S&P Global
Ratings

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Summary:

San Francisco Municipal Transportation Agency; Transit

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Long Term Rating	A+/Negative	Downgraded

Rating Action

S&P Global Ratings lowered its long-term rating to 'A+' from 'AA-' on the San Francisco Municipal Transportation Agency's (SFMTA) revenue bonds outstanding. The outlook is negative.

The rating action reflects our view of SFMTA's sustained, weakened market position stemming from a combination of social risks, including health and safety and social capital demographic changes, that has prolonged SFMTA's ridership recovery, affecting its financial performance and S&P Global Ratings-calculated debt service coverage, which has been less than 1x on a net revenue basis, excluding federal aid, for three years.

The negative outlook reflects our view that, over the next one to two years, there is a one-in-three chance we could lower the rating further to the extent that ridership lags projections, as this could negatively affect our view of SFMTA's already weakened market position and further erode financial metrics. In making this assessment, we will also examine whether management has balanced its budget without reliance on nonrecurring revenue, or whether it has a credible plan to bring expenses into balance with its "new normal" of lower ridership and fare revenue. We understand pursuing a new revenue source is a last resort, if or when management is unable to use other cash flow management tools.

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. Pledged revenue added in fiscal 2020 includes federal pandemic support. In addition, although its yield is relatively small, a traffic congestion mitigation tax is a 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 provided significant revenue to the agency (46% of gross revenue in fiscal 2021).

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, 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, 2022, was $439 million.

Credit overview

The 'A+' long-term rating reflects SFMTA's very strong enterprise risk profile, adequate financial risk profile, and significant support by various tax revenue. We have also applied a one-notch positive holistic adjustment to arrive at the 'A+' rating to reflect our view of SFMTA's low debt burden and manageable capital needs versus those of peers because we believe this promotes greater financial flexibility.

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 and financial performance. We believe the sharp decline in demand for mass transit will be long-term rather than temporary, as all other U.S. transportation infrastructure asset classes in terms of recovery are materially outpacing the sector nationwide as a result of a slow or partial return to office commuting patterns. Many airports, for example, are already seeing demand approaching or even surpassing pre-pandemic levels. In addition, financial performance, especially S&P Global Ratings-calculated debt service coverage, has weakened considerably and, we understand, could remain insufficient for several years.

The rating reflects our view of SFMTA's:

- Very strong market position despite weakening, 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;
- 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 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 $2.6 billion; and
- Strong liquidity and financial flexibility, reflecting 230 days' cash on hand on average in fiscal years 2019 to 2021 and estimated unaudited liquidity of $814 million as of fiscal 2022, which we expect will be preserved at no less than $700 million or 180 days through fiscal 2025 partly as a result of significant federal aid received.

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

- Exposure to prolonged weak ridership as a result of the pandemic and lingering ancillary effects (such as economic effects, 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, without federal aid) that will likely be insufficient through fiscal 2024 and potentially longer as the agency relies on federal aid to bolster revenue and delays significant cost cutting.

Management reports that over the next 24 months it will monitor revenue and expenses at least quarterly, taking into consideration certain revenue expectations. SFMTA will pause budgeted expense augmentations if revenue targets are not met, and the agency will balance the budget around updated revenue projections through June 2024. A reauthorization of a sales tax planned for the November 2022 ballot could provide $10 million annually in funding. But generally, if revenue does not rebound and no other revenue bond measure is planned to generate new funding by November 2024, management plans to align costs with revenue, potentially entailing significant labor and service reductions. If budget alignment is not successful, the final lever management would pull is drawing down reserves in fiscal 2026.

While transit and parking are its core operations, SFMTA does not significantly rely on related revenue for operations at just 25% of gross revenue, and, in our view, this partly offsets SFMTA's exposure to reduced activity. By contrast, we note that some mass transit systems in the U.S. have fare revenue that exceeds 50% of gross revenue. Nevertheless, fares and parking are important revenue streams to sustaining solid financial metrics, and, absent activity level recovery or other budget adjustments, we believe the financial risk profile could further erode once federal aid is depleted.

In addition to federal aid, SFMTA's overall revenue mix provides financial resilience to the system. An important credit consideration is financial support from various tax revenue that does not directly rely on transportation activity. Tax revenue, typically accounting for around 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 $443 million, or 46% of gross revenue, in fiscal 2021. We also note that the majority of San Francisco City and County general fund revenue (66%) consisted of various taxes in fiscal 2021, lending credit stability, especially during exogenous shock events that depressed transportation activity. Operating grants, taxes, and general fund support typically account for almost three-fourths of gross revenue. General fund support, however, declined 10% in fiscal 2020 and 7% in fiscal 2021, but is projected to grow an average of 5% annually through fiscal 2027.

SFMTA's ridership declined 24% in fiscal 2020 and 64% in fiscal 2021 to 61 million boardings, with fiscal 2021 ridership at just 27% of the fiscal 2019 figure (224 million boardings). Estimated ridership for fiscal 2022 improved to 47% of fiscal 2019 levels, and is forecast at 57%, 71%, 78%, and 88% recovery for fiscal years 2023 to 2026, sequentially. Ridership data for June 2022 alone indicates demand at 56% of the June 2019 level, which suggests that management's forecast of 57% recovery for full fiscal 2023 is conservative. Parking, garage, and related revenue declined to about one-fifth of pre-pandemic levels during the early months of the pandemic in 2020, but are now in line with pre-pandemic levels. S&P Global Ratings' baseline activity estimates for mass transit relative to pre-pandemic levels show ridership nationally returning to 75% of pre-pandemic levels by the fourth quarter of 2024, which appears consistent with SFMTA's forecast. For more information, see "Updated U.S. Transportation Infrastructure Activity Estimates Show Air Travel Normalizing By 2023 And A Stymied Transit Recovery," published Jan. 12, 2022, on RatingsDirect.

S&P Global Ratings will continue to assess the impact of the COVID-19 pandemic on ridership and key credit metrics, but we believe liquidity, mitigation measures taken thus far, and $1.3 billion in federal aid (which is being used in fiscal years 2020 through 2025) will likely allow SFMTA to weather the prolonged decline in demand.

Environmental, social, and governance

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 credit neutral. We view social risks, however, as a negative consideration in our credit rating analysis. At the onset of the pandemic, SFMTA's exposure to significant health and safety social risks related to COVID-19 resulted in precipitous ridership and revenue declines, leading to operating and financial pressures. However, vaccination progress allowing for easing of social restrictions in San Francisco, has supported some ridership recovery. While ridership may continue to gradually rebound over the next few years, and parking activity is already near pre-pandemic levels, we believe longer-term social capital demographic changes in rider preferences and behavior, especially commuting patterns and remote work conditions (also what we consider a social risk) will likely result in a permanent loss of ridership for several years, with ultimate recovery, both in terms of timing and actual ridership, highly uncertain. With regard to governance, we view SFMTA's comprehensive financial planning and disclosure practices as credit neutral. We also view environmental risks as credit neutral, although we note that SFMTA is located in a region prone to earthquakes, which introduces some risk.

Negative Outlook

Downside scenario

Over the next one to two years, there is a one-in-three chance we could lower the rating further to the extent that ridership lags projections or S&P Global Ratings' baseline activity estimates referenced above, as this could negatively color our view of SFMTA's already weakened market position and further erode financial metrics. In making this assessment, we will also examine whether management has balanced its budget without reliance on nonrecurring revenue, or whether it has a credible plan to bring expenses into balance with its "new normal" of lower ridership and fare revenue.

Return to stable scenario

If SFMTA is able to maintain liquidity and align expenditures with revenues, or if transit 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

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

We consider SFMTA's service area economic fundamentals extremely strong, reflecting high GDP per capita of approximately $150,000 and a historically below-average unemployment rate compared with the national level. SFMTA serves a city population of approximately 875,000 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 ongoing demand for transit services. While we note that the city has a relatively high percentage of jobs in financial services and technology where remote work is more possible, and is in some cases encouraged or required, the economy's underlying strength supports general demand for transit.

We still believe SFMTA provides an essential service to the 49-square-mile city, but a highly capable competitor to SFMTA's quasi-monopolistic position in the form of widespread telecommuting has emerged. Since the pandemic's onset, we have adjusted our assessment of SFMTA's market position to very strong from extremely strong given our view that the system's essentiality has been materially and potentially permanently degraded (or at least degraded for the short-to-medium term, with long-term full recovery uncertain) given the evolution of telecommuting. Transit riders are not returning in the way that air travelers (airports) and drivers (toll roads) are, and transit even lags the rebound seen in the parking sector. Many local employers are adopting hybrid return-to-office models or offering 100% work-from-home options, which will create a long-lasting gap in pre- versus post-pandemic ridership. We believe that ridership in some metro areas such as San Francisco could take more than a decade to recover, and that population and employment growth may be the catalyst (rather than changing remote working options). We still view the system as well integrated with San Francisco Bay Area Rapid Transit (BART), Alameda-Contra Contra Transit District (AC Transit), and Caltrain (Peninsula Corridor), but we note those transit systems are also suffering from low ridership for similar reasons. 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 recession. SFMTA also enjoys broad political support with the City of San Francisco issuing GO bonds for transportation projects from time to time, although a recent GO ballot measure for transit capital projects fell slightly short of the two-thirds approval requirement.

Muni reported a 95% decline in ridership in April 2020 year over year, with ridership improving gradually since but remaining at a fraction (56%; June 2022 versus June 2019) of pre-pandemic levels. SFMTA has been taking advantage of partial system closures to make capital improvements to increase service reliability when full service resumes. Management believes improvements in SFMTA's transit offerings and competitiveness versus other modes will attract other discretionary passengers. But as technology has advanced to allow for a greater percentage of office workers to seamlessly work remotely during the pandemic, we believe that post-pandemic SFMTA (and many other transit agencies) will suffer a permanent loss of a meaningful portion of ridership that could make full recovery more sluggish. 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 Act money. In fiscal 2021, management bolstered underperforming revenue with an additional $450 million in federal aid receipts. An additional $252 million was applied to fiscal 2022, and $431 million to fiscal years 2023 to 2025, for a total of $1.3 billion in federal aid assistance. SFMTA has also been enacting cost control measures, including a hiring freeze for all noncritical positions, reduced overtime, controls on materials and supplies, and contract expenditure cuts. Management reports that it will appropriate $52 million in savings generated in fiscal 2022 (produced from tighter management of supply costs and purchase orders and prior hiring controls) into fund balance available for fiscal 2023. SFMTA also has a fare evasion task force in place, as recovery of fare revenue has lagged ridership recovery. For fiscal years 2020 through 2022, we estimate a cumulative decline of $853 million in gross revenue as compared with the 2019 level, and an estimated $431 million in federal aid remains to cover gaps through fiscal 2025.

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 4.4x in fiscal 2020 and negative 5.6x in fiscal 2021 given the ridership effects. Our coverage calculations exclude the $197 million in CARES Act funds that apply to fiscal 2020 (and $450 million in combined CARES Act and 2021 Coronavirus Act federal aid applied to fiscal 2021) as a result of the funds' nonrecurring nature. However, we do recognize that the total CARES Act and 2021 Coronavirus Act funding of $608 million and other federal aid receipts will allow SFMTA to maintain strong liquidity through fiscal 2025. (Coverage on a net revenue basis, inclusive of federal aid, was 3.5x for fiscal 2020 and 13.5x for fiscal 2021.) Based on SFMTA's estimates for fiscal 2022 and budget for fiscal years 2023 and 2024, and without the inclusion of the use of fund balance or federal aid as revenue, we calculate that coverage will be significantly less than 1x in all years. While this continues to be a significant departure from historically extremely strong coverage during fiscal years 2015 to 2019, we understand the situation remains fluid pending the trajectory of ridership and the pandemic, implementation of vaccines, permanence of increased telecommuting, system utilization, potential additional budget adjustments, and performance of other revenue sources such as taxes and general fund support. We also understand management may also investigate new revenue sources, if needed.

We continue to assess SFMTA's overall liquidity position and debt capacity as strong, despite our view of its very large $2.6 billion five-year capital plan. In its bond offering in 2021, SFMTA took most of the refunding savings upfront through fiscal 2023 to help offset projected budget deficits given the effects of the COVID-19 pandemic. 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), and transit expansion and enhancement. Bond proceeds will fund just $129 million, or 5% of the proposed capital improvement plan.

SFMTA's available cash and investments totaled $715 million, or 236 days' cash, in fiscal 2021, with available liquidity to debt at 157%. Estimated liquidity as of June 30, 2022, was $814 million, or 232 days' cash. Overall, we assess SFMTA's liquidity and financial flexibility as strong, and the receipt of federal aid has allowed for maintenance of ample liquidity throughout the pandemic. Cash balances on a nominal basis have been growing since measuring $576 million in fiscal 2016.

Economic outlook

S&P Global Ratings believes that economic momentum will likely protect the U.S. economy from recession in 2022. But, with supply chain disruptions worsening as the weight of extremely high prices damage purchasing power and as aggressive Federal Reserve policy increases borrowing costs, economic effects are likely in 2023. Our U.S. GDP growth forecast is 2.4% for 2022 and 1.6% for 2023 (compared with 2.4% and 2.0%, respectively, in May 2022), and while our baseline signals a low-growth recession we believe the likelihood of a contraction or technical recession are rising, to 40% (35%-45% band). The wider band reflects increased uncertainty over the Russia-Ukraine conflict. Supply chain disruptions, worsened by the Russia-Ukraine conflict and the China slowdown, remain the largest stumbling block for the U.S. economy. As inflation expectations become more entrenched, extreme price pressures will likely last well into 2023. We expect the unemployment rate, at 3.6% in May and just over its pre-pandemic level, will remain near that rate until early 2023 before surpassing 4.3% by the end of 2023 and 5.0% by the end of 2025 as the economy slows. The Federal Reserve is now likely to push rates to 300 basis points by year end from zero at the beginning of the year and reach 3.50% to 3.75% by mid-2023. The Fed will keep monetary policy tight until inflation decelerates and nears its target in second-quarter 2024. We expect the Fed to start to cut rates in third-quarter 2024. Our lower GDP and inflation forecasts for 2023 and 2024 reflect this more aggressive policy stance. (See "Economic Outlook U.S. Q3 2022: The Summer Of Our Discontent," published June 27, 2022.)

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022