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San Francisco Municipal Transportation Agency; Transit

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Long Term Rating	A+/Negative	Affirmed

Credit Highlights

- S&P Global Ratings affirmed its 'A+' long-term rating on the San Francisco Municipal Transportation Agency's (SFMTA) revenue bonds outstanding.
- The outlook is negative.

Security

Certain pledged gross revenue before the payment of SFMTA expenses secures the bonds, although our financial performance analysis focuses on net revenues after payment of operating expenses. Pledged revenue consists of passenger fares; traffic fines, fees, permits, and taxi medallion fees; parking meter revenue and parking citations; parking garage and surface parking lot revenue; Assembly Bill 1107 revenue; rent and advertising revenue; State Transit Assistance revenue; and Transportation Development Act sales tax revenue. Pledged revenue added in fiscal 2020 includes federal pandemic support. In addition, although its yield is relatively small, a traffic congestion mitigation tax was introduced as a source of pledged revenue in fiscal 2021. Transfers to SFMTA from the city's general fund, including the baseline and the "in lieu of parking" tax, are not pledged to the bonds but have historically provided significant revenue to the agency (49% of gross revenue in fiscal 2023).

Bond provisions include an additional bonds test of 3x pledged revenue, but, in our view, an additional bonds test based on a gross pledge is permissive. Cash-funded stand-alone debt service reserve funds totaling $32.9 million for all but the series 2017 bonds, provide additional liquidity to bondholders, if needed. Although the series 2017, 2021AB, and 2021C bonds lack a debt service reserve, we do not consider this a significant credit weakness given SFMTA's strong overall liquidity position.

Total SFMTA debt outstanding as of June 30, 2023, was $592 million.

Credit overview

SFMTA's market position and financial performance have weakened since pre-pandemic levels, in our view, nonetheless the 'A+' long-term rating reflects our view of SFMTA's still important role as the main mass transit and parking provider within San Francisco and the strong political and financial support it receives from the city, state, and federal government in the form of revenue that have historically accounted for about 60% of its budget (and even more in recent years), as well as significant support from various tax revenue. We anticipate that financial performance will continue to be weaker than pre-pandemic levels for the near term, but SFMTA has significant remaining federal and state operating assistance, which we view as providing near-term financial flexibility through 2026 as it pursues new longer-term funding solutions for enhanced credit stability. We have applied a one-notch positive holistic adjustment from the adjusted anchor to arrive at the 'A+' rating to reflect our view of SFMTA's very low debt burden, local support, and manageable capital needs versus those of peers because we believe this promotes greater financial flexibility.

The rating reflects our view of SFMTA's:

- Virtually monopolistic business position, diverse service offerings (bus, light rail, streetcar, and cable car, as well as parking), and strong support from non-transportation-related revenue sources that recently have made up about three-fourths of the agency's budget;
- Robust service area economic fundamentals, including favorable economic activity as measured by GDP per capita and historically low unemployment;
- Continued extremely strong management and governance, with a record of routinely meeting or exceeding fiscal targets, mitigating risk, and managing all operating divisions;
- Relatively low debt burden for a transit agency of its size and no immediate direct debt plans, offset by a large capital plan of about $2.6 billion; and
- Ample liquidity and financial flexibility, with unrestricted cash on hand of $731 million, exceeding total debt and representing reflecting 239 days' cash on hand on average in fiscal years 2021 to 2023, which we expect will be preserved likely at least through fiscal 2026 largely because of significant aid received.

Partly offsetting the above strengths, in our view, are SFMTA's:

- Exposure to prolonged weak ridership because of lingering ancillary effects of the pandemic, including behavioral changes with respect to use of public transit that are outside of management's control;
- Future financial risk related to sizable budget gaps beginning in fiscal 2027, when nonrecurring relief funds will likely be depleted, and the associated need for a new recurring revenue stream to support ongoing services; and
- Weak financial performance, with debt service coverage (S&P Global Ratings-calculated, on a net revenue basis, without pandemic-related federal or state aid) that has been insufficient in fiscal years 2020 through 2023 and will likely be insufficient through fiscal 2026 and potentially longer as the agency relies on federal and state aid to bolster revenue and delays significant cost cutting.

SFMTA is an enterprise department of the City and County of San Francisco (AAA/Stable general obligation rating), and is a comprehensive transportation agency responsible for transit, parking meters, parking garages and lots, traffic, taxi regulation, accessible services, bicycles, and pedestrian accessibility programs.

Federal-aid-derived substantial financial flexibility and newly announced state operating assistance partly offset the pandemic's negative effects on SFMTA's market position assessment and financial performance. We believe the softness in demand for mass transit (and, to a lesser extent, for parking) will be sustained largely as a result of remote work flexibility and changing rider behavior. Financial performance, especially S&P Global Ratings-calculated debt service coverage without inclusion of federal aid, has weakened considerably and, we believe, could remain insufficient through at least fiscal 2026.

Ridership and parking revenue were still well below 2019 pre-pandemic levels at 45% and 88% (with transit boardings at 61%), respectively, as of fiscal year-end June 30, 2023. However, the agency has been comfortably able to meet obligations, avoid significant labor reductions, maintain liquidity, and sustain most service levels given the diversity of its revenue mix and particularly through the use of significant federal aid of slightly more than $1 billion over fiscal years 2020 to 2023. The agency anticipates fully depleting its remaining $339 million pandemic-related federal aid by the end of fiscal 2026, but it and other transit providers in the state are set to receive operating assistance pursuant to Senate Bill (SB) 125. Specifically, under SB 125, SFMTA anticipates about $309 million in operating assistance--$99 million in fiscal 2025 and $209 million in fiscal 2026--subject to adjustments and meeting various accountability requirements such as customer experience and efficiency enhancements. We believe this will provide SFMTA additional time to investigate new revenue sources and rightsize its budget based on a clearer view of what future level of transit demand is sustainable, and, importantly, to preserve liquidity. The agency, along with other state transit systems, has also been pursuing a regional ballot initiative for 2026 to create a funding stream for public transportation. We believe a new ongoing revenue stream such as this will likely be needed to close large budget gaps identified in fiscal 2027 and beyond to maintain service levels.

Management reports that for its two-year budget (fiscal 2024-25 and 2025-26), it plans to realign expenditures relative to revenue, with the goal of extending federal operating assistance and state relief to fiscal 2027, creating a bridge to a possible regional revenue ballot measure in 2026. In addition, management reports a small budget gap for fiscal 2026 of about $13 million that it will work to close over the next few months. Generally, the agency aims to use attrition, rather than layoffs, to reduce labor costs, where possible. SFMTA may also, in the interim period, look for new revenue sources, such as adjusting transit fares and parking and taxi fees and fines. But generally, if revenue does not rebound and no other funding sources materialize, significant labor and service reductions could occur, and, if budget alignment is not successful, balance sheet liquidity could be drawn down.

Environmental, social, and governance

We analyzed SFMTA's environmental, social, and governance risks relative to its market position, management and governance, and financial performance, and determined that, with the exception of social risks, all are credit neutral. We view social risks as a negative consideration in our credit rating analysis. While ridership may continue to rebound over the next few years, and parking revenue is just 12% below pre-pandemic levels, we believe longer-term social capital demographic changes in return-to-work requirements and rider behavior will likely result in a permanent loss of ridership for several years, with ultimate recovery, both in terms of timing and actual ridership, highly uncertain. With regard to governance, we view SFMTA's comprehensive financial planning, transparency, and disclosure practices as prudent and credit neutral. We also view environmental risks as credit neutral, although we note that SFMTA is located in a region prone to earthquakes, which introduces some risk.

Outlook

The negative outlook reflects our opinion that there is at least a one-in-three chance we could lower the rating over the two-year outlook period.

Downside scenario

We could lower the rating to the extent that ridership and fare revenue lag projections, as this could negatively affect our view of SFMTA's already weakened market position, further erode financial metrics, and deplete federal and state aid more quickly than planned. In making this assessment, we will also examine whether management has a credible plan to close out-year budget gaps.

Upside scenario

If SFMTA is able to maintain liquidity and align expenditures with revenue, or if transit activity and operating revenue rebound to levels that we believe are sustainable and sufficient to cover all obligations, we could revise the outlook to stable. We could also revise the outlook to stable if a recurring revenue source materializes that we believe will be sufficient to address future budget gaps.

Credit Opinion

Enterprise Risk Profile: Very Strong

We have maintained our enterprise risk profile assessment at very strong, reflecting SFMTA's essentiality and political support, continued recovery of activity, robust management and governance, and deep and diverse economic base.

Ridership and parking recovery support improved operations

SFMTA's ridership numbers continue to improve, but are still materially lower than pre-pandemic levels. The lower ridership, in our opinion, is now attributable to remote work patterns and, to a lesser extent, the reluctance of passengers to return to mass transit because of reliability, service levels, or safety concerns. As a result of the pandemic, SFMTA's ridership declined sharply, with fiscal 2021 ridership at just 27% of the fiscal 2019 figure (224 million boardings). Ridership for fiscal 2023 improved to 61% of fiscal 2019 levels, and is forecast at 71% to 87% for fiscal years 2024 to 2028. Accurate forecasts of ridership and downtown office occupancy have been elusive and, trends lead us to believe that targets could be a challenge to achieve. Monthly weekday ridership data for the first half of fiscal 2024 indicate Muni ridership at 60% to 66% of comparable fiscal 2019 levels, which suggests that management's forecast of 71% recovery for full fiscal 2024 is possible. Parking, garage, and related revenue declined to about one-fifth of pre-pandemic levels during the early months of the pandemic in 2020, but are now about 88% recovered.

S&P Global Ratings will continue to assess the impact of SFMTA's lagging transit activity on key credit metrics, but we believe internal liquidity, prudent expense management, and $1.7 billion in federal and state aid (which is being used in fiscal years 2020 through 2026) will likely allow SFMTA to weather the prolonged decline in demand. For additional information, see "U.S. Transportation Infrastructure 2023 Activity Estimates Show Air Travel Likely To Fully Recover, With Transit Ridership Still Lagging," published Jan. 9, 2023, on RatingsDirect, and "U.S. Transportation Infrastructure Transit Update: End Of The Line Nears For Federal Assistance As Low Ridership Pressures Operators," published Sept. 28, 2023.

Broad financial and political support now and historically

We consider the support that the agency has received at the federal, state, and local levels significant. SFMTA received approximately $1.4 billion of combined federal relief under the CARES Act, Coronavirus Response and Relief Supplemental Appropriations Act, and American Rescue Plan Act, has applied $1.0 billion in fiscal years 2020 to 2023, and plans to apply another $340 million to fiscal years 2024 to 2026; this excludes an additional $309 million as a result of SB 125, as mentioned. This external liquidity allowed management time to assess the recovery in ridership and parking revenue and determine how it will rightsize its budget or determine which revenue enhancements might support the high likelihood of lower future activity. Even prior to the pandemic, SFMTA received significant local support from general fund and other city departments at approximately half of its budget.

Deep and diverse economic base remains credit supportive

We consider SFMTA's service area economic fundamentals extremely strong, reflecting high GDP per capita of approximately $166,000 and a historically below-average unemployment rate compared with the national level. SFMTA serves a city population of approximately 883,000 in addition to those commuting into the city by auto or other public transit. In our view, the underlying strength of SFMTA's catchment area--with generally steady population and employment growth and high income levels--helps provide ongoing demand for transit services. While we note that the city has a relatively high percentage of jobs in financial services and technology, where remote work is more possible and is in some cases encouraged or required, the economy's underlying strength supports general demand for transit.

Financial Risk Profile: Adequate

We continue to assess SFMTA's financial risk profile at adequate, reflecting our expectation that financial metrics, especially with forecast S&P Global Ratings-calculated coverage slightly below break-even, will come under pressure because of potentially slowly recovering or plateauing ridership and ongoing fixed costs or capital needs that significantly surplus cash flows have historically supported.

Revenue diversity tempers weak ridership volume

In addition to federal aid, SFMTA's overall revenue diversity provides financial resilience to the system. While transit and parking are its core operations, SFMTA does not significantly rely on associated revenue for operations; transit-, parking-, and transportation-related fines and penalties represented just 32% of gross revenue in fiscal 2019 and 23% in fiscal 2023. This partly offsets SFMTA's exposure to reduced activity. Nevertheless, these are important revenue streams for sustaining solid financial metrics and as of fiscal 2023 were 33% off of fiscal 2019 levels ($280 million versus $418 million); absent activity recovery or other budget adjustments, we believe the financial risk profile could further erode once federal aid and state operating assistance are depleted.

Taxes and city general fund provides revenue stability and predictability

An important credit consideration is financial support from various tax revenue that does not directly rely on transportation activity. Tax revenue, accounting for around 16% of gross revenue, is incremental to the significant support provided by other nonfare or parking revenue, and is also incremental to the support by the City and County of San Francisco as relates to general fund transfers that alone totaled $556 million, or 46% of gross revenue, in fiscal

2023. We also note that the majority of San Francisco City and County general fund revenue (72%) consisted of various taxes in fiscal 2023, lending credit stability, especially during exogenous shock events that depressed transportation activity. Operating grants, taxes, and general fund support typically account for almost three-fourths of gross revenue. General fund support is forecast to remain at no less than 40% of gross revenue over the next few years.

Financial performance and liquidity reliant on federal aid and management actions

In fiscal 2020, SFMTA suffered a revenue loss of $234 million but offset that through $37 million in expenditure savings and use of $197 million in CARES Act money. In fiscal 2021, management bolstered underperforming revenue with an additional $450 million in federal aid receipts. An additional $241 million was applied to fiscal 2022, and $138 million to fiscal 2023, for a total of $1 billion in federal aid assistance applied thus far. (Three hundred thirty-nine million dollars remains for fiscal years 2024 to 2026 outside of $309 million in SB 125 operating assistance.) SFMTA has been enacting cost control measures, including a hiring freeze for all noncritical positions, reduced overtime, controls on materials and supplies, and contract expenditure cuts. Recovery of fare revenue has lagged ridership recovery largely as a result of a higher proportion of free or reduced fares over the past three years, and partly as a result of fare evasion. SFMTA plans to add additional transit inspectors to reduce fare evasion.

For fiscal years 2020 through 2023, S&P Global Ratings-calculated coverage on a net revenue basis, excluding federal aid, has been less than 1x. Coverage excluding federal and state operating assistance is unlikely to be sufficient through fiscal 2026 as the agency balances external aid funding with rebounding fare and parking revenue and appropriate service. While this continues to be a significant departure from historically extremely strong coverage during fiscal years 2015 to 2019, we understand the situation remains fluid pending the trajectory of rebounding ridership, permanence of increased telecommuting, system utilization, potential additional budget adjustments, and performance of other revenue sources such as taxes and general fund support. We also understand that management continues to investigate new revenue sources, including the potential 2026 regional ballot measure. We do recognize that COVID-19 federal aid and to-be-received SB 125 operating assistance will allow SFMTA to maintain strong liquidity, which totaled $731 million, or 216 days of operating cash, in fiscal 2023.

Capital needs are manageable with no additional agency debt planned

While SFMTA's five-year capital plan is large at $2.6 billion, no additional parity bonds are anticipated (though the proceeds of previously issued bonds will fund various projects). In its bond offering in 2021, SFMTA took most of the refunding savings upfront through fiscal 2023 to help offset projected budget deficits given the effects of the pandemic. The agency, as with most transit and transportation agencies, faces challenges in maintaining infrastructure in a good state of repair. Projects include transit infrastructure needs, fleet replacement, the Central Subway Project (an extension of the Third Street light rail line into Chinatown), and transit expansion and enhancement.

Related Research

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