



# CGOBOC Training Session:

# General Obligation Bonds and Fiscal Oversight



Controller's Office of Public Finance

June 2026

# Introduction to the Controller's Office of Public Finance

## MISSION

To provide and manage low-cost debt financing for large-scale, long-term capital projects and improvements that produce social and economic benefits to the City and its citizens at cost-effective financing costs while balancing market and credit risk with prudent mitigations and controls.

## OBJECTIVES

- Maintain cost-effective access to capital markets with prudent policies
- Maintain moderate debt and debt service levels with effective planning and coordination with City departments
- Meet significant capital demands through debt financing and alternate financing mechanisms such as public/private partnerships
- Maintain the highest practical credit ratings





# Funding Infrastructure in California

## THREE OPTIONS FOR FUNDING CAPITAL PROJECTS

### **Pay As You Go: Pay for capital assets from cash/current revenues or capital reserves**

- Requires ample cash reserves and manageable capital program; intergenerational equity concerns.

### **Beg: Obtain state or federal grants or low-interest loans**

- Requires available funding on attractive terms
- Timing delays and program restrictions can offset subsidy

### **Borrow: Issue debt**

- Spreads payment over useful life of asset so that current and future users share costs
- Can accelerate phased projects to capture cost savings
- Preserves cash reserves for other uses

# Municipal Bonds

## WHAT ARE MUNICIPAL BONDS?

- Financing of public facilities and public improvements by State and local governments in the municipal bond market

## WHAT AUTHORIZATION IS REQUIRED?

- In California, each political subdivision must have either express or implied statutory authority (*see next page*)

## WHAT ARE THE BENEFITS?

- Interest is typically tax-exempt at the state and federal income tax levels
  - Investors will purchase tax-exempt bonds at lower rates
- Investor audience is broad – ranging from individuals to large institutions
  - Investors compete against each other, bringing down rates

## WHAT ARE THE LIMITATIONS/REGULATIONS?

- IRS – provides rules for tax-exemption, and use of facilities
- SEC – indirect regulation by SEC; issuers subject to anti-fraud provisions of securities laws
- State law – limits the use of taxes for repayment; 2/3 voter approval for general obligation debt
- Local law – limits use of general fund sources, new debt requires BOS approval



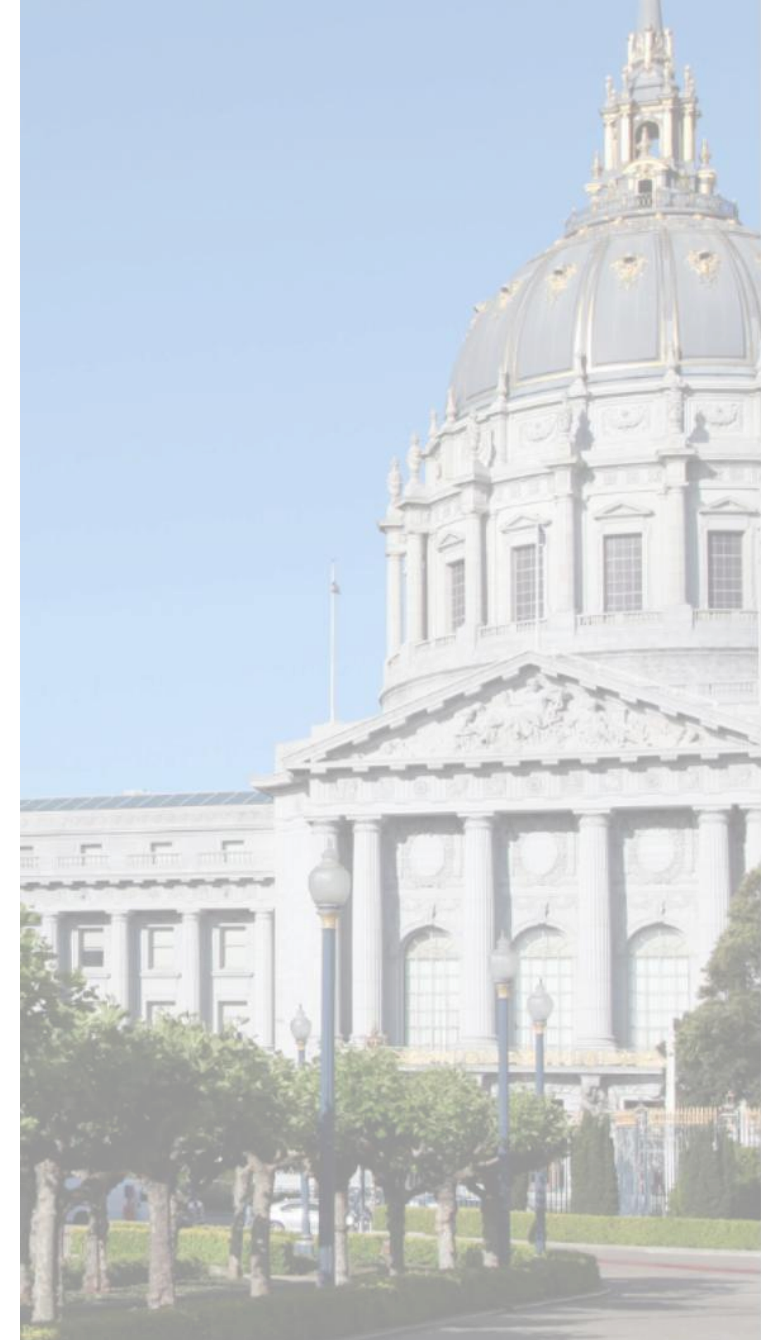
# Limits on Municipal Borrowing

## California Constitutional Debt limit

- Cities or counties cannot issue “debt” without a 2/3rds voter approval
  - Exceptions
    - Long term leases not long term “debt” if subject to annual appropriation/abatement (City’s power to lease)
    - Special fund debt, such as water or sewer enterprise (rates and charges)
    - “Obligation imposed by law”, such as pension or judgement liability

## Federal Tax Law Limitations

- Projects must be for **governmental use** to qualify for tax-exemption
- Certain uses – housing, student loans, industrial development must compete for state private activity volume cap allocations (CDLAC in California) to qualify for tax-exemption
  - Arbitrage restrictions – no “printing press”; not investment hedge
  - Taxable bonds are an alternative but are typically bear higher interest costs



# Questions to Ask Before Issuing Bonds

## CAN THE CITY AFFORD THE DEBT?

- Do we have adequate revenues and reserves?
- What can go wrong?

## WHO IS ADVISING CITY?

- Important to get good advice from respected professionals

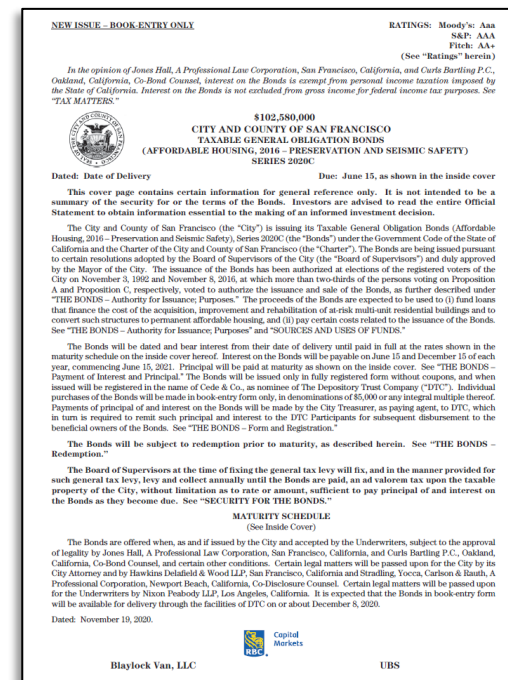
## DISCLOSURE MUST BE ACCURATE!

- The Official Statement ("OS") is the City's document
- Has the City told investors everything they need to know in the OS?
- Has the City set up a system to fulfill our continuing disclosure obligations?
- Not a marketing document
- Ongoing obligations in addition to initial disclosure

## Securities Exchange Act of 1934 Rule 10b-5:

"It shall be unlawful for any person. . .

- (a) to employ any device, scheme or artifice to defraud,
- (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading..."



# Types of Municipal Bonds

## Bonds vary by underlying pledged revenue stream

- Approval requirements, use of funds and credit considerations vary among options

	General Obligation (GO)	Certificates of Participation (COPs)	Special Tax/ Assessment	Tax Increment	Enterprise Revenue
Security	Secured by new ad valorem property taxes	General fund appropriations for lease payments  Requires a leased asset	Special tax (CFD) or assessment levied on property tax bill	% of increased property tax revenues above base level in project area	Net enterprise revenue pledge (i.e. water, sewer, parking)  Covenant to charge sufficient rates
Threshold	2/3rds vote threshold for non-school elections	No public vote; approved by legislative body	Property owners' consent or vote	Varies by type of Infrastructure Financing District (IFD)	No public vote; approved by legislative body
Examples	ESER, Health & Recovery, Affordable Housing, Healthy Safe & Vibrant SF	Animal Care & Control, 49 South Van Ness, Critical Repairs	Mission Rock, Transbay, Treasure Island, Central SOMA	Treasure Island IRFD, Mission Rock/Pier 70 IFD, Power Station	Airport, SFPUC, MTA, Port

# Summary Use of Municipal Bonds

- Match payment of project costs with benefit
- Acquisition or improvement of a tangible asset

## GENERAL OBLIGATION BONDS

- Project timeline can accommodate a lengthy election process

## GENERAL FUND LEASE FINANCINGS

- Underlying project typically generates revenue to support debt payment
- Finance items (equipment) that cannot be funded with GO bonds



# General Obligation Bonds

## Overview

- Annual tax levied on property tax roll in proportion to total assessed property values
- Voters (2/3<sup>rd</sup>s requirement) approve total bond authorization and use of proceeds
- City Charter limit: outstanding GO bonds can't exceed 3% of assessed valuation

## Advantages

- Broad-based tax support for public improvements—real property and real property improvements
- Highest rating and lowest interest cost due to *ad valorem* security and unlimited tax pledge
- New property tax levy repays debt rather than general fund

## Disadvantages

- Time, expense and uncertain outcome of election
- Property tax increase

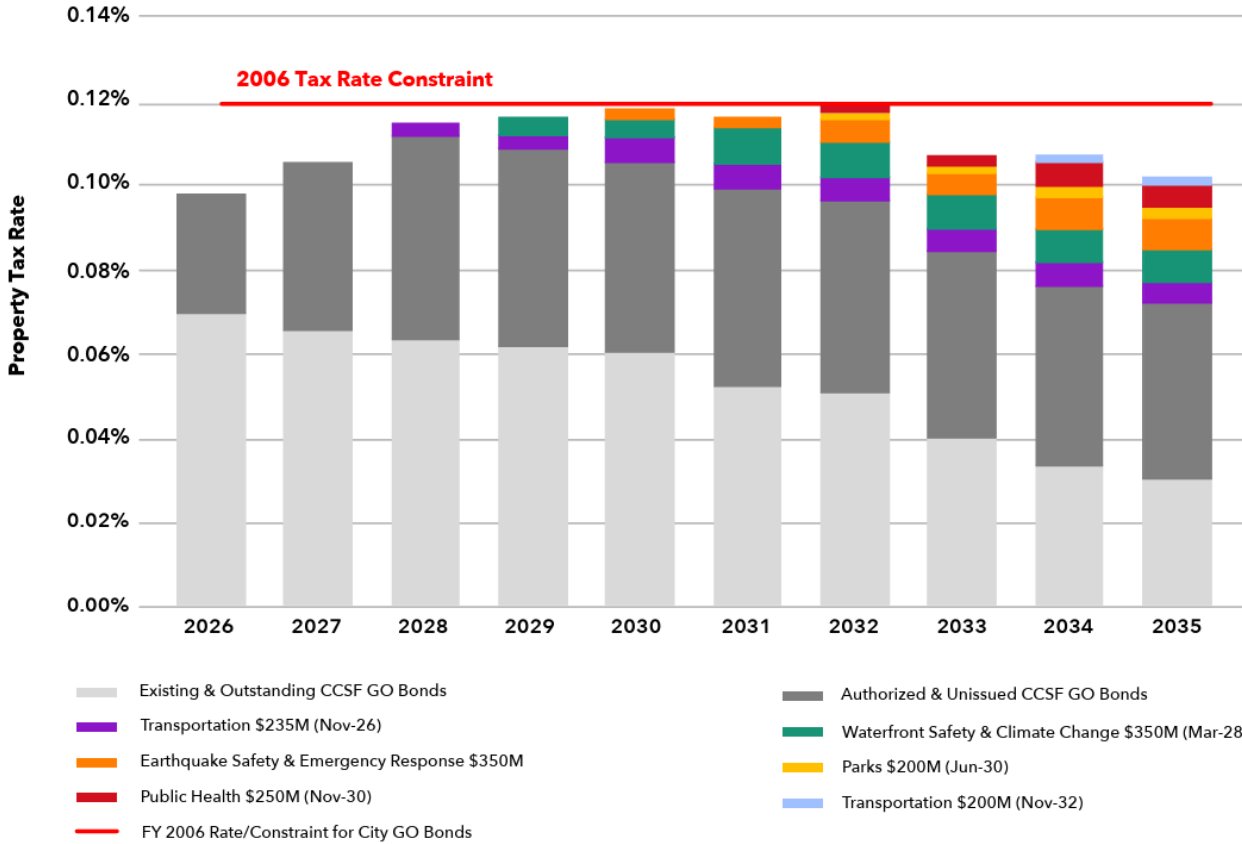
## When Used?

- Typically for projects with broad political support; core City purposes



# General Obligation Bonds Debt (Adopted Capital Plan FY26-FY35)

G.O. Bond Debt Program (Dollars in Millions)		
Election Date	Bond Program	Amount
Nov 2026	Transportation	235
Mar 2028	Waterfront Safety & Climate	350
Nov 2028	Earthquake Safety & Emergency Response	350
June 2030	Parks & Open Space	200
Nov 2030	Public Health	250
Nov 2032	Transportation	200
Nov 2034	Affordable Housing	200
<b>Total</b>		<b>1,785</b>



AV projection assumes AAB reserves in FY26, and growth of 0.52% in FY27, 2.63% in FY28, 3.18% in FY29, 3.28% in FY30, and 3% per year thereafter Revised 11-26-24

# Credit Rating Overview

- The three largest credit rating agencies are Moody's Investors Service, Standard & Poor's (S&P), and Fitch Ratings
- Standardized creditworthiness metric
- All else being equal, a higher credit rating generally will result in lower borrowing costs

		Credit Ratings		
		Moody's	S&P	Fitch
Investment Grade		Aaa	AAA	AAA
		Aa1	AA+	AA+
		Aa2	AA	AA
		Aa3	AA-	AA-
		A1	A+	A+
		A2	A	A
		A3	A-	A-
		Baa1	BBB+	BBB+
		Baa2	BBB	BBB
		Baa3	BBB-	BBB-
Speculative Grade		Ba	BB	BB
		B	B	B
		Caa	CCC	CCC
		Caa	CCC	CCC
		C	C	C

Indicates current City GO Bond rating

# General Obligation Bond Credit Ratings (as of October 2025)

## MOODY'S – Aa1 (STABLE)

### Downside Scenario

- Draws on general fund reserves that bring the available balance to 27.5% of revenue
- Decline in real GDP for 2024
- Worsening commercial vacancy rates and rents or a trend of greater successful commercial property valuation appeals
- Material increase in projected property tax refunds beyond current expectations

### Upside Scenario

- Maintaining general fund balances at  $\geq 40\%$  of revenue
- Growth in total net annual assessed valuation of at least 2% for multiple years
- Meaningful restructuring of economically sensitive taxes to minimize fiscal impact of commercial real estate declines

## S&P – AA+ (NEGATIVE)

### Downside Scenario

- Management and City's governing board lack ability or willingness make significant and sustainable spending cuts, resulting in further consecutive operating deficits in fiscal 2025+ that lead to a material reduction in City's general fund reserves or liquidity
- Local economy, particularly its downtown office corridor, fails to sufficiently recover to the extent that it results in a prolonged loss in property tax and business tax revenues

### Upside Scenario

- City restores balance to general fund operations without significant drawing on reserves
- Local economy recovers faster than anticipated, resulting in stronger growth in its major revenues that eliminates near-term deficits, with projected growth in reserves consistently during the next several years

## FITCH - AAA (NEGATIVE)

### Downside Scenario

- Failure to implement available policy measures to continue progress in reducing the structural deficit resulting in material use of non-recurring measures to balance budgets
- Expected or actual available reserves sustained below 15% of spending
- A roughly 50% increase in the City's long-term liability burden
- Weakened economic and demographic performance (such as population loss, rising unemployment and/or lower resident income)

### Upside Scenario

- Revision of Outlook to Stable depends on the City making demonstrable progress in closing its budget gap through ongoing measures

# Use of Bond Proceeds - Overview

The City issues tax-exempt bonds pursuant to the Internal Revenue Code and related regulations (“Code”). The Code sets forth rules that govern the use of tax-exempt bond proceeds. In today’s training, we will review the key guidelines for:

- Permitted bond expenditures
- Bond proceeds must be timely spent – timing and sizing considerations
- Disbursement Process, reimbursement of prior expenditures with bond proceeds
- Records retention and audit



# Permitted Bond Expenditures

- Most City bonds are issued as governmental bonds
  - Governmental bonds can finance governmentally-owned capital assets that have at least 90%-95% public use
  - In general, any use of property by an entity other than a state or local government is potential **private use** (more on this later)
- Bond proceeds are spent on the construction, acquisition or improvement of a capital asset:
  - A **capital asset** is real or tangible property with a useful life > 1 year
  - Capital **improvements** or rehabilitation of capital assets that **extend their useful life**

# Permitted Bond Expenditures

- Bond proceeds can pay for necessary and incidental costs incurred to acquire or improve capital asset (directly-related staff costs, soft/professional costs, environmental, demolition).
- What does **not** qualify as a financeable “capital asset”?
  - Costs for repair or maintenance (no additional useful life)
  - Costs for goods expected to be consumed within one year (e.g., pencils, paper goods)



# Permitted Bond Expenditures

- **Private Use/Payment** – generally refers to the use of the financed facilities in the trade or business of any person other than the City on terms which differs from that of the public, and the security pledged to bond repayment. Too much private use/private payments (i.e. 10 percent) will limit the ability to issue bonds on a tax-exempt basis.
  - City must have a reasonable belief at the time of issuance (and during life of bond issue) that only minimal private use is expected
  - private use can be triggered by contracts, leases or other special arrangements.
- Consult with OPF and CAT re the analysis of any use by private parties of bond financed property.

A circular inset image on the left side of the slide shows the Golden Gate Bridge in San Francisco, California. The bridge is a large suspension bridge with two prominent towers and a network of cables. The background is a clear blue sky with some light clouds. The bridge spans across a body of water, and some rocks are visible in the foreground.

# Spenddown Rules – Arbitrage and Rebate

- General consideration: Hedge Bonds Rule (IRC Section 149(g))
  - At issuance, issuer **must expect to spend at least 85% of proceeds within 3 years.**
  - Policy rationale: Limit amount of tax-exempt bonds on market, limit opportunity for issuers to invest at higher interest rates.
- Arbitrage (can you earn it?) and rebate (can you keep it?)
  - Arbitrage rules: Generally, proceeds cannot be invested at above the bond yield.
  - There is a general **three-year exception for construction proceeds**, provided
    - issuer expects to spend 85% in 3 years
    - binding commitment of 5% within 6 months

# Arbitrage and Rebate Rules & Exceptions

- Rebate rules: Can you keep excess interest earnings? Generally, no. Federal tax code requires that all interest earned above yield on bonds be 'rebated' (i.e. paid) to federal government. Exceptions to the rebate requirement are:
  - 6-month exception
  - 18 month exception
  - 2 year exception (75% must be spent on construction costs)
- Spenddown rules focus on actual expenditures; deposits into reserve fund are not treated as proceeds. Both the 18-month and 2-year exceptions do not apply to refunding bonds.
  - Consult with OPF to determine if any of qualifying IRS spenddown rule apply to your transaction. If not, City will have to rebate earnings over bond yield.

# Rebate Liabilities

## What if we don't meet an available exception?

- If you do not meet arbitrage exception, must **invest** at or below bond yield or make yield reduction **payments**
- If you do not meet rebate exception, must **pay** excess earnings to IRS
- Need to proceed with due diligence to **spend** proceeds
- Also – generally important to **document** bona fide reasons for spending delays; *IRS does focus on unspent proceeds in an audit*
- If project is done and proceeds remain, can seek a “Closing Agreement” with IRS – City may be asked to retire bonds with unspent proceeds, pay penalties to IRS, or delay future tax-exempt issuance until proceeds are spent

# IRS Reimbursement Rules

- The City is allowed to spend **up to 20%** of bond proceeds on preliminary soft costs. If the City adopts a **Reimbursement Resolution**, it can reimburse **up to 100%** of bond proceeds for preliminary (soft) costs. Hard costs can be reimbursed (i) if expenditure occurred 60 days prior to adoption of resolution, and (ii) no later than 3 years after cost was paid.
  - *Preliminary (soft)* costs include architectural, engineering, surveying, soil testing and costs of issuing bonds.
  - *Hard costs such as* land acquisition, site preparation, and “dirt-kicking” construction are excluded from preliminary costs.
- **A finding of non-compliance by IRS could result in declaration of taxability or settlement requiring payment to IRS and/or redemption of bonds.**

# IRS Records Retention and Audit

- Records of investment and expenditure of bond proceeds should be retained until 6 years after the last of the bonds is retired. Electronic records are acceptable.
- Records include the bond transcript, contracts for bond-funded projects or to operate bond-funded facilities, related invoices, investment records, City employee timekeeper records, and transactions with bond proceeds recorded in the financial system.
- IRS can examine any matter relating to the issuer's compliance with applicable laws and regulations.
- Correspondence from IRS should immediately be forwarded to senior finance staff and your assigned finance Deputy City Attorney for review and response.

# Accountability & Oversight

## Citizens' General Obligation Bond Oversight Committee

- Proposition F - The Ordinance established a committee of nine members for the purpose of informing the public concerning the expenditure of general obligation bond proceeds through active review and the publishing of regular reports.

<https://sf.gov/public-body/citizens-general-obligation-bond-oversight-committee>

## City Services Auditor

- The City Services Auditor is responsible for monitoring the level and effectiveness of services provided by the government of the City and County of San Francisco to the people of San Francisco. The City Services Audit Unit in the Controller's Office works to ensure the financial integrity and improve the overall performance and efficiency of City government pursuant to Appendix F of the City's Charter.

## Board of Supervisors

- The Board of Supervisors serves as the elected legislative body governing the City's operations and debt issuances, as well as for Community Facilities Districts and certain Infrastructure Financing Districts. The Board has expenditure control and authority to conduct oversight on City departments to ensure funds are being expended in line with City purposes.

## Capital Planning Committee

- The Capital Planning Committee makes recommendations to the Mayor and Board of Supervisors on all of the City's capital expenditures. The CPC annually reviews and approves the Capital Plan, Capital Budget, and issuances of long-term debt. Under the City Administrator, staff of the Capital Planning Program review and prioritize Capital Plan and Capital Budget requests; project and coordinate funding sources and uses; produce the 10-year Capital Plan; provide policy analysis and reports on interagency capital planning; and provide staff support to the Capital Planning Committee.

<http://onesanfrancisco.org>