

MOODY'S

INVESTORS SERVICE

New Issue: Moody's assigns Aa3 to San Francisco Municipal Transportation Agency's \$75M revenue bonds; outlook stable

Global Credit Research - 02 Oct 2013

\$60.7M of parity debt outstanding

SAN FRANCISCO MUNICIPAL TRANSPORTATION AGENCY, CA
Mass Transit
CA

Moody's Rating

ISSUE

RATING

Revenue Bonds, Series 2013

Aa3

Sale Amount \$75,000,000

Expected Sale Date 11/11/13

Rating Description Revenue: Government Enterprise

Moody's Outlook

Opinion

NEW YORK, October 02, 2013 --Moody's Investors Service has assigned an Aa3 rating to the San Francisco Municipal Transportation Agency's \$75 million Revenue Bonds, Series 2013. Proceeds of the bonds, expected to price the week of November 11, will be used to finance a variety of capital improvement projects.

SUMMARY RATING RATIONALE

The bonds are secured by a pledge of SFMTA's gross revenues, excluding City General Fund transfers and restricted revenues. 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 3 times additional bonds test
- Diverse revenue stream including dedicated taxes, fares, parking revenues, fines, and governmental subsidies
- Automatic indexing policy that applies to fares, fees and charges

CHALLENGES

- 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 Bay Area region's largest

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and most heavily utilized. SFMTA transports close to 43% of all transit passengers in the region and carried 223 million passengers in fiscal 2013. SFMTA is governed by a seven-member board of directors, which is appointed by the San Francisco mayor and confirmed by the city's Board of Supervisors. The agency operates 80 bus routes, 50 motor coaches, 14 electric trolley bus lines, six light rail lines, three cable car lines, and a historic street car line. The agency manages 28,000 on-street parking spaces and 15,000 parking spaces in 19 garages and 21 surface lots (30% of downtown and 15% of citywide parking spaces).

The agency is an enterprise department of San Francisco (G.O. rated Aa1/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 OPERATIONS BOLSTERED BY DIVERSE REVENUE STREAM AND ECONOMIC RECOVERY; COMMITMENT TO MAINTAINING SOUND COVERAGE ON A NET-BASIS

We expect debt service coverage on all SFMTA obligations by net revenues to remain sound given the diverse revenue pledge and management's flexibility to increase revenues and implement any necessary budgetary adjustments. In 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 adjust 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 are secured by a gross pledge of system revenues, we believe it is important to evaluate coverage on a net basis since the pledged revenues provide the bulk of the agency's operating revenues in addition to supporting debt service. In fiscal 2012, operating grants comprised 13% of operating expenses, with passenger fares accounting for 21% and general fund transfers and parking and traffic revenues accounting for 29% and 11% respectively. Passenger fares, parking and an 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 52.6%. Net working capital in 2012 was sizeable at \$283 million (29.5% of gross operating expenses). Cash and investments totaled \$429.2 million or approximately 164 days of operating cash on hand.

In 2011, SFMTA was successful in negotiating a three-year contract with its largest labor union representing about 50% of its employees which is expected to produce \$41 million in savings over the next three 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 \$139 million in 2012. SFMTA expect that salary and fringe benefit costs will increase by 9.2% in 2013.

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 times annual debt service coverage on all outstanding revenue debt. The additional bonds test is set at a strong 3 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.

MODERATE DEBT, CONSERVATIVELY STRUCTURED

The current offerings add only slightly to the agency's annual debt obligations. SFMTA's peak debt service payment obligation with the 2013 issuance is \$11.3 million in fiscal 2016, or about 3% of the agency's budgeted fiscal 2012 operating revenues. The SFMTA has an internal policy to cap debt service payments at 5% of the operating budget. SFMTA maintains sound maximum annual coverage of debt service obligations of 44.3 times including the 2013 issuance, although this level is expected to decrease in upcoming years as the agency increases leverage to address replacement, enhancement or expansion of capital assets. 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 August 2010. 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.

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

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

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