

Tax Supported
New Issue

City and County of San Francisco, California

Ratings

New Issues	
General Obligation Bonds (San Francisco General Hospital Improvement Bonds, 2008), Series 2009A	AA-
City and County of San Francisco Finance Corporation Lease Revenue Bonds (Branch Library Improvement Program) , Series 2009A	A+
Outstanding Debt	
General Obligation Bonds	AA-
Settlement Obligation Bonds	A+
Certificates of Participation	A+
Lease Revenue Bonds	A+
Lease Revenue Bonds (Open Space Fund)	AA-

Fitch issued an exposure draft on July 31, 2008 proposing a recalibration of tax-supported and water/sewer revenue bond ratings, which, if adopted, may result in an upward revision of this rating (see Fitch Research on "Exposure Draft: Reassessment of Municipal Ratings Framework"). Fitch has deferred its final determination on municipal recalibration due to market conditions and plans to revisit the recalibration in the first quarter of 2009 (see press release "Fitch Defers Final Determination on U.S. Municipal Ratings Recalibration," dated Oct. 7, 2008).

Rating Outlook

Stable

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Rating Rationale

- San Francisco's economy is diverse, with a tax base that captures most of the economic activity in the city, including property, sales, hotel, utility, and parking taxes. Until the fall of 2008, all revenues had been performing well, supported by its strong tourism draw and low unemployment rate of 4.5%.
- While the nationwide housing market has had a comparatively modest impact on the city (foreclosures and tax delinquencies are higher but not dramatically), the adverse events in the credit market have negatively affected the city's real property transfer tax, which had grown to 7% of the city's locally generated revenues as several large commercial properties were sold and resold over a short period.
- The city's financial position is adequate but weakened, as revenue slowing was not entirely offset by expenditure reductions. However, reserves remain at adequate levels, aided by the city's voter-approved rainy day fund. However, this benefit is somewhat offset by the city's ability and tendency to use up to 25% of the rainy day fund to provide supplemental funding to the local school district.
- Maintaining even the current financial position will require fiscal discipline, as the city's political and structural characteristics limit flexibility by earmarked revenue, mandated funding levels, and funding programs at levels beyond the state appropriations. This may be particularly challenging given the state's own budget challenges and likelihood of severe cuts to state-funded social service programs.
- The city's OPEB liability is large, although its growth will slow due to a recent ballot measure tightening the eligibility and benefits of future employees.
- Lease ratings reflect strong lease features, the long and solid operating history of the city's equipment leasing program, and the essential character of the leased assets.

Key Rating Drivers

- Inability to make progress in achieving more structural balance; the fiscal 2009 budget gap was closed with only about 50% ongoing solutions.
- Inability to maintain fund balances and rainy day reserve at the current projected level.

Credit Summary

The 'AA-' GO bond rating reflects San Francisco's diverse local economy and tax base, wealthy and highly educated populace, strong tourism draw, affordable debt levels, and adequate but pressured financial position. These strengths are offset by the city's structural budget imbalance, rising fixed costs (labor and pension), high level of required revenue set-asides, weakening revenue base, sizable and largely unfunded capital improvement needs, and large, unfunded OPEB liability. The structure of the city's rainy day fund, which permits its use to supplement local school district funding, somewhat

New Issue Details

Sale Information \$131,825,000 General Obligation Bonds (San Francisco General Hospital Improvement Bonds, 2008), Series 2009A, and \$35,000,000 City and County of San Francisco Finance Corporation Lease Revenue Bonds (Branch Library Improvement Program), Series 2009A, scheduled to price the week of March 2.
Security: GO bonds: GOs of the city, secured by an unlimited ad valorem tax on all taxable property in the city. Lease revenue bonds: lease payments made by the city to the corporation for beneficial use and occupancy of the city's main library.
Purpose: GO bonds: improve the city's hospital and trauma center. Lease revenue bonds: improve various branch libraries throughout the city.
Final Maturity: GO bonds: June 15, 2029. Lease revenue bonds: June 15, 2034

Related Research

- *City and County of San Francisco, California, Aug. 8, 2008*
- *Local Government General Obligation Bond Rating Guidelines, March 27, 2007*

Rating History — General Obligation Bonds

Rating	Action	Outlook/ Watch	Date
AA-	Affirmed	Stable	2/23/09
AA-	Affirmed	Stable	8/5/08
AA-	Affirmed	Stable	7/2/08
AA-	Affirmed	Stable	3/18/08
AA-	Affirmed	Positive	3/13/06
AA-	Downgraded	Stable	5/18/04
AA	Affirmed	Negative	6/17/03
AA	Assigned	—	5/11/99

Rating History — Lease and Settlement Obligations

Rating	Action	Outlook/ Watch	Date
A+	Affirmed	Stable	2/23/09
A+	Affirmed	Stable	8/5/08
A+	Affirmed	Stable	7/2/08
A+	Affirmed	Stable	3/18/08
A+	Upgraded	Positive	3/13/06
A	Downgraded	Stable	5/18/04
A+	Affirmed	Negative	6/17/03
A+	Assigned	Stable	5/11/99

counterbalances its benefits. The key rating driver is the city's ability to better align its ongoing revenues and expenditures as the economic and revenue picture weakens.

The rating is based on the historical volatility of the city's reserve levels, but could be pressured should the city's reserve levels (beyond the rainy day fund) dip below their minimal projected level for fiscal 2009.

The budget deficit going into fiscal 2009 was the largest in several years and only about one-half was closed with ongoing solutions (on both the expenditure and revenue sides). Since budget adoption, the revenue picture has deteriorated as the local economy stalled. The city identified a budget gap and took action to cut expenditures. As both a city and a county, San Francisco enjoys a diverse revenue base. Tax revenues include property, sales, hotel, business, utility, property transfer, and parking taxes and make up about 76% of all revenues, thereby reducing somewhat the city's exposure to changes in state funding (18% of general fund sources) as compared with other counties. While the nationwide housing market has had a comparatively modest impact on the city (foreclosures and tax delinquencies are higher than in prior years, though not dramatically), the adverse events in the credit market are contributing to a steep decline in the city's real property transfer tax, which had grown to 7% of the city's locally generated revenues in 2007 when several large commercial properties were sold and resold over a short period. The real property transfer tax's projected decline to \$45 million for fiscal 2009 contributes approximately \$49 million to the \$167 million in projected revenue underperformance for fiscal 2009.

San Francisco's economy is still performing better than most California metro areas and the nation as a whole. The unemployment rate increased to 6.6% in December 2008 from 4.4% in December 2007, but is significantly below the state's 9.1% rate of December 2008. Hotel occupancy rates declined to 68% in November 2008 from 76% in November 2007, although December 2008 showed some improvement over December 2007. Average room rates were also down in November with a small improvement in December, indicating some weakness and volatility in the tourism sector.

Nonetheless, the city's role as a regional center provides long-term stability, with the job base consisting of a good mix of professional and business services (such as architecture and engineering), education, healthcare, and finance.

The most recent audited results for fiscal 2008 show a large deficit of \$135.8 million, ending four consecutive years of positive operations. The year-end unreserved general fund balance declined to \$77 million, a still adequate 2.6% of expenditures and transfers out. Adding the \$118 million in the city's rainy day fund for budget stabilization, the cushion was good at 6.6% of spending. The rainy day fund is structured to build a financial cushion in strong economic years and keep high revenue gains from building unsustainable spending into the budget. The city expects to draw on the rainy day fund in fiscal years 2009 and 2010 for its own operations as well as to provide funds for the school district, an action permitted through a voter referendum pursuant to voter approval; \$19.3 million was budgeted for the district for fiscal 2009.

The city's OPEB liability is sizable, estimated in November 2007 at \$2.6 billion. However, a voter-approved measure from June 2008 will reduce benefits for new employees and establish a trust for prefunding.

San Francisco's debt burden remains affordable despite sizable recent issuances. Including overlapping debt, debt totals \$2,669 per capita and 1.6% of taxable market value. Future issuance plans are rising as the city begins to address needs identified in its sizable 10-year \$19.7 billion CIP, which includes \$4.8 billion in general fund supported projects and an estimated \$61 million in pay-as-you-go funding.

General Fund Financial Summary

(\$000, Audited Fiscal Years Ended June 30)

	2001	2002	2003	2004	2005	2006	2007	2008
Property Tax	462,171	507,308	516,955	547,819	705,949	783,303	887,690	939,812
Business Tax	277,094	274,125	276,126	264,351	292,172	322,407	336,757	394,267
Sales Tax	143,815	111,293	115,578	120,642	94,689	103,074	107,813	111,400
Hotel Tax (Other)	—	—	74,729	98,457	108,913	130,824	143,072	165,500
Utility User Tax	—	—	71,378	70,938	72,574	76,444	78,729	87,000
Parking Tax	—	—	29,715	31,994	33,090	36,165	64,763	67,300
Real Property Transfer Tax ^a	—	—	N.A.	N.A.	N.A.	N.A.	143,976	86,200
Other Local Revenues	404,642	325,846	195,361	237,847	292,595	333,951	200,921	204,819
Locally Generated Revenues	1,287,722	1,218,572	1,279,842	1,372,048	1,599,982	1,786,168	1,963,721	2,056,298
Federal Sources	135,410	150,444	151,790	163,047	165,739	182,448	183,573	173,059
State Sources	501,020	510,952	515,382	497,196	438,697	490,187	479,748	476,864
Other Revenues	91,197	76,850	11,880	29,564	12,376	15,036	21,697	17,948
Total Revenues	2,015,349	1,956,818	1,958,894	2,061,855	2,216,794	2,473,839	2,648,739	2,724,169
Public Protection	626,136	650,019	695,693	670,729	697,450	739,470	809,075	874,881
Human Welfare/Neighborhood Development	431,266	467,688	492,083	489,001	503,874	524,516	568,241	79,187
Community Health	365,290	395,465	424,302	413,725	413,110	377,226	410,169	613,135
Other Expenditures	374,960	398,637	337,511	354,455	330,236	326,596	373,991	825,171
Total Expenditures	1,797,652	1,911,809	1,949,589	1,927,910	1,944,670	1,967,808	2,161,476	2,392,374
Net Change	217,697	45,009	9,305	133,945	272,124	506,031	487,263	331,795
Transfers In	134,983	109,941	105,211	121,491	152,288	62,431	71,277	70,969
Other Sources	—	63,121	4,621	35,996	3,063	5,220	8,245	5,050
Transfers Out	(257,317)	(316,867)	(303,216)	(277,316)	(330,230)	(420,086)	(486,600)	(543,640)
Net Income/(Deficit)	95,363	(98,796)	(184,079)	14,116	97,245	153,596	80,185	(135,826)
Total Fund Balance	479,187	380,391	196,312	210,435	307,680	461,276	541,461	405,635
As % of Expenditures and Transfers Out	23.3	17.1	8.7	9.5	13.5	19.3	20.4	13.8
Unreserved Fund Balance	207,467	136,664	44,718	63,657	134,199	138,971	141,037	77,117
As % of Expenditures and Transfers Out	10.1	6.1	2.0	2.9	5.9	5.8	5.3	2.6
Unreserved Fund Balance Plus Rainy Day Fund ^b	207,467	136,664	44,718	118,796	182,338	382,923	408,281	312,701
As % of Expenditures and Transfers Out	12.9	7.5	2.9	5.4	8.0	10.9	10.4	6.6

^aUntil fiscal 2007, the real property transfer tax was included in other local taxes, included here in other local revenue. ^bThe rainy day fund was established starting in fiscal 2005 but not funded until fiscal 2006. N.A. – Not available. Note: Numbers may not add due to rounding.

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