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Summary:

San Francisco Municipal Transportation Agency; Transit

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Summary:

San Francisco Municipal Transportation Agency; Transit

Credit Profile

San Francisco Municipal Transportation Agency rev rfdg bnds

Long Term Rating

AA/Stable

Affirmed

San Francisco Municipal Transportation Agency ICR

Long Term Rating

AA/Stable

Affirmed

Rationale

S&P Global Ratings affirmed its 'AA' long-term rating on the San Francisco Municipal Transportation Agency's (SFMTA) revenue bonds outstanding. At the same time, we affirmed our 'aa' stand-alone credit profile (SACP) and 'AA' issuer credit rating (ICR) on the agency. The outlook, where applicable, is stable.

The 'AA' rating is currently the highest rating on revenue bonds or certificates of participation issued by a U.S. transit agency. The strength of the local market and management practices and policies, combined with the parking and transit revenue of the SFMTA's operations, results in an extremely strong enterprise risk profile and a very strong financial risk profile.

The ratings reflect our view of the SFMTA's:

- Very low industry risk, with low cyclical volatility of earnings during economic cycles, and very low competition;
- Extremely strong economic fundamentals, with extremely strong per capita personal income and insignificant employment concentration;
- Very strong market position with generally good ridership trends, despite some weakening in fiscal 2017;
- Very strong management and governance policies and practices, with strong financial policies;
- Strong debt service coverage (DSC) and financial flexibility;
- Very strong liquidity; and
- Low debt burden.

Partly offsetting the above strengths, in our view, is the SFMTA's relatively large, \$3.4 billion capital improvement plan (CIP), which we believe will likely increase system leverage and reduce DSC.

Securing the bonds is certain gross revenue before the payment of SFMTA expenses. The 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. The transfers from the general fund, including the baseline and the "in lieu of parking" tax, are not pledged to the bonds. All pledged revenue is set aside, deposited into the SFMTA enterprise account, and then transferred to the trustee for the debt service fund. Bonds outstanding, other than the series 2017 bonds, are additionally secured by fully funded, stand-alone debt service reserve funds.

The SFMTA is an enterprise department of the City and County of San Francisco (the city). 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. The 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.

Throughout the city, the agency manages 19 public parking garages and 20 surface parking lots (totaling 15,000 off-street parking spaces) as well as approximately 28,000 on-street parking meters. As a result of significant deferred maintenance, the garage facilities require significant rehabilitation and equipment upgrades to bring them up to modern standards and for environmental reasons. However, all SFMTA meters now accept payment by mobile phone, credit card, debit card, coins, and prepaid SFMTA parking cards. The extensive parking system has a solid competitive position, in our opinion. The facilities generally have high utilization rates during peak hours. The agency owns and manages 30% of all downtown spaces and 15% of all citywide spaces in garages and lots. The agency also issues parking citations and enforces parking regulations.

We believe that the SFMTA provides a highly essential service to the city and operates as a virtual monopoly within most of its service area, although in many areas other providers providing overlapping alternative service, such as Bay Area Rapid Transit (BART). It serves a 49-square-mile service area composed of San Francisco. According to the agency, it is the eighth-largest transit operator in the country and the largest in the region. MUNI carries almost 45% of all transit passengers in the Bay Area, almost twice the number of passengers of the second-largest transit operator in the area (BART). MUNI's infrastructure includes 604 motor buses, 262 trolley buses, 149 light rail vehicles, 42 historic streetcars, and 28 cable cars, covering approximately 74 routes throughout San Francisco, providing a transit stop within a quarter mile of everyone who lives in, works in, and visits the city.

The SFMTA's transit system, and the mass transit industry as a whole, is mature and has historically demonstrated only minor cyclicity (including ridership trends), so we characterize the cyclicity and volatility of operating earnings as low risk. We also characterize competition and the threat of substitute products or services as very low risk. Barriers to entry are very high given the size of the system and its large infrastructure. Given the above, we characterize the SFMTA's industry risk as very low.

In our view, the underlying strength of the SFMTA's catchment area--with steady population and employment growth and high income levels--helps provide stable demand for transit services. Gross population growth for San Francisco from 2012 to 2017 was a strong 6.5% and employment growth over the same period was an extremely strong 22.4%. Projections from Global Insight indicate annual population growth will be 1% for 2018 and 2019 with employment growth ranging from 2.3% to 2.6% through fiscal 2019. San Francisco's per capita personal income was extremely high at 229% of the national average in 2017. Because of these factors, we consider the SFMTA's economic fundamentals

extremely strong.

SFMTA's ridership has been relatively stable over the past nine years, with generally good growth but also with mild declines in some years despite fare increases, service reductions, and the economic recession. Annual boardings totaled 225.8 million in fiscal 2017, a 2.8% decline from 232.3 million in fiscal 2016 but up 1.6% compared with the fiscal 2012 result. In fiscal years 2011 to 2016, gross ridership growth was 8.7%; these statistics suggest ridership is weakening somewhat for the SFMTA, a trend also seen at other large mass transit agencies across the country. Nonetheless, the SFMTA is estimating ridership growth 0.7% for fiscal 2018, and projects 2.3% growth in fiscal 2019. We consider these projections mildly aggressive given recent trends, but we do note that the SFMTA is adding more rapid bus transit and is working to reduce surface street congestion; these measures could improve ridership (not to mention other system expansion plans). We consider the SFMTA's market position very strong given growth in ridership over the past five years and the SFMTA's status as a virtual monopoly for public transit in San Francisco.

In terms of management and governance, the SFMTA has detailed strategic initiatives and examples of market leadership and innovation, including technology improvements providing real-time information to users. The SFMTA uses several key performance indicators typical to the industry, and management has generally demonstrated a strong track record of meeting benchmarks while addressing operating risks. We view senior management as experienced and broad, and the SFMTA's board of directors' experience in the fields of government, finance, labor relations, and public transportation provides strategic direction. Given these key factors, we view the SFMTA's management and governance as very strong.

In summary, our analysis of the four factors that constitute the SFMTA's enterprise risk profile results in an enterprise risk profile score of extremely strong.

The SFMTA maintains prudent financial policies on transparency and disclosure, liquidity, long-term financial planning, and debt management. The SFMTA produces and publishes monthly operational and financial reports, and financial audits are clean. The SFMTA has formal reserve and liquidity policies to maintain financial stability and ensure adequate funds to cover various risks of losses. Debt is managed in a manner consistent with the SFMTA's debt policy, and the agency maintains a five-year detailed capital plan that identifies sources and uses of funding. The SFMTA has covenanted to adopt a two-year balanced budget in accordance with the city charter. In addition, the SFMTA has covenanted that it will maintain pledged revenue in each fiscal year equal to or greater than the total of annual debt service, operating costs of the transit system, and any subordinate obligations. Management has also covenanted to the continued operation and maintenance of the transit system. Given these key factors, we view the SFMTA's financial policies as strong.

The SFMTA receives funds from a diverse set of sources. The bulk of total revenue comes from operations, including parking/traffic (26% in fiscal 2017) and passenger fares (19%); in our opinion, this combined percentage represents a significant portion of revenue, over which the agency has direct control. City general fund contributions account for 36% of total revenue, and operating grants for 13%. Rent, advertising, and interest provide the remainder. Total fiscal 2017 revenue was \$1.1 billion. The pledged revenue totaled \$615 million in fiscal 2017 and does not include city general fund contributions. In our opinion, the agency has proactively managed expenses. Total expenses, including transfers out for capital projects (\$50 million), were \$1.04 billion in fiscal 2017.

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 DSC according to our criteria. The agency benefits from the strength of the revenue supplied by the parking operations, while the transit operations ultimately lead to break-even results in general. DSC on a net revenue basis was 2.4x in fiscal 2017 and 3.1x in fiscal 2016. DSC is 1.8x based on the SFMTA's fiscal 2018 estimates and 1.1x based on the SFMTA's fiscal 2019 budget. These figures include transfers to capital as well as appropriated fund balances. We view the SFMTA's DSC as strong.

The SFMTA's available cash and investments totaled \$599 million, or 210 operating days' cash, in fiscal 2017. Cash balances have been growing over the past five years, and have more than doubled since the \$271 million in fiscal 2012. Management does not project significant changes in cash balances for fiscal years 2018 and 2019. Management projects unrestricted cash at \$560 million (191 days) in fiscal 2018 and \$586 million (192 days) in fiscal 2019. Cash (including cash in reserve funds) to debt service was 36x in fiscal 2017 and is projected to decline to 24x by fiscal 2019 with the issuance of the 2017 bonds, although this is still a level we consider extremely strong. In our view, the SFMTA has exceptional access to external liquidity, with a track record of access to capital markets and banks. Based on these factors, we view the SFMTA's liquidity as very strong.

The system's farebox recovery ratio--farebox revenue (plus parking revenue in the case of the SFMTA) divided by operating costs-- was, in our view, strong, at 32.1% in fiscal 2017, although down from 35.1% in fiscal 2016. In our view, this indicates strong financial flexibility, in that the SFMTA is more in control of its revenue than are agencies that receive a lower share of total revenue from fares. Farebox and parking/traffic revenue provided approximately 45% of total revenue in fiscal 2017. Effective fiscal 2011, the SFMTA adopted an "Automatic Indexing Implementation Plan." Under this plan, transit fares, parking citations, garage parking rates, and other charges not governed by law are increased periodically according to a set formula as part of the agency's budget. The formula adjusts charges by a rate equal to one-half of any change in the Consumer Price Index for the Bay Area plus one-half of the annual percentage increase or decrease in the agency's labor costs included in the budget. The increase is then rounded up to the nearest 25 cents, 50 cents, or \$1 depending on the base charges as long as the rounding does not result in more than a 10% increase in the charge. The board may increase or decrease charges by more or less than those derived from the formula. Revenue not automatically indexed is calculated at cost recovery. We consider the plan favorable for the agency. The basic adult cash fare for transit is \$2.75. The SFMTA's debt service carrying charge is also a very low 1.65% in fiscal 2017 and is projected at 2.65% in fiscal 2018 and 2.33% in fiscal 2019. We view the SFMTA's financial flexibility as strong.

The SFMTA has a substantial \$3.4 billion five-year capital program. 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. The revenue sources for the capital program include federal grants (primarily for the Central Subway), state and local funds, debt (including revenue and GO debt), and SFMTA resources in place. Debt to total revenue in fiscal 2017 was very low, in our opinion, at 0.34, with debt to net revenue at 8.71, and these same ratios are projected at 0.30 and 11.81 by fiscal 2019, respectively. We view SFMTA's debt burden as low.

Voters in San Francisco approved two ballot measures in November 2014: Proposition A, authorizing the city to issue as much as \$500 million in general obligation bonds to finance various transportation projects, and Proposition B, amending the city's charter to adjust the required annual appropriation from the general fund to the transportation fund to reflect population growth. We consider this support a credit strength.

In summary, our analysis of the five factors that make up the SFMTA's financial risk profile results in a financial risk profile score of very strong.

Given our view of the extremely strong enterprise risk profile and the very strong financial risk profile scores, the final SACP is 'aa+', per our criteria (see table 1 in our report "Mass Transit Enterprise Ratings: Methodology And Assumptions," published Dec. 18, 2013 on RatingsDirect). Based on peer comparisons, we applied one notch of flexibility downward in the process of arriving at the final SACP of 'aa', and applied no rating caps. We are assigning the 'aa' final SACP rather than the 'aa+' final SACP given the relatively large size of the SFMTA's CIP and our view that, based on its size, lower DSC or liquidity metrics could result, especially if operating revenue such as fare revenue weakens. Given our view that the SFMTA is not a government-related entity under S&P Global Ratings' criteria, the ICR is also 'AA'.

Given our analysis of the SFMTA's bond provisions, the issue rating for the revenue bonds is also 'AA'. Bond provisions include an additional bonds test of 3x pledged revenue. While an industry standard, an additional bonds test based on a gross pledge is, in our opinion, weak. While the fully funded debt service reserve funds on previously issued parity debt do improve the SFMTA's overall liquidity, in our view, strong DSC and very strong unrestricted cash balances led us to consider the debt service reserve fund immaterial to the rating. The series 2017 bonds were issued without a debt service reserve fund.

Outlook

The stable outlook reflects our expectation that the SFMTA's market position will remain at least very strong, especially given projected ridership growth, and that the SFMTA will continue to produce very strong financial metrics, including strong DSC and strong financial flexibility. The outlook also reflects our expectation that the SFMTA's capital needs will receive adequate funding to ensure continued system preservation and that the agency will continue receiving support from federal, state, and local governments so that its debt burden does not materially escalate beyond projections.

Upside scenario

We don't expect to raise the ratings within the next two years given our expectation of potentially lower DSC as a result of the recent series 2017 bonds and the potential for additional debt given a very large \$3.4 billion capital plan. Additional upward rating potential is also limited by some recent weakness in ridership, and uncertainty over whether it will rebound.

Downside scenario

We don't expect to lower the rating given the SFMTA's very strong financial metrics and extremely strong economic fundamentals.

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