

RatingsDirect®

Summary:

San Francisco Municipal Transportation Agency; Transit

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Summary:

San Francisco Municipal Transportation Agency; Transit

Credit Profile

US\$234.965 mil rev bnds (Tax-Exempt) ser 2021C due 03/01/2051		
<i>Long Term Rating</i>	AA-/Negative	New
US\$166.0 mil rfdg rev bnds (Federally taxable) ser 2021A due 03/01/2031		
<i>Long Term Rating</i>	AA-/Negative	New
US\$7.0 mil rfdg rev bnds (Tax-Exempt) ser 2021B due 03/01/2044		
<i>Long Term Rating</i>	AA-/Negative	New
San Francisco Mun Transp Agy transit		
<i>Long Term Rating</i>	AA-/Negative	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA-' long-term rating to the following proposed bonds to be issued by the San Francisco Municipal Transportation Agency (SFMTA):

- \$166 million series 2021A refunding revenue bonds (federally taxable),
- \$7 million series 2021B refunding revenue bonds (tax-exempt), and
- \$235 million series 2021C revenue bonds (tax-exempt).

At the same time, we affirmed our 'AA-' long-term rating on SFMTA's revenue bonds outstanding. The outlook is negative.

The series 2021A and 2021B bond proceeds will be used to refund SFMTA's series 2012A, 2012B, 2013, and 2014 bonds outstanding for considerable savings estimated at about \$20 million, or 13% of refunded par, subject to market conditions at pricing. SFMTA is taking most of the savings upfront through fiscal 2023 to help offset projected budget deficits given the effects of the COVID-19 pandemic. The series 2021C bond proceeds will be used to finance various capital improvement projects, including replacement of vehicles and modernization of infrastructure, such as tracks and stations.

Certain gross revenue before the payment of SFMTA expenses secures the bonds, although our analysis of financial performance is on a net basis after payment of operating expenses. This 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. Newly pledged revenue added in fiscal 2020 includes federal pandemic support (Coronavirus Aid, Recovery, and Economic Security, or CARES, Act), and additional federal

pandemic support from the federal bill signed on Dec. 27, 2020. In addition, although its yield is relatively small, a traffic congestion mitigation tax is a new source of pledged revenue that began 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 been a significant revenue source to the agency (43% of gross revenue in fiscal 2020), and are projected to be materially lower than pre-pandemic levels.

All pledged revenue is set aside, deposited into the SFMTA enterprise account, and then transferred to the trustee for the debt service fund. 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, except for the series 2017 bonds, provide additional liquidity to bondholders, if needed. Although the series 2017 and proposed 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, 2020, was \$323 million, but is anticipated to increase to \$573 million by June 30, 2021, as a result of this transaction.

Credit overview

The 'AA-' long-term rating reflects SFMTA's very strong enterprise risk profile, strong financial risk profile, and significant support by various tax revenue. While we believe SFMTA entered the pandemic in a solid financial and operational position, the rating reflects our view of the pandemic's negative effects on SFMTA's market position assessment, which we assess as very strong instead of extremely strong, resulting in an enterprise risk profile assessment of very strong. Additionally, our expectation of significant stress to SFMTA's key financial metrics such as coverage (S&P Global Ratings-calculated) result in a financial risk profile assessment of strong, which reflects our expectation that SFMTA's overall liquidity position will remain no less than strong and that SFMTA's debt and liabilities capacity will be strong, despite our view of its very large \$2.3 billion five-year capital plan, although recently downsized from \$2.5 billion. Financial support provided by various tax revenue that SFMTA receives, which does directly rely on transportation activity, also was an important credit consideration along with SFMTA's diverse revenue mix. More specifically, tax revenue, typically accounting for around 10% to 12% of gross revenue, is incremental to the significant support provided by other nonfare or parking revenue, including support by the City and County of San Francisco as relates to general fund transfers that alone totaled \$473 million, or 43% of gross revenue, in fiscal 2020. Operating grants, taxes, and general fund support typically account for almost two-thirds of gross revenue. General fund support, however, declined 10% in fiscal 2020 with a 30% decline projected for fiscal 2021.

The negative outlook reflects our view of the significant financial and operational challenges posed by the ongoing pandemic and our view that, as or if the pandemic worsens and becomes more prolonged, further credit deterioration is possible to the extent that SFMTA is unable to align expenditures with a lower revenue base or if additional federal funding does not materialize.

SFMTA ridership declined 24% in fiscal 2020, and management projects a 72% decline in fiscal 2021 as compared with fiscal 2019. The severe drop in ridership, in our view, has diminished SFMTA's overall credit quality, putting pressure on financial metrics over the near term, with SFMTA's diverse revenue mix somewhat tempering this. For additional information, see "Ratings Outlooks On U.S. Transportation Infrastructure Issuers Revised To Negative Due To

COVID-19 Pandemic," published March 26, 2020, on RatingsDirect, and "Updated Activity Estimates For U.S. Transportation Infrastructure Show Public Transit And Airport Operators Still Face A Long Recovery," published Jan. 13, 2021.

S&P Global Ratings will monitor the impact of the COVID-19 pandemic on SFMTA's ridership, parking activity, and key credit metrics, but we believe SFMTA's liquidity, mitigation measures taken thus far, the \$378 million in CARES Act funding allotted (which is all being used in fiscal years 2020 and 2021), and additional 2021 Coronavirus Act funds supplemental to CARES funding estimated at \$230 million (being used in fiscal years 2021 and 2022) will allow SFMTA to weather the near-term activity declines. We could weaken SFMTA's enterprise and/or financial risk profile if ridership and parking activity remains depressed for an extended period, extends or widens budget deficits, and pressures financial metrics on a sustained basis.

The rating reflects our view of SFMTA's:

- Very strong market position, reflective of an essential public transit system with varied offerings (bus, light rail, streetcar, and cable car) that plays a vital role within a service area that has historically steady ridership;
- Extremely strong service area economic fundamentals, including favorable economic activity as measured by GDP per capita and historically low unemployment, although unemployment has worsened during the pandemic, but in line with national trends;
- Extremely strong management and governance, with a management team that has considerable expertise and a record of success in routinely meeting or exceeding fiscal targets, mitigating risk, and successfully managing all operating divisions;
- Strong debt and liabilities capacity, with a relatively low debt burden for a transit agency of its size and no immediate debt plans, offset by a large capital plan of about \$2.3 billion; and
- Strong liquidity and financial flexibility, reflecting 224 days' cash on hand on average in the previous three fiscal years, which we expect will be preserved at no less than 180 days through fiscal 2022 partly as a result of \$378 million of CARES Act receipts and expectation of additional federal aid estimated at \$230 million, which SFMTA will use in fiscal years 2021 through 2022 to limit draws on its cash reserves.

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

- Exposure to potentially prolonged weak or unpredictable ridership and parking activity as a result of the pandemic and lingering ancillary effects (such as the pandemic-induced recession, shifting travel restrictions, stay-at-home and social-distancing restrictions, or behavioral changes with respect to use of public transit) that are outside of management's control; and
- Weakened financial performance, reflecting our expectation of debt service coverage (S&P Global Ratings-calculated, on a net revenue basis) that will be diminished for fiscal years 2020 to 2022 (lower than levels we consider extremely strong in fiscal 2019 and earlier) given the effects of the pandemic.

SFMTA is an enterprise department of the City and County of San Francisco (AAA/Stable GO rating). The agency was created in 1999, consolidating the San Francisco Municipal Railway (Muni, the transit provider for the City of San Francisco) and the Department of Parking and Traffic. SFMTA is a comprehensive transportation agency, responsible

for transit, parking meters, parking garages and lots, traffic, taxi regulation, accessible services, bicycles, and pedestrian accessibility programs.

Environmental, social, and governance factors

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 in line with our view of the sector standard. SFMTA is exposed to health and safety social risks related to social distancing that will continue to present financial and operational challenges in the short term, particularly if transit activity remains low and parking-related revenue significantly underperforms. We will evaluate these risks as the fluid situation evolves.

Negative Outlook

Downside scenario

Rating pressure could increase over the next one to two years if financial metrics suffer sustained weakness absent offsetting expenditure adjustments, revenue recovery, and, if received, federal grants or stimulus funding. While we believe that general fund contributions, operating grants, and tax support bolster and stabilize the credit from a revenue diversity standpoint, debt service coverage or liquidity that are consistently and materially lower than our expectations, or sustained and depressed transit and parking activity could result in a lower rating.

Return to stable scenario

If SFMTA is able to maintain liquidity and enact expenditures adjustments to bring its budget into alignment, or, if transit and parking activity and operating revenue rebound to levels we believe are sustainable and sufficient to cover all obligations, we could revise the outlook to stable.

Credit Opinion

As vaccine rollouts in several countries continue, S&P Global Ratings believes uncertainty remains high about the evolution of the coronavirus pandemic and its economic effects. Widespread immunization, which certain countries might achieve by midyear, will help pave the way for a return to more normal levels of social and economic activity. We use this assumption about vaccine timing in assessing the economic and credit implications associated with the pandemic. As the situation evolves, we will update our assumptions and estimates accordingly.

S&P Global Economics' baseline forecast anticipates a negative 3.9% real GDP growth rate in 2020 rebounding to a slower growth phase heading into 2021, with 4.2% estimated for next year, up from the 3.9% in September's economic forecast but weaker than the 5.2% in June's economic forecast and the previous 2021 estimate of 6.2%. The baseline forecast assumes passage of a \$1 trillion stimulus package before year end (2020). The unemployment rate declined to 8.4% in August from its post-1947 record high of 14.75% (in April 2020), but we don't expect it will return to its pre-pandemic low until after 2023. Our downside U.S. economic forecast, which shows real GDP declining 4.4% in 2020 and rising only 0.8% in 2021, assumes no more fiscal stimulus and a COVID-19 resurgence that cripples growth in the fourth quarter of 2020. Our upside U.S. economic forecast, which shows real GDP declining 3.8% in 2020 and rebounding 4.5% in 2021, assumes reopenings taking place sooner amid promising treatment and vaccine news, and

the government providing \$1.5 trillion of additional support. (See "Economic Research: Staying Home For The Holidays," published Dec. 2, 2020.)

We consider SFMTA's service area economic fundamentals extremely strong, reflecting high GDP per capita of near \$121,000 and a historically below-average unemployment rate compared with the national level. SFMTA serves a city population of approximately 880,000 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 stable demand for transit services.

We believe that SFMTA provides a highly essential service to the 49-square-mile city and operates as a virtual monopoly within most of its service area. Prior to the pandemic's onset in March 2020, SFMTA's ridership had been relatively stable for a decade, with slight ridership growth (but also with mild declines in recent years) despite fare increases and the economic recession. SFMTA also enjoys broad political support with the City of San Francisco issuing GO bonds for transportation projects from time to time and voters recently approving a congestion mitigation tax and new sales tax for Caltrain that will improve revenue and reduce subsidy expenditures, respectively.

Muni reported a 95% decline in ridership in April 2020 year over year, with ridership improving gradually since but remaining at a fraction of pre-pandemic levels. While in November 2020 only buses were operating with almost two-thirds of bus routes suspended, on Dec. 19, 2020, a phased reopening of the light rail system began with one rail line reopening. SFMTA is taking advantage of partial system closure to make capital improvements to increase service reliability when full service resumes. Ridership declined 25% in fiscal 2020 (ended June 30), and management projects a ridership decline of 72% for fiscal 2021 versus 2019 when averaging larger declines in the first half with assumed continued higher partial recovery through June 2021. To model ridership recovery, SFMTA is using a model based on a May 2020 McKinsey report commissioned by the New York MTA, with some modifications. SFMTA assumes COVID-19 vaccines will be widely available by fiscal 2022, leading to a rebound in San Francisco's economy in fiscal 2023 and a return to pre-pandemic ridership levels by fiscal 2024. Management believes improvements in SFMTA's transit offerings and competitiveness versus other modes will attract other discretionary passengers. We view a projected full rebound in ridership by fiscal 2024 as somewhat aggressive. As technology has advanced to allow for a greater percentage of office workers to seamlessly telecommute during the pandemic, we believe that after a pandemic or once a vaccine is widely available and administered, SFMTA (and many other transit agencies) will suffer a permanent loss of a meaningful portion of ridership that could make full recovery more sluggish. On the other hand, we view SFMTA's projections for parking revenue recovery by fiscal 2022 as more reasonable given data indicative of a faster rebound and because parking and traffic revenue did not decline as sharply as did fare revenue. We will factor these considerations into our view of SFMTA's overall essentiality and importance as we assess its market position in the future.

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 money. In fiscal 2021, management projects a \$262 million revenue loss that it anticipates resolving with \$118 million in expenditure savings and use of \$144 million in 2021 Coronavirus Act funding. And finally, for fiscal 2022, management expects \$91 million in expenditure savings and use of \$86 million in 2021 Coronavirus Act funding to partly offset a revenue loss of \$239 million, leaving a deficit of \$62 million that it

plans to continue to work to resolve. Cost control measures already implemented include a hiring freeze for all noncritical positions, reduced overtime, controls on materials and supplies, and contract expenditure cuts. Planned cost control measures include maintenance of the hiring freeze and potential delays in cost-of-living adjustments. SFMTA also is exploring other cost-cutting measures with its labor unions, and may consider using its \$130 million contingency reserve in fiscal 2022.

Although certain gross revenue legally secures the bonds, we consider the finances and operations of the agency as a whole when evaluating the credit and coverage according to our criteria. S&P Global Ratings-calculated coverage on a net revenue basis was 7.3x in fiscal 2019, declining to negative 5.3x in fiscal 2020 given the ridership effects. Our coverage calculation excludes the \$197 million in CARES funds that apply to fiscal 2020 (and another \$321 million in combined CARES and 2021 Coronavirus Act federal aid applied to fiscal 2021) as a result of its nonrecurring nature. However, we do recognize that the total CARES and 2021 Coronavirus Act funding of \$608 million will allow SFMTA to maintain liquidity through fiscal 2022. (Coverage on a net revenue basis, inclusive of the CARES money, was 4.2x for fiscal 2020.) Based on SFMTA's budget for fiscal years 2021 and 2022, and without the inclusion of the use of fund balance as a revenue source, we calculate that coverage will be significantly less than 1x both years with or without the inclusion of federal aid money. While this is a significant departure from historically extremely strong coverage during fiscal years 2015 to 2019, we understand the situation remains fluid pending the trajectory of the pandemic, availability and implementation of vaccines, the permanence of increased telecommuting, system utilization, potential additional budget adjustments, and the performance of other revenue sources such as taxes and general fund support.

We note that 71% of SFMTA revenue in fiscal 2020 was not directly tied to transportation activity (transit fares, parking, fines) and provided the agency with a degree of financial stability during challenging times for system utilization such as the present. City and County of San Francisco general fund contributions accounted for a sizable 43% of total revenue, although we note the amount of the general fund transfer is susceptible to deteriorating economic conditions as reflected in the 30% projected decline in fiscal 2021.

SFMTA recently downsized its five-year capital program for fiscal years 2021 to 2025 to \$2.3 billion from \$2.5 billion. The agency, like most transit and transportation agencies, faces challenges in maintaining infrastructure in a state of good repair. Projects include transit infrastructure needs, fleet replacement, the Central Subway Project (an extension of the Third Street light rail line into Chinatown), a transportation management center, and transit expansion and enhancement (including the Van Ness bus rapid transit project). No additional SFMTA direct debt is anticipated to fund the capital plan.

SFMTA's available cash and investments totaled \$735 million, or an adequate 222 days' cash, in fiscal 2020; liquidity has been relatively consistent on a cash basis versus fiscal years 2016 to 2019. Available liquidity to debt was 219%, which we view as extremely strong, in fiscal 2020. Overall, we assess SFMTA's liquidity and financial flexibility as strong, as we placed a greater emphasis on liquidity given SFMTA's significant operating expenses. Cash balances on a nominal basis have been growing since measuring \$576 million in fiscal 2016, but management projects liquidity to decline to \$598 million by the end of fiscal 2022 given the effect of lower activity or the need to plug budget deficits.

For more information with regard to SFMTA, please see our full analysis published on Nov. 20, 2020.

Related Research

- How We Apply Our Global Not-For-Profit Transportation Infrastructure Enterprise Criteria, Nov. 2, 2020
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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