New Issue: **Moody's assigns initial Aa3 rating to San Francisco Municipal Transportation Agency's $68 million revenue and refunding bonds, series 2012 A & B**

Global Credit Research - 22 May 2012

Outlook is stable

SAN FRANCISCO MUNICIPAL TRANSPORTATION AGENCY, CA
Mass Transit
CA

Moody's Rating

ISSUE		RATING
Revenue Bonds, Series 2012 A		Aa3
Sale Amount	$44,375,000	
Expected Sale Date	06/25/12	
Rating Description	Revenue: Government Enterprise	
Revenue Bonds, Series 2012 B		Aa3
Sale Amount	$25,700,000	
Expected Sale Date	06/25/12	
Rating Description	Revenue: Government Enterprise	

Moody's Outlook STA

Opinion

NEW YORK, May 22, 2012 --Moody's Investors Service has assigned a Aa3 rating and stable outlook to the San Francisco Municipal Transportation Agency's initial issuance of Revenue Bonds, Series 2012A and 2012B. The bonds are expected to be issued with a par amount of $68 million. The bonds are expected to price the week of June 25 and to have a 30-year maturity.

SUMMARY RATINGS RATIONALE

The bonds are secured by the agency's gross revenue pledge not including City General Fund revenues. Proceeds of the bonds will refund all outstanding parking project bonds and finance the first phase of a variety of capital improvement projects. The Aa3 long term rating reflects SFMTA's diversified revenue base; sound financial management with strong revenue raising flexibility; and strong demand for the essential services it provides in San Francisco. The rating also incorporates SFMTA's low debt burden and satisfactory legal provisions.

STRENGTHS

--Large service area with high essentiality

--Strong Additional Bonds Test (3 times)

--Diverse revenue stream including dedicated taxes, fares, parking revenues, fines, and governmental subsidies

--Automatic Indexing Policy that applies to fares, fees and charges

CHALLENGES

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--Rising fixed costs attributable to healthcare and pension liability

--Deferred capital needs for a complex multimodal system

DETAILED CREDIT DISCUSSION

ESSENTIAL TRANSPORTATION SYSTEM IN A STRONG ECONOMIC SERVICE AREA

Established in 2002 through consolidation of the San Francisco Municipal Railway (Muni), and the Department of Parking and Traffic, SFMTA is the seventh largest transit system in the country and the region's largest and most heavily utilized. SFMTA transports close to 43% of all transit passengers in the region and carries more than 213 million passengers per year. SFMTA is governed by a seven-member board of directors, which is appointed by the city's mayor and confirmed by the city's board of supervisors. The agency operates 80 bus routes, 50 motor coaches, 14 electric trolley bus lines, 6 light rail lines, three cable car lines, and a historic street car line and manages 27,000 on-street parking spaces and 15,000 parking spaces in 20 garages and 21 surface lots (15% of all citywide parking spaces).

The agency is an enterprise department of San Francisco (G.O. rated Aa2/Stable) and a multi-modal transportation authority responsible for planning, designing, constructing, managing, operating and maintaining public transit, paratransit, street and traffic management and improvements, bicycle and pedestrian safety and enhancement programs, on and off-street parking improvements and programs, and the regulation of taxis and commercial vehicles. Located in San Francisco, the agency benefits from the economy of the Bay Area which includes retail, entertainment and the arts, conventions and tourism, service businesses, banking, professional and financial services, corporate headquarters, international and wholesale trade, multimedia and advertising, biotechnology and higher education.

SOUND OPERATION BOLSTERED BY DIVERSE REVENUE STREAM AND ECONOMIC RECOVERY; COMMITMENT TO MAINTAINING SOUND COVERAGE ON A NET-BASIS

Moody's expects coverage of debt service on all SFMTA obligations by net revenues to remain sound given the diverse mix of revenues and management's ability to increase revenues and implement the necessary budgetary adjustments. April 2009, the agency adopted an Automatic Indexing Implementation Plan applicable to fares, parking citations and garage parking rates, fines, fees and other charges. The plan, through use of a formula, allows SFMTA to adjusts the aforementioned charges by a rate equal to one-half of any change in the Bay Area Consumer Price Index, plus one-half of the annual percentage increase or decrease in the SFMTA's labor costs.

Although the bonds carry a gross pledge on pledged revenues, Moody's believes it is important to evaluate coverage on a net basis since the pledged revenues provide the bulk of the agency's operating revenues as well as supporting debt service. In fiscal 2011, operating grants (TDA and AB 1107) comprised 14% of operating revenues, with passenger fares accounting for 24.3% and general fund transfers and parking and traffic revenues accounting for 33% and 26% respectively. Passenger fares, parking and increase in charges coupled with the positive impacts from the economic recovery significantly bolstered total operating revenues. SFMTA's recovery ratio based on all pledged revenue is among the highest in the transit sector at 59.9%. Net working capital in 2011 was sizeable at $222 million (28.6% of gross operating expenses). Cash and investments totaled $290.6 million or approximately 371 days of operating cash on hand. As of March 2012, passenger revenues have come in 13.1% above prior year figures and passenger fares by general fund transfers are up by 10%.As of March 2012, passenger revenues have come in 13.1% above prior year figures.

SFMTA was successful in negotiating a three-year contract with its largest labor union representing about 50% of its employees in 2011 which is expected to produce $41 million in savings over the next 3 years. SFMTA employees are covered by benefit plans offered through the city of San Francisco which continues to face challenges related to healthcare and pensions. Despite the passage of pension reform and the city's efforts to lower employee costs, pension and benefit expenditures remain key challenges. SFMTA's pension and medical expenses have increased considerably over the last five years from $77.6 million in 2007 to $113 million in 2011. Salaries and benefits are expected to finish $50 million over budget in fiscal 2012 but have been offset by reductions in fringe benefits and other expenses.

The trajectory of SFMTA's long term pension and other post-employment benefit (OPEB) solution is contingent upon City of San Francisco as the SFMTA is a participant in the city's retirement and healthcare plans. San Francisco's OPEB liability is extremely large and a significant long-term challenge. The most recent actuarial valuation, prepared

December 2010, puts the city's unfunded liability at $4.4 billion as of July 2008. The city funds its OPEB obligations on a pay-go basis, paying $146 million in fiscal 2011. The pay-go figure compares to an ARC of $392 million for fiscal 2011. City voters approved a charter amendment that reduces the post-retirement eligibility and benefits for new hires starting after July 1, 2010 and increases the employee contribution rate from 7.5% of covered pay to 9.0%. This will help slow the growth of the OPEB obligation, but does not address the cost associated with current employees. This is a long-term challenge, rather than one that is pressing, but it is nonetheless significant.

Despite these considerable pressures, however, SFMTA successfully maintained its sound net coverage of all debt service obligations of 34.6 times, although this level is expected to decrease in upcoming years as the agency increases leverage to address replacement, enhancement or expansion of capital assets.

MODERATE DEBT, CONSERVATIVELY STRUCTURED

The current offerings add only slightly to the agency's annual debt obligations. SFMTA's current peak debt service payment obligation is $7 million in fiscal 2013, or about 1% of the agency's budgeted fiscal 2011 operating revenues. SFMTA's low debt burden is partly explained by support from the city and state sources that fund capital projects and deferral of major capital expenditure, which is not unusual for many transit and infrastructure focused agencies during the peak of the national economic downturn. Historically, planned major capital projects have been deferred, when either the project has been prioritized lower due to changing circumstances or the planned funding as part of the total project has not materialized. The SFMTA had a deferred replacement total of $2.2 billion as of fiscal 2009. Going forward the agency will finance projects in phases in an effort to avoid future deferral of capital expenses. A significant increase in debt would add negative pressure to the credit rating.

SATISFACTORY LEGAL PROVISIONS WITH FULLY FUNDED DEBT SERVICE RESERVE FUND

Legal protections as defined in the agency's bond resolution provide satisfactory security for bondholders. The rate covenant stipulates that the agency maintain revenues at levels to ensure an adequate 1.0 times annual debt service coverage on all outstanding revenue debt. The additional bonds test is set at a strong 3.0 times maximum annual debt service for all outstanding revenue bonds and additional bonds. The bond resolution also requires a debt service reserve fund fully funded equal to the lesser of maximum annual debt service (MADS), 10% of the bonds and parity senior lien bonds outstanding or 125% of the average principal and interest coming due in any succeeding fiscal year.

Outlook

Our outlook for the agency's long-term rating is stable. This outlook recognizes that the agency's diverse and stable revenue stream. The outlook also reflects the agency's large service area with high essentiality.

WHAT COULD MAKE THE RATING GO UP

--Sustained growth in pledged revenues combined with ridership growth leading to significantly increased reserves

WHAT COULD MAKE THE RATING GO DOWN

--Significant increase in fixed costs that pressure financial operations

--Sustained declines in ridership and revenues leading to depleted reserves and debt service coverage

PRINCIPAL RATING METHODOLOGY

The principal methodology used in this rating was Mass Transit published in June 2000. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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