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Summary:

Successor Agency to the San Francisco City and County RDA, California; Tax Increment

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Credit Profile		
US$45.0 mil tax alloc bnds (Mission Bay Housing Projects) ser 2017C due 08/01/2043		
Long Term Rating	A/Stable	New

Rationale

S&P Global Ratings assigned its 'A' long-term rating to the Successor Agency (SA) to the San Francisco City and County Redevelopment Agency (RDA), Calif.'s tax allocation bonds, series 2017C, issued for the Mission Bay project areas. The outlook is stable.

The rating reflects our view of:

- Pledged tax increment revenue derived from two small but dense mixed-use project areas located near downtown San Francisco and the waterfront, with additional coverage provided by residual tax increment from 10 other cross-collateralized project areas;
- The very strong historical assessed value (AV) growth and significant future development potential in the project areas;
- The low volatility ratio of 2.62%; and
- Very strong maximum annual debt service (MADS) coverage from pledged revenue, and an additional bonds test (ABT) requiring at least 1.25x MADS on the 2017C bonds and any parity debt.

Partially offsetting these strengths, in our view, is the Mission Bay project areas' concentrated tax base, including several large residential and commercial developments with a significant medical and biotech research presence.

The 2017C bonds are secured by a subordinate lien on 20% housing set-aside tax increment revenues generated by the Mission Bay North (MBN) and Mission Bay South (MBS) project areas, after payment of senior loan obligations that partially secure outstanding tax increment revenue bonds issued for the former RDA by the San Francisco City & County Redevelopment Financing Authority. In addition to the Mission Bay housing tax increment, the 2017C bonds are secured by a pledge of residual tax increment from the agency's redevelopment property tax trust fund (RPTTF), after prior obligations from other project areas are paid.

The 2017C bonds have a 1.25x MADS ABT, and the senior housing liens of both project areas are closed. We expect that the agency will issue additional debt on parity with the 2017C bonds to finance its remaining development obligations for affordable housing in the Mission Bay project areas. However, we note that the agency's ability to issue additional tax increment debt is somewhat limited by statute to financing existing enforceable obligations, which include the development of roughly 1,450 affordable housing units in the Mission Bay project areas.

The MBN and MBS project areas are located along the Bay waterfront south of San Francisco's financial district and

SOMA neighborhoods. The project areas are separated by the China Basin Canal, with the smaller, 65-acre MBN area consisting primarily of existing residential and retail developments, while the larger MBS area is centered on the UCSF Mission Bay campus and still-growing research and commercial developments, residential developments, and a planned Golden State Warriors basketball arena. Combined, the two project areas encompass 303 acres, roughly 117 of which generate tax increment revenue.

Together, the project areas have grown rapidly in the last four years, with AV growth averaging 11% annually between 2013 and 2017. The bulk of the increase has been generated in the MBS project area, where new development has proceeded at a rapid pace in recent years, while the more mature residential MBN project area has grown at a more moderate rate. Given the area's strategic location and the scale of development occurring here, AV growth was relatively strong even in the years following the recession, with only one year of very modest decline (0.6%) in fiscal 2011-2012. We expect this rate of AV growth to continue over the medium term as redevelopment in this formerly industrial area of the city continues; however, we believe the areas' small size and location make them vulnerable to event risk, particularly from earthquakes, which could temporarily reduce AV and tax increment revenue beyond historical peak declines.

The taxing base in the combined project areas is somewhat concentrated, in our view, with the top 10 taxpayers making up 45.3% of 2017 AV. While we consider some of the concentration to be tempered by the density of residential development, we have observed that delinquency rates among residential owner/taxpayers tend to be correlated. We also note that the risk of earthquake damage is similar for all residential units in the project areas, regardless of taxpayer.

We consider the risk of reduction in value due to open taxpayer appeals to be small. The agency estimates that exposure to open pending taxpayer appeals could result in a reduction of $3.7 million in AV, corresponding to a loss of 0.08% of gross tax increment revenue, based on historical successful appeals.

Debt service coverage from both the Mission Bay housing tax increment and residual RPTTF in fiscal 2017 is very strong, at roughly 5.07x MADS, assuming the agency issues debt against prior liens with remaining authorization to their maximum potential. We consider coverage of debt service from only the Mission Bay housing tax increment revenue good, at 1.25x MADS based on fiscal 2017 revenue. The bonds have a 1.25x ABT. We calculate that, at 1.25x coverage and a 0.03 volatility ratio, the combined project areas could withstand a decline of 19.6% in total AV and maintain 1x MADS coverage. The potential decline in AV is enough to cover the loss of the project area's two largest taxpayers, both real estate investors. While we expect that the agency will issue additional debt on parity with the 2017C bonds to finance its remaining development obligations for affordable housing in the Mission Bay project areas, we note that there are statutory constraints on the issuance of additional debt as described above.

The agency, officially known as the Office of Community Infrastructure and Investment (OCII), became the acting SA to the former redevelopment agency following the dissolution of California RDAs in 2011. Subsequent to dissolution, the state legislature passed Senate Bill 107, which specifically authorizes the City and County to issue additional debt secured by tax-increment revenues. To our knowledge, the City and County is alone among SAs in its ability to continue issuing tax increment debt to finance new redevelopment projects.

The trust indenture permits the agency to issue additional parity bonds, provided pledged revenues are sufficient to cover annual debt service on all parity obligations by at least 1.25x MADS. The SA received its finding of completion from the State Department of Finance on May 29, 2013. The SA has also completed its asset transfer review by the state Controller's Office, with no findings that we believe could result in an interruption in tax increment revenue.

Dissolution law limits the SA revenue to payment on enforceable obligations and requires more proactive management than under the predissolution flow of funds. SA and oversight officials must adhere to deadlines for requesting debt service payment amounts and subordinating pass-through payments when necessary, and property taxes continue to be disbursed by counties semiannually, requiring active cash management on the part of agency officials tasked with depositing revenues in keeping with indenture provisions. The series 2017C indenture requires the SA to request, for distribution Jan. 1 of each calendar year, amounts sufficient to pay full annual principal and interest on the bonds and all senior and parity obligations.

San Francisco, with an estimated population of 867,000, covers 49 square miles on a peninsula bounded by the Pacific Ocean to the west and the San Francisco Bay to the east. The city is one of the nine counties in the Bay Area, the residents of which have access to major industries that include technology, business services, hospitality, manufacturing, and food processing. Median household effective buying income in the city and county is equal to 139% of the national median, which we consider very strong. The city and county's unemployment rate was 3.3% in 2016.

Outlook

The stable outlook reflects our expectation that MADS coverage on the bonds will remain at least good over the next two years, and incorporates our expectation of additional parity debt as well as further gains in AV. We do not expect to change the rating over the two-year outlook horizon.

Upside scenario

We could raise the rating should our expectations for additional parity debt change, MADS coverage increase, and tax base concentration decrease.

Downside scenario

Should the agency experience a sudden decline in AV, resulting in coverage levels falling substantially below the ABT, then we could lower the rating.

Related Research

- Revisiting The Dissolution Of California Redevelopment Agencies, June 11, 2013
- Following A Decade Of Change, The Tax Increment Sector Shows Improving Credit Quality, March 28, 2016

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.globalcreditportal.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.