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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 reflects our view of the strength of the local market, very strong management practices and policies, strong general fund support from the City and County of San Francisco, and the resilient parking and transit revenue of the SFMTA's operations, which results in very strong enterprise and financial risk profiles.

The ratings further reflect our view of the SFMTA's:

- Very low industry risk, with low cyclicality and volatility of earnings during economic cycles, and very low competition;
- Extremely strong economic fundamentals, with extremely strong per capita personal income and a lack of employment concentration;
- Adequate market position with some ridership softness in recent years, but with generally good overall enduring demand for transit and parking;
- Very strong management and governance policies and practices, with strong financial policies;
- Very strong debt service coverage (DSC) and liquidity, and conservative budgeting practices;
- Strong financial flexibility; and
- Low debt burden, with no definitive plans to issue additional debt.

Partly offsetting the above strengths, in our view, is the SFMTA's relatively large, $3 billion capital improvement plan, which we believe could 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, but add significant revenue to the agency. 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; 'AAA/Stable' general obligation, or 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. 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 38 off-street public parking garages and lots (totaling about 15,000 off-street parking spaces) as well as approximately 28,500 on-street parking meters. As a result of significant deferred maintenance, the garage facilities require significant rehabilitation and equipment upgrades for modernization and for environmental reasons. However, all SFMTA meters 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 give overlapping alternative service, such as Bay Area Rapid Transit (BART). It serves a 49-square-mile service area composed of San Francisco. MUNI carries an estimated 45% of all transit passengers in the Bay Area, about twice the number of passengers of the second-largest transit operator in the area (BART). MUNI's infrastructure includes 859 motor and trolley buses, 151 light rail vehicles, 46 historic streetcars, and 40 cable cars, covering approximately 87 routes throughout San Francisco and 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 cyclicality (including ridership trends), so we characterize the cyclicality 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 2013 to 2018 was a strong 5.1%, and employment growth over the same period was an extremely strong 22.8%. Projections from IHS Markit indicate population growth will be 4.3% for 2019 and 3.6% for 2020 with annual employment growth ranging from 2.0% to 3.8% through fiscal 2020. San Francisco's per capita personal income was extremely high at 242% of the national average in 2018. Because of these factors, we consider the SFMTA's economic fundamentals extremely strong.

The SFMTA's ridership has been relatively stable over the past decade, with generally good growth (but also with mild declines in some recent years) despite fare increases and the economic recession. Annual boardings totaled 224.6 million in fiscal 2018, a 0.5% decline from 225.8 million in fiscal 2017 but up 0.7% compared with the fiscal 2013 result. In fiscal years 2012 to 2017, gross ridership growth was 1.6%; these statistics suggest ridership is weakening slightly for the SFMTA, a trend also seen at other large mass transit agencies across the country, but SFMTA's declines have been much less extreme. SFMTA has estimated another slight ridership decline of almost 1% for fiscal 2019 but with slight rebounding growth of almost 1% for fiscal 2020. We consider the SFMTA's projections reasonable, and we note that the SFMTA is adding more rapid bus transit and is working to reduce surface street congestion and open driver positions; these measures could improve ridership (not to mention other system expansion plans). We consider the SFMTA's market position adequate given some ridership weakness in recent years but also in consideration of 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. While fairly new to their positions, the director and chief financial officer appear capable and experienced to lead and manage the agency through future challenges. 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 a score of very 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; the agency is considering revisiting and bolstering its reserve policy. 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 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, in our view. The bulk of total revenue comes from operations, including parking/traffic (25% in fiscal 2018) and passenger fares (18%); 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 a sizable 36% of total revenue, and operating grants for 14%. Rent, advertising, and interest provide the remainder. Total fiscal 2018 revenue was a robust $1.13 billion. The pledged revenue totaled $653 million in fiscal 2018 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 ($35 million), were $1.1 billion in fiscal 2018.

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 2.8x in fiscal 2018 and 2.4x in fiscal 2017. DSC is 4.3x based on the SFMTA's fiscal 2019 estimates and 1.1x based on the SFMTA's fiscal 2020 budget. We believe the fiscal 2020 budget includes conservative assumptions. These figures include transfers to capital as well as appropriated fund balances. We view the SFMTA's DSC as very strong.

The SFMTA's available cash and investments totaled $653 million, or 227 days' cash, in fiscal 2018. Cash balances have been growing over the past five years, and have more than doubled since the $271 million in fiscal 2012. Management projects unrestricted cash at $705 million (230 days) in fiscal 2019 and about the same for fiscal 2020. Cash (including cash in reserve funds) to debt service was 24x in fiscal 2018 and is projected at about 28x for fiscal years 2019 and 2020. 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—historically has been consistently strong, averaging 38% during fiscal years 2010 to 2018. 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. Based on our evaluation of estimated financial results for fiscal 2019 and budgeted figures for fiscal 2020, we expect SFMTA's farebox recovery ratio to exceed 30% for both fiscal years 2019 and 2020. However, if SFMTA's farebox recovery ratio sustains actual declines to less than 30%, this could trigger a cap on the rating of 'A+'. Farebox and parking/traffic revenue provided approximately 43% of total revenue in fiscal 2018. 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 a more than 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 $3.00 but just $2.50 with a Clipper card. The SFMTA's debt service carrying charge was a very low 2.7% in fiscal 2018 and is projected at 2.2% in fiscal years 2019 and 2020. We view the SFMTA's financial flexibility as strong.

The SFMTA has a substantial $3 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 (including the Van Ness bus rapid transit project). 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. No additional direct debt is planned to address the CIP. Debt to total revenue in fiscal 2018 was very low, in our opinion, at 0.30, with debt to net revenue at 4.27, and these same ratios are projected at 0.30 and 11.4 by fiscal 2020, 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 GO 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 score of very strong.

Given our view of SFMTA's very strong enterprise and financial risk profiles, the final SACP is 'aa/aa-', per our criteria. (See table 1 in our report "Mass Transit Enterprise Ratings: Methodology And Assumptions," published Dec. 18, 2013 on RatingsDirect.) We are assigning the 'aa' final SACP rather than the 'aa-' final SACP given the relatively strong financial metrics produced by the SFMTA versus comparable peers, and given the exceptional strength of the economic base. 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 lead 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 adequate, especially given projections indicating stabilizing ridership, and that the SFMTA will continue to produce very strong financial metrics, including very strong DSC and liquidity. 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 possible pressure on financial metrics as a result of a very large $3 billion capital plan. Upward rating potential is also limited by some recent weakness in ridership and uncertainty over whether it will rebound.

Downside scenario

Although we are unlikely to do so, we could lower the rating in the event our assessment of SFMTA's financial flexibility worsens, which could occur if the farebox recovery ratio experiences sustained declines to less than 30%.