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INVESTORS SERVICE

CREDIT OPINION
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San Francisco Muni.Transp. Agcy., CA

Update to credit analysis

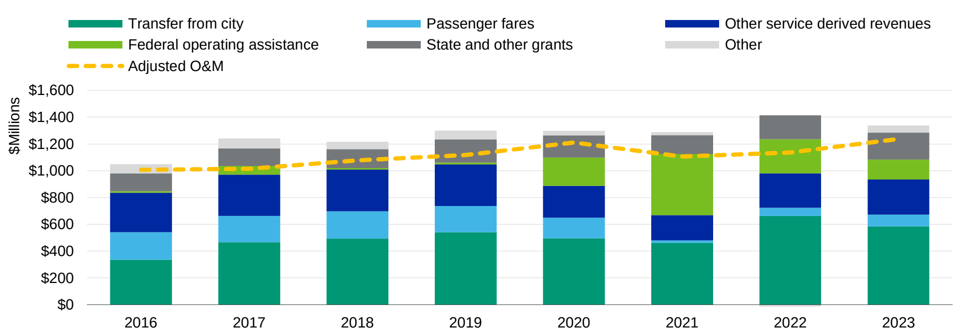
Summary

The credit quality of the San Francisco Municipal Transportation Agency, CA (SFMTA, Aa3 stable) is supported by its strategic importance as the main public transportation provider in the City and County of San Francisco (Aaa negative), its revenue diversity and sound liquidity. The agency also benefits from proactive and conservative fiscal management, as well as demonstrated financial support from the city, State of California (Aa2 negative) and the federal government. These strengths are offset by the agency's significant deferred capital needs and high fixed costs for pensions and OPEB. Also, like other transit systems in the US, SFMTA's ridership likely will not return to pre-pandemic levels because of shifting work conditions post-COVID 19. While federal pandemic aid and state one-time financial assistance will help the agency bridge funding gaps over the next two years, SFMTA will need to seek additional ongoing revenue to address long-term funding challenges. The agency's ability to adapt its operations and financials under the post-pandemic environment will be crucial for its credit quality.

Exhibit 1

SFMTA benefits from diverse revenue stream, and significant federal pandemic aid is blunting the effects of fare revenue losses under and following the pandemic

Fiscal year ends June 30



O&M is adjusted to net out depreciation, interest expense and use annual cash contributions for pensions contribution and OPEBs; transfer from city exclude general obligation bond proceeds dedicated to capital projects

Source: SFMTA; Moody's Investors Service

Credit strengths

» Above average system utilization in a large service area

» Demonstrated federal, state and city support; the availability of one-time federal pandemic aid and state financial assistance to offset fare revenue losses in the near term

» Relatively diverse revenue stream that includes fares and parking fees as well formula-driven, voter approved transfers from the city's general fund that embedded in the City Charter

» Low debt levels with strong coverage by both pledged revenue and net revenue

» Proactive and conservative fiscal management

Credit challenges

» Slow recovery of ridership because of shifting work patterns following the coronavirus pandemic

» Relatively high fixed costs and long term liabilities largely attributable to pensions and OPEB

» Significantly deferred capital needs

» Significant labor shortage challenges

Rating outlook

The stable outlook reflects our expectation that the agency's finances will be balanced with federal aid and state financial assistance over the next 18-24 months as fare revenue remains depressed. Over the longer term, we expect that SFMTA will proactively seek additional revenue sources or make expenditure adjustments, if needed, to maintain structural balance.

Factors that could lead to an upgrade

» The addition of significant new sources of revenue to the existing pledged revenue mix, combined with limited issuance of new debt

» Significant reduction in pension liabilities and deferred capital needs

Factors that could lead to a downgrade

» Significant and long term reduction in ridership and essentiality beyond current projections

» Inability to maintain balanced operations

» Material weakening of debt service coverage

» Sustained erosion of liquidity position

Key indicators

Exhibit 2

	2018	2019	2020	2021	2022	2023
Annual Ridership (000)	224,611	222,938	170,284	61,641	102,512	137,115
Annual Ridership Change (%)	-0.5%	-0.7%	-23.6%	-63.8%	66.3%	33.8%
Utilization (Trips/ Population)	253	250	195	72	122	165
Farebox Recovery Ratio (%)	18.8%	17.5%	12.6%	1.6%	5.4%	7.1%
3-Year Average Fixed Costs as % of Operating Expenditures	12.8%	13.2%	13.6%	14.4%	14.7%	14.5%
Net Deb/ Revenues	0.3	0.3	0.3	0.4	0.3	0.3
3-Year Average Annual Debt Service Coverage by Net Revenues (GAAP)	6.6	8.3	5.0	6.1	8.6	8.9
Days Cash on Hand	221	230	222	236	271	216
Additional Measures						
Pledged Revenues ($000)	652,919	689,996	764,755	789,614	726,201	692,706
Annual Change in Pledged Revenues	6.0%	5.7%	10.8%	3.3%	-8.0%	-4.6%
Annual Debt Service Coverage by Pledged Revenues (Indenture) (x)	4.4	7.2	3.4	7.8	14.6	4.3

Source: SFMTA; Moody's Investors Service

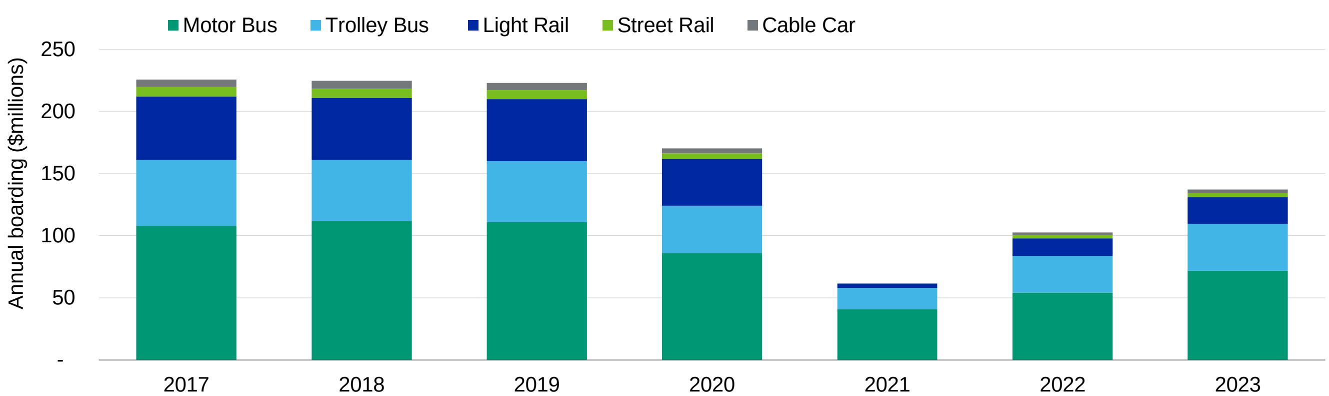
Profile

SFMTA is an enterprise department of the City and County of San Francisco, responsible for the management of all ground transportation in the city. SFMTA oversees public transit as well as bicycling, paratransit, parking, traffic, pedestrian safety and infrastructure and taxis. SFMTA has autonomy to set its passenger fares, parking fees and fines.

Exhibit 3

SFMTA offers a diverse fleet of vehicles for its transit services

Fiscal year ridership breakdown



Note: ridership count not completed for street rail in fiscal 2021 because of staff availability; cable car service did not operate in FY2021

Source: SFMTA; Moody's Investors Service

Detailed credit considerations

Size and market position

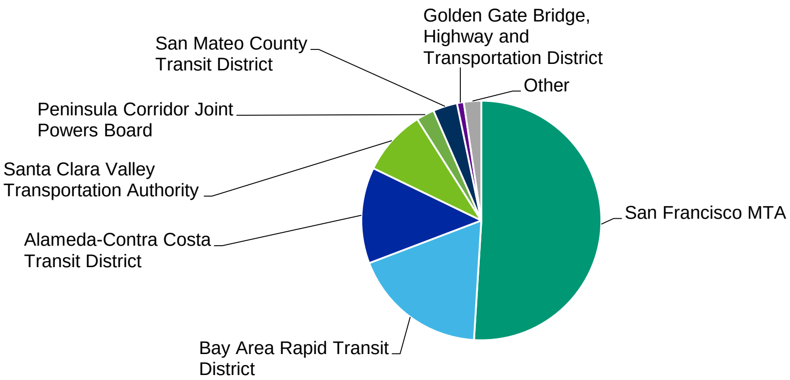
We expect SFMTA's ridership levels will slowly recover to 80-85% of pre-pandemic levels by 2026 in light of the shift to remote and hybrid working patterns. The agency's system utilization, measured by ridership over population, will remain among the highest in the nation as SFMTA plays an important role in reducing congestion in one of the most densely populated US city .

SFMTA serves the City and County of San Francisco with a population of around 831,000[1]. It is the eighth largest transit system in the country and the largest in the San Francisco Bay Area, based on total ridership before the pandemic. As of calendar year 2023, the agency carried a little over 50% of total Bay Area riders (see exhibit below), up from around 45% before the pandemic.

Exhibit 4

SFMTA remains the largest transit operator in the San Francisco Bay Area

Distribution of calendar year 2023 ridership

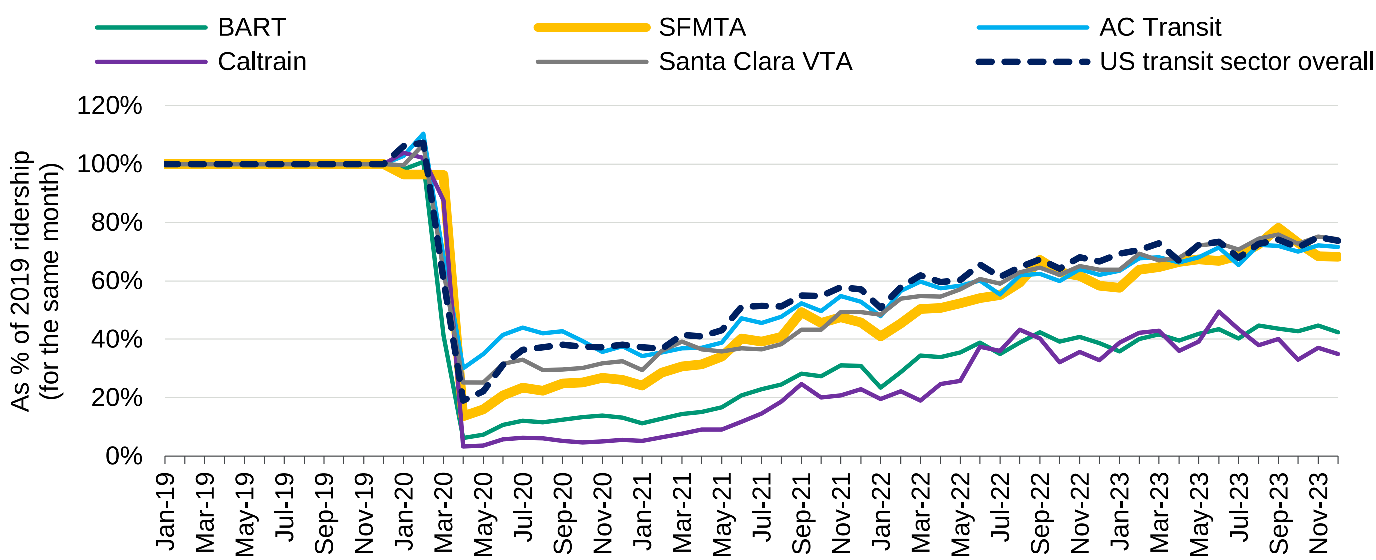


Source: Federal Transit Administration National Transit Database

Like all transit systems nationwide, SFMTA's ridership levels remain below pre-pandemic patterns. Positively, while the agency's ridership recovery initially lagged the sector, it has picked up in recent quarters and now follows closely with the sector average (Exhibit 5). Given the San Francisco Bay Area's above-average share of remote/hybrid work, commuter-rail only transit systems in the area, including [Bay Area Rapid Transit District, CA] (BART; GO bond rating Aaa negative) and [Peninsula Corridor Joint Power Board, CA] (Caltrain; revenue bond rating A1 stable) are experiencing slower recovery (Exhibit 5). This highlights SFMTA's importance in accessing schools, non-office jobs, services and recreation.

Exhibit 5

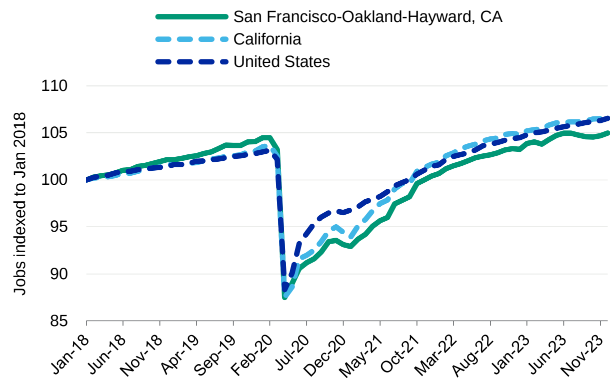
While SFMTA's ridership recovery initially lagged the sector average, it has picked up in recent quarters



Source: Federal Transit Administration; Moody's Investors Service

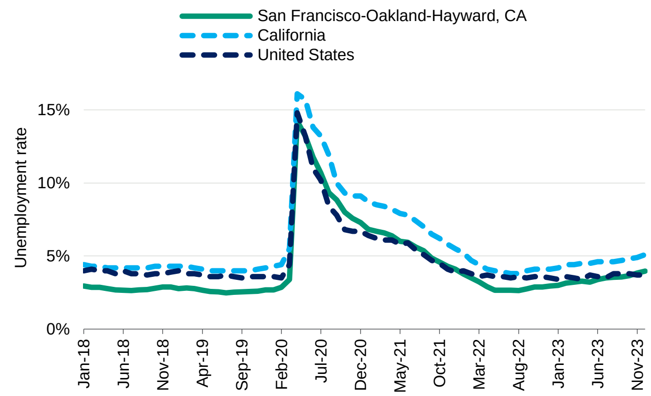
San Francisco benefits from a robust economy anchored by a massive tax base, status as a premier technology ecosystem and strong median family income representing 154.3% of US after adjusting for regional cost of living. However, weakness in the city's commercial real estate market post-COVID, slow recovery in tourism and retail and lagging demographic trends (see ESG section) collectively weigh on its economic vibrancy. The metro area's job growth is slowing down in step with the nation (Exhibit 6) under higher interest rates, although unemployment rate remains low (Exhibit 7).

Exhibit 6
The San Francisco-Oakland-Hayward metro area's job growth slightly trailed the nation's and California since the pandemic...



Source: Bureau of Labor Statistics; Moody's Investors Service

Exhibit 7
...but unemployment rate remains low



Source: Bureau of Labor Statistics; Moody's Investors Service

Longer term, San Francisco's highly skilled workforce and its entrepreneurial culture will ensure a solid tech presence. Notably, an emerging focus on generative artificial intelligence is re-energizing the city's tech community.

Financial flexibility and metrics

SFMTA's budget should be balanced over the next two years with federal pandemic aid, one-time state financial support and the agency's fiscal prudence. We expect that management will identify new revenue source(s), and/or modify operations to maintain structural balance once one-time federal and state fundings are exhausted.

The agency's finances benefit from a diverse mix of operating revenue (see Exhibit 1). Transfers from the city's general fund represented the largest source for operating revenue, at around 40%, before the pandemic. The general fund transfers are formula-driven, voter approved and embedded in the City Charter. They do not require appropriation by the city and cannot be diverted to other city purposes. However, growth of this major revenue source is likely to slow given the city's current economic and financial conditions.

Service derived revenue, mainly passenger fares, parking fees and fines, advertising and license and permits, made up around 39% of total operating revenue before 2020 and has not recovered to pre-pandemic levels (Exhibit 1). Lastly, the agency's revenue also includes: dedicated tax subsidies, including AB 1107, the ½-cent BART sales tax, a portion of which is allocated by formula to SFMTA; State Transit Assistance (STA) made up of a state sales taxes on diesel fuels allocated to counties for transit; and state Transportation Development Act (TDA) funding, made up of a state ¼-cent sales tax returned to counties for transit. We expect these sources will remain a stable revenue source for the agency. Most of SFMTA's operating revenue, with the primary exception of the general fund transfers, are pledged to the revenue bonds.

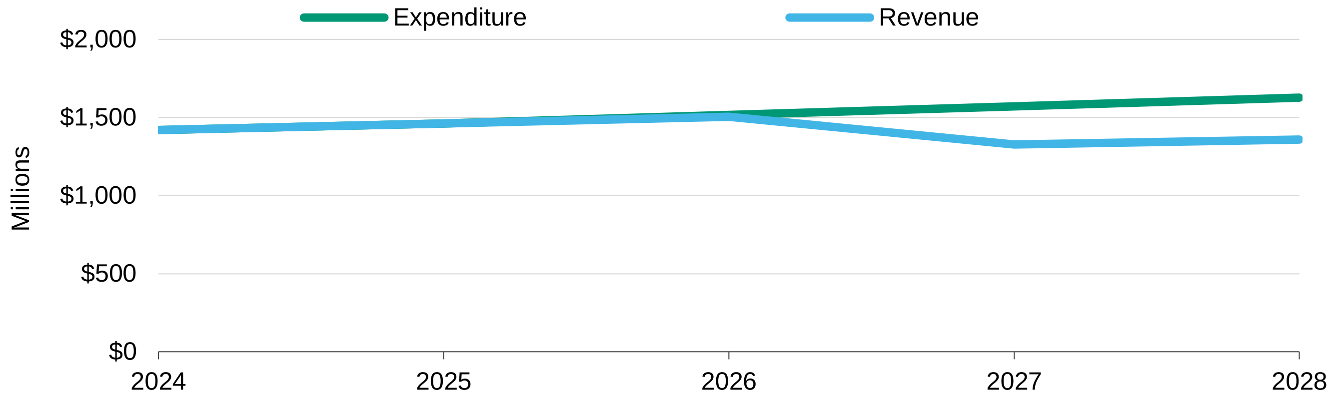
Despite declines in service derived revenue, the agency ended recent fiscal years (through 2023) with balanced operations given the availability of federal pandemic aid. Early on during the pandemic, the agency also enacted expenditure cuts and redirected to operations revenue previously earmarked for capital. Currently, management also expects to end fiscal 2024 (ends June 30, 2024) with balanced operations [2].

Going forward, remaining federal pandemic aid, around $300 million of state one-time relief and a few operating adjustments should allow SFTMA to maintain balanced operations through fiscal 2026 (June 30, 2026). The agency is currently crafting its budget for the fiscal 2025-2026 biennium and proposes to eliminate clipper card discount, increase parking fines and various fees, as well as control expenses to balance the budget. To achieve longer-term financial stability, management expects to seek additional voter approved taxes, because a sizable structural budget gap of approximately $240 million (18.4% of expenditure) is currently projected starting in fiscal 2027 when one-time resources are exhausted [3]. This may entail a regional revenue measure in all nine Bay Area counties, benefiting multiple local transit systems.

Exhibit 8

SFMTA is projecting a sizable structural fiscal gap after fiscal 2026, when one-time federal and state fundings are expended

Fiscal year



Source: SFMTA January 2024 budget workshop five-year forecast; Moody's Investors Service

Liquidity

SFMTA's liquidity is strong. As of fiscal end 2023, its unrestricted cash and investments totaled $731.1 million, representing 216 days cash on hand, well exceeding its contingency reserve policy that targets reserve at 10% of operating expenditures.

The bulk of SFMTA's cash and investments are with City Treasury; as of June 30, 2023, SFMTA's total cash and investments represented 6.4% of the City's investment pool. SFMTA also has the ability to borrow from the city's larger investment pool, if needed.

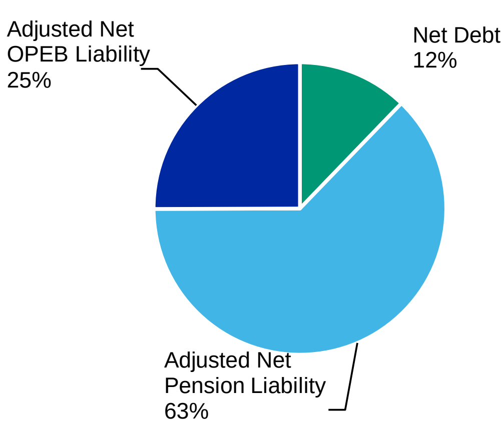
Leverage and fixed costs

SFMTA's direct debt burden is relatively low, despite a large capital plan, because of the availability of external funding: voter approved San Francisco general obligation bonds in the past, federal grants, state and regional grants and sales tax funds from the San Francisco County Transportation Authority. As of fiscal 2023, SFMTA's direct debt burden represented 0.3 times operating revenue.

The agency's pension and OPEB burden are more sizable, and it is total leverage (based on Moody's adjusted pension and OPEB liability) is much higher at 2.8 times operating revenue, but manageable. The agency's fixed costs (based on actual pension contribution) represented around 12.8% of operating revenue as of fiscal 2023.

Exhibit 9

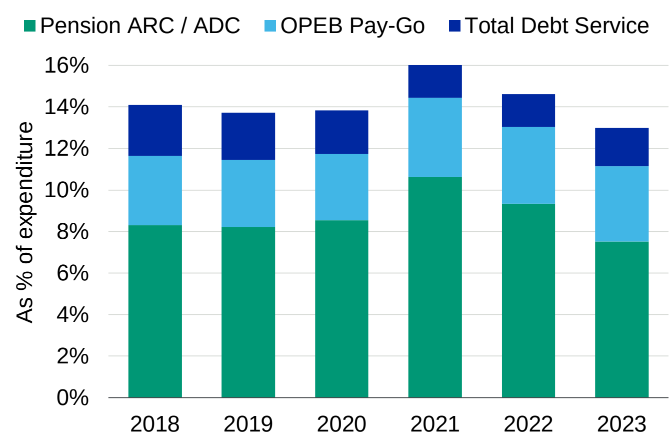
SFMTA's debt burden is relatively modest in comparison to its pension and OPEB liabilities



Source: SFMTA; Moody's Investors Service

Exhibit 10

SFMTA's fixed costs primarily consist of pension and OPEB contributions



Source: SFMTA; Moody's Investors Service

SFMTA's capital needs are large given its significant deferred maintenance needs. Notably, the agency's draft capital improvement plan for fiscal 2025-2029 meets near-term good repair needs, but does not have sufficient resources to address capital backlog [4]. The city will likely seek additional transportation general obligation bonds to address the agency's capital needs.

Legal security

SFMTA's revenue bonds are secured by a gross pledge on diverse mix of operating and non-operating revenue including transit fares, parking revenue, parking and traffic fines and dedicated taxes, but excluding transfers from the city's general fund and certain other restricted revenue.

Legal protections as defined in the agency's bond resolution provide satisfactory security for bondholders. SFMTA covenants to adopt balanced budgets and manages its operations and set charges so that pledged revenue in each fiscal year, and available fund balances, will be at least equal to annual debt service and payment of all costs reasonably necessary to operate the transportation system. The additional bonds test is set at a strong 3.0 times maximum annual debt service for all outstanding revenue bonds and additional bonds.

Debt structure and debt service coverage

SFMTA's revenue bonds are long-term fixed rate obligations with a final maturity in 2051. The maximum annual debt service represents around 2.1% of fiscal 2023 operating revenue. SFMTA has a policy to maintain debt service at below 5% of its operating budget.

Pledged revenue for fiscal 2023, including federal relief funds, provided 24.8 times coverage of maximum annual debt service on the agency's outstanding revenue bonds. Excluding federal relief funds, fiscal 2023 pledged revenue provided 19.9 times coverage of MADS.

Using net revenue, the agency's debt service coverage was 4.3 times as of fiscal 2023.

Debt-related derivatives

SFMTA has no debt-related derivatives.

Pensions and OPEB

The trajectory of SFMTA's long term pension and other post-employment benefit (OPEB) solution is contingent upon City of San Francisco as SFMTA is a participant in the city's retirement and healthcare plans.

SFMTA's share of the city's pension liability is manageable, with Moody's adjusted pension liability (ANPL) representing 1.8 times operating revenue as of fiscal 2023 reporting. Positively, the agency's pension contributions exceeded our tread water calculations in recent years, meaning that reported liability will decline if investment targets are met.

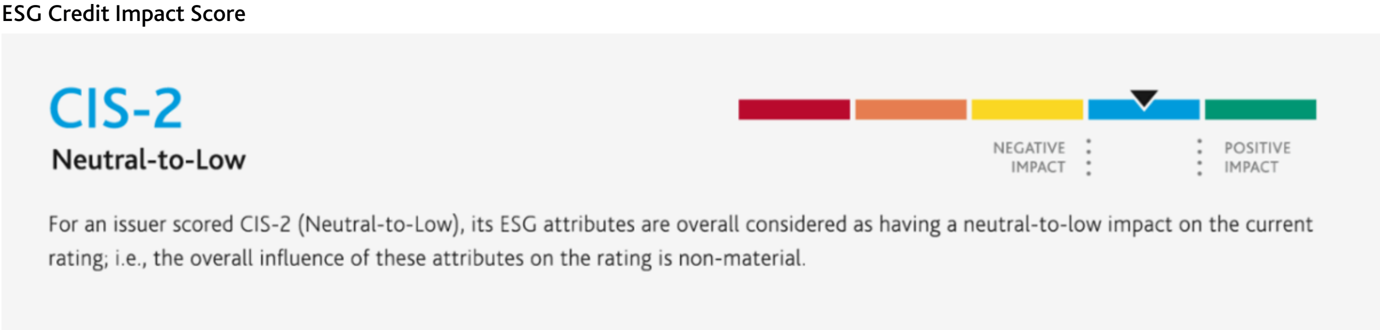
SFMTA's share of the city's OPEB liability represented 0.7 times revenue.

ESG considerations

SFMTA's ESG Credit Impact Score is **CIS-2**, reflecting moderately negative exposure to environmental and social risks and a positive governance profile.

Exhibit 11

ESG Credit Impact Score



Source: Moody's Investors Service

Exhibit 12
ESG Issuer Profile Scores

Source: Moody's Investors Service

Environmental

SFMTA's environmental issuer profile score is **E-3**, reflecting the area's elevated exposure to sea level rise, which poses risk to some of SFMTA's capital assets, particularly its subway in downtown San Francisco. Positively, San Francisco is actively planning and implementing seawall improvements to mitigate this costly, long-range challenge. The city, like many communities in California, also has risk associated with water availability given its own limited watershed and regular cycles of drought across the state. Partially mitigating this risk is the city's proactive water management planning and strong levels of stored water.

SFMTA will benefit from carbon transition opportunities because its various energy-efficient transportation modes, including light rail, biodiesel-electric hybrid buses, electric trolley buses and cable cars will likely see increased usage as governmental policies and public preference shift from carbon inefficient travel. The agency is also committed to transitioning all buses to electric vehicles by 2035 as the transit system plays a critical role in the City and County of San Francisco's air quality and climate action plan that targets net-zero emissions by 2040. SFMTA is also likely to benefit from state and local initiatives to reduce vehicle emissions.

Social

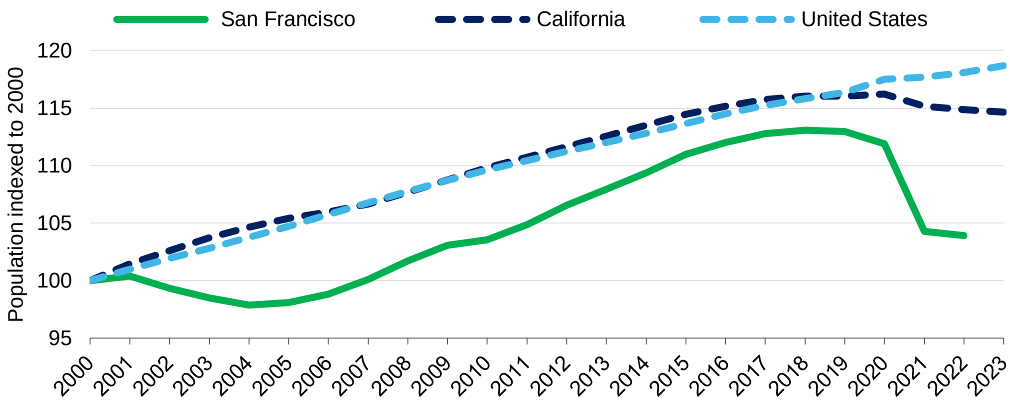
SFMTA's social issuer profile score is **E-3**, given the agency's labor intensive and customer-oriented operations that is not atypical for a transit enterprise. The mass transit sector serves a wide range of customers with diverse service needs, and relies on customer satisfaction to maintain ridership levels (i.e. utilization) and support fare increases. Changes in customer satisfaction can be monitored through on-time performance metrics, and is susceptible to public perception regarding the effectiveness and adequacy of operating performance. Deterioration in public opinion can lead directly to operating revenue declines that increase the need for politically sensitive fare increases. In addition, SFMTA directly employs the majority of its labor force that are represented by strong collective bargaining units and thus has less flexibility to control cost growth. The transit sector will benefit from social opportunities as a responsible producer of energy efficient services and low-cost transportation; however this does not offset the potential risks mentioned above.

SFMTA's social issuer profile score also incorporates the demographic and societal trends of its service area. While San Francisco benefits from a highly educated population and strong resident wealth measures, its income inequality is among the highest in the nation, contributing to housing affordability changes, high per capita homelessness and crime rate. The high cost of living in San Francisco often contributes to SFMTA's worker shortage, while homelessness causes operational challenges and incurs extra costs.

The city's population trends are also slightly negatively, especially following the pandemic, although recent population decline appears to have plateaued (Exhibit below). Lastly, SFMTA will likely see permanent ridership loss driven by changing residential and commuting patterns following the pandemic.

Exhibit 13

San Francisco County's population decline post pandemic appear stabilizing



Source: US Census Bureau; Moody's Investors Service

Governance

Governance is a material consideration for all mass transit credits. Prudent planning, proper asset management and assistance from local, state and federal governments provide strong foundations for mass transit credits to weather economic downturns and the challenges of running capital intensive operations. Overall, the transit sector benefits from governance opportunities through supportive organizational structures that promote strong operating environments and generous funding for operations and capital projects. Pandemic related federal government aid to mass transit systems particularly demonstrates the strong support for mass transit by government entities.

SFMTA's governance issuer profile is **G-1.** SFMTA benefits from prudent fiscal management with conservative budgetary practices, long term financial and capital planning, and institutionalized policies for reserve, debt, and investments. Most recently, SFMTA has proactively addressed operational and financial challenges as a result of COVID-19. The agency demonstrates sound management credibility and track record given its consistent ability to out-perform budgets and maintaining reserves and debt levels in line with targets.

SFMTA was established in 2002 through consolidation, by a city charter amendment, of the San Francisco Municipal Railway (Muni), and the Department of Parking and Traffic. The agency is an enterprise department of San Francisco governed by a seven member board of directors, appointed by the San Francisco mayor and confirmed by the city's Board of Supervisors. Transits overseen by a government municipality face some risk associated with board structure. This results from the concentrated control of a city or county's government and the risk of political opposition to required fare increases or capital investment.

Endnotes

1 source: California Department of Finance population estimates

2 SFMTA's operating budget update presented to the Board on March 5, 2024

3 SFMTA Jan 2024 Budget workshop 5-year financial forecast

4 source: SFMTA's capital improvement program update presented at March 5, 2024 Board Meeting

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