed by a board of supervisors, elected from eleven districts, and a mayor who serves as chief executive officer, elected citywide. The City has over 36,000 employees and operates the San Francisco Airport Commission (A1 stable), San Francisco Public...
Utilities Commission Water Enterprise (Aa2 stable), Hetch Hetchy Water and Power, San Francisco Municipal Transportation Agency (Aa3 stable), San Francisco General Hospital, San Francisco Public Utilities Commission Wastewater Enterprise (Aa2 stable), San Francisco Port Commission (Aa3 stable), Laguna Honda Hospital and CleanPowerSF (A2 stable).

METHODOLOGY


REGULATORY DISCLOSURES

For further specification of Moody’s key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody’s Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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