MOODY'S INVESTORS SERVICE

New Issue: Moody's upgrades San Francisco MTA, CA revenue bonds to Aa2 from Aa3; outlook stable

Global Credit Research - 05 Nov 2014

$205 million revenue bonds outstanding following current issue

SAN FRANCISCO MUNICIPAL TRANSPORTATION AGENCY, CA
Mass Transit
CA

Moody's Rating

ISSUE	RATING
Revenue Bonds, Series 2014	Aa2

Sale Amount $75,000,000
Expected Sale Date 11/18/14
Rating Description Revenue: Government Enterprise

Moody's Outlook STA

Opinion

NEW YORK, November 05, 2014 --Moody's Investors Service has upgraded the rating on the San Francisco Municipal Transportation Agency's Revenue Bonds to Aa2 from Aa3 and assigned a Aa2 rating to its $75 million Series 2014 Revenue Bonds. Proceed of the Series 2014 bonds will be used to fund portions of the SFMTA's capital program. Following the issuance of the Series 2014 bonds, the agency will have $205 million revenue bonds outstanding. We have also upgraded the bank bond rating on the SFMTA's Subordinate Commercial Paper Notes, Series A-1 and A-2 to Aa3 from A1. The commercial paper program is authorized in an amount of $100 million and rated P-1 based on a LOC from State Street Bank and Trust Company (Aa3/P-1). No notes are currently outstanding. The outlook on the long-term ratings is stable.

SUMMARY RATING RATIONALE

The SFMTA's revenue bonds are secured by a gross pledge of the agency's operating revenues, excluding City General Fund transfers and certain restricted revenues. The upgrade to Aa2 rating reflects a steady trend of positive financial operations, significantly improved liquidity levels, limited plans for the issuance of new parity debt, and the strength of the city and regional economies. The rating also incorporates the agency's strong underlying fundamentals including an unusually diverse revenue base, strong revenue raising flexibility, high demand for the essential service it provides in San Francisco (Aa1/stable), and very low debt levels.

STRENGTHS

- Large service area with high utilization and essentiality.

- Very low debt levels with strong coverage by pledged revenues.

- Diverse revenue stream including dedicated taxes, fares, parking revenue, and fines.

- Rate-setting autonomy and automatic indexing policy that applies to fares, fees and charges.

- Demonstrated sound financial management.

CHALLENGES

--Rising fixed costs attributable to pensions.

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--Significant 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, the SFMTA is 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. 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.

As a transit operator SFMTA is the eighth largest system in the country and the Bay Area region's largest based on ridership. It transports close to 45% of all transit passengers in the region and carried 225 million passengers in fiscal 2014. The agency operates 50 motor coach lines, 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. The garage and surface lots represent approximately 30% of downtown and 15% of citywide parking spaces.

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. San Francisco's employment has grown strongly in recent years and is now at an all-time high.

COVERAGE IS EXTREMELY STRONG ON BOTH A GROSS AND NET BASIS; FUTURE BORROWING PLANS ARE VERY LIMITED

We expect debt service coverage on SFMTA's revenue bonds to remain sound given the diverse revenue pledge, management's flexibility to increase revenues and implement any necessary budgetary adjustments, and very limited future borrowing plans. Pledged revenues consist of an extremely diverse mix of farebox revenues, parking fees, parking fines, and sales taxes allocated to the agency on a formula basis. The agency has autonomy to set transit fares, parking fees and parking fines. In April 2009, it 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.

Pledged revenues for fiscal 2014 totaled $623 million and provide 37.4 times coverage of maximum annual debt service following the issuance of the Series 2014 bonds, $16.6 million in 2016. Although the bonds are secured by a gross pledge, coverage is also extremely strong on a net basis. Net revenues (before debt service and depreciation) for fiscal 2014 equaled $108 million and provided 6.5 times coverage of peak debt service. Other debt metrics are strong as well - net debt equals 20% of total revenues. The agency's debt is conservatively structured. Annual debt service is declining. Other than the subordinate commercial paper program, the agency has no variable rate debt. The agency has no swaps.

The agency has significant capital needs, in part due to the age of its facilities and rolling stock. Total capital needs over the next 20 years are estimated to exceed $15 billion. The current five-year (2015-19) capital program totals $3.4 billion. Approximately $790 million of the program is related construction of new Central Subway project. The balance of the program is focused on improving system reliability and addressing deferred maintenance. The five-year capital program is fully funded, almost entirely from sources other than the agency's revenue bonds, primarily federal grants, state grants, and general obligation bonds approved by the city's voters on November 4. The agency expects new issuance of revenue bonds during this time period to be limited to approximately $150 million in 2017. It plans to use the subordinate commercial paper program to provide temporary financing prior to the receipt of grant moneys.

The additional bonds test is 3 times maximum annual debt service, but the rating assumes that the agency will not leverage pledged revenues to this extent. The board's policy is that debt service cannot exceed 5% of the operating budget and, as noted, additional borrowing plans are very limited.

FINANCIAL PERFORMANCE HAS BEEN STRONG; LIQUIDITY IS GREATLY IMPROVED

Financial performance has been strong reflecting sound management and the SFMTA's budgeting and rate setting autonomy. In addition to the pledged revenues described above, agency operating revenues also include transfers from city's General Fund. These transfers are made by formula, pursuant to the city's charter. Therefore, they are not subject to annual appropriation and provide an additional highly reliable source of funding for the agency. The SFMTA is responsible for its own labor negotiations. Contracts are in place through fiscal 2017.

The agency has demonstrated consistent positive financial performance. Operating margin (net revenues before debt service and depreciation, divided by total operating revenues) exceeded 5.0% in every fiscal year from 2011 through 2014. Reserves and liquidity have improved greatly. Budget-basis undesignated fund balance grew from less than $20 million in fiscal 2010 to $139 million in fiscal 2014. The board's policy is to maintain an undesignated fund balance equal to at least 10% of budgeted O&M costs. Total liquidity, primarily cash on deposit with the city treasury, increased from $257 million in fiscal 2010 to $748 million in fiscal 2014.

FIXED COSTS FOR PENSIONS ARE GROWING

Healthcare, pensions and other post-employment benefits for SFMTA employees are provided through the city's plans. Although the city's pension plan is relatively well-funded and the city has enacted some reforms, pension costs have risen. The SFMTA's required pension contribution was $41.7 million in fiscal 2011 but increased to $82.9 million in fiscal 2014. OPEB is funded on a pay-go basis. OPEB contributions have grown more slowly than pension contributions, increasing from $25.9 million in fiscal 2011 to $27.0 million fiscal 2014. The OPEB Actuarially Required Contribution for 2014 was $44.1 million.

Outlook

The outlook on the rating is stable, recognizing the agency's positive governance structure, its limited borrowing plans, and the strength of the city and regional economies.

WHAT COULD MAKE THE RATING GO UP

- Sustained growth in revenues at a rate higher than past growth leading to significantly increased coverage and reserves.

WHAT COULD MAKE THE RATING GO DOWN

- Stagnation or decline in revenues resulting in decreased coverage and reserves.

- Unanticipated weakening of the city and regional economies.

- Issuance of additional parity debt in amounts greater than planned.

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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