S&P Global Ratings

RatingsDirect®

Summary:

San Francisco Bay Area Rapid Transit District; General Obligation; Note

Primary Credit Analyst:
Alyssa B Farrell, Centennial (1) 303-721-4184; alyssa.farrell@spglobal.com

Secondary Contact:
Chris Morgan, San Francisco (1) 415-371-5032; chris.morgan@spglobal.com

Table Of Contents

Summary:

San Francisco Bay Area Rapid Transit District; General Obligation; Note

Credit Profile		
US$568.7 mil GO bnds (Election Of 2016) ser 2020 C-1 due 08/01/2050		
Long Term Rating	AAA/Negative	New
US$131.3 mil GO bnds (Election Of 2016) ser 2020 C-2 due 09/15/2020		
Short Term Rating	A-1+	New
San Francisco Bay Area Rapid Transit District GO bnds		
Long Term Rating	AAA/Negative	Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating to the San Francisco Bay Area Rapid Transit (BART) District, Calif.'s $568.7 million 2020 series C-1 general obligation (GO) bonds (election of 2016)(tax-exempt)(green bonds) and affirmed its 'AAA' rating on BART's existing GO bonds. The outlook is negative.

At the same time, S&P Global Ratings assigned its 'A-1+' short-term rating to the district's $131.3 million 2020 series C-2 GO bonds (election of 2016) (federally taxable) (green bonds).

The long-term GO bonds are secured by an unlimited ad valorem property tax levied on taxable property within the county of Alameda, the county of Contra Costa, and the city and county of San Francisco, which together comprise the three-county BART district. The Alameda, Contra Costa, and San Francisco County Boards of Supervisors have the power and obligation to levy these taxes at the district's request for the bonds' repayment. Under a trust agreement, proceeds of the tax are to be automatically transferred to the bond trustee, U.S. Bank National Assn., in advance of debt payment dates.

The series C-2 bonds will be repaid from original issue premium generated by the sale of the series C-1 bonds, which will be held by the trustee in the interest and sinking fund and transferred by the trustee for payment of the bonds, which mature on Sep. 15, 2020 (subject to change). Should the amounts in the interest and sinking fund be insufficient to cover debt service, the bonds are also secured by an unlimited ad valorem property tax levied within the district. Additionally, we understand that BART has obtained programmatic pre-issuance certification that both of the 2020 bond issuances comply with the Climate Bond Standards Board's Low Carbon Land Transport Standard.

The 2020 bonds will finance certain improvements to system facilities authorized under Measure RR. Inclusive of the current issuances, the district will have approximately $2.5 billion in net direct debt outstanding.

BART's GO bonds are eligible to be rated above the sovereign because we believe the district can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign--Corporate

And Government Ratings: Methodology And Assumptions," published Nov. 19, 2013, on RatingsDirect, U.S. local governments are considered to have moderate sensitivity to country risk. Locally derived revenue is the primary revenue sources for BART, and the institutional framework in the U.S. is predictable with significant local government autonomy and flexibility is demonstrated by independent treasury management.

Credit overview

BART benefits from its large service area and depends primarily on fare-based revenue for operations. While ridership had been declining gradually in the last three years, the onset of the COVID-19 pandemic and the global recession spurred a more significant decline in ridership as the shelter-in-place orders took effect and leisure and business travel slowed. Despite the reduction in the ridership and correlated revenues, the district anticipates balanced operations in fiscals 2020 and 2021, supported by proactive management of the budget and the anticipated receipt of emergency federal funds. However, we believe that uncertainty remains surrounding the reopening and recovery, which, if prolonged, could result in budgetary pressure in the medium-term, particularly if fare and sales tax revenues, on which the district relies, exhibit a slower than expected recovery and one-time federal funding rolls off. Therefore, rating stability will depend on the district's continued response to adjusting for any potential midyear changes in revenue and lingering financial and economic effects from the pandemic and subsequent recession.

While our outlook generally covers up to two years, we believe that the next six to 12 months will be critical when evaluating the effects on the district's revenue and any corresponding expenditure adjustments. Although we believe COVID-19's shocks are temporary, the recovery period is dependent upon the duration of social distancing requirements and consumer demand. For more information on the coronavirus' effect in U.S. Public Finance, please see our reports titled "The COVID-19 Outbreak Weakens U.S. State And Local Government Credit Conditions" (April 2, 2020) and "The U.S. Faces A Longer And Slower Climb From The Bottom" (June 25, 2020).

The rating reflects our view of the district's:

- Exceptionally deep and very diverse regional economic base that is home to 3.7 million residents, or nearly half of the San Francisco Bay Area population, with very strong incomes and extremely strong wealth indicators;
- Leading regional economy in terms of industrial diversity, job growth, and affluence;
- Prudent management, demonstrated by very strong formalized reserve policies and comprehensive capital planning, as well as its willingness and ability to adjust its budget; and
- Historically positive operating performance, supporting its very strong reserve position.

Environmental, social, and governance (ESG) factors

We analyzed the district's ESG risks relative to its economy, management, financial measures, and debt and liability profile. The district's governance risks are in line with our view of the sector standard. Although the district has elevated exposure to seismic risks, we believe that the risks have been substantially managed through recent seismic improvements to system infrastructure. In addition, our ratings incorporate our view regarding the health and safety risks posed by the COVID-19 pandemic, which has contributed to significant reductions in operating revenue to date and which we believe could continue dependent upon the route of recovery.

Negative Outlook

Downside scenario

We could lower the rating if BART were to underperform its current projections as a result of a prolonged recessionary period, resulting in sustained operational imbalance and a significant reduction in its cash position to levels no longer commensurate with those of similarly rated peers.

Return to stable scenario

Should the district maintain its positive operations throughout the reopening phases, gradually stabilizing ridership and sustaining its very strong unrestricted reserve position, we could revise the outlook to stable.

Credit Opinion

Economy

BART serves a substantial and very diverse service area, which spans three counties of the San Francisco Bay Area--Alameda County, Contra Costa County, and The City and County of San Francisco. The BART system consists of 131 miles of double track, 50 stations, approximately 860 cars, and approximately 47,200 parking spaces across the three counties, northern San Mateo County, and northern Santa Clara County.

Reflective of the rebounding residential market and continuous growth in the greater Bay Area, the combined assessed value (AV) increased over the last decade to $804.7 billion in 2020, equating to what we consider an extremely strong $215,051 per capita. While we acknowledge the historic resiliency in the tax base, which experienced a modest 1.7% decline in AV throughout the Great Recession, we believe that the current recession could curb the area's recent growth trend. However, any slowdown in AV would not be reflected in the property tax rolls until at least 2022, and management anticipates additional AV growth in 2021 based on current estimates. Income levels for the three counties are what we consider very strong, with a weighted-average-by-population median household effective buying income (EBI) at 154% of the national level and per capita EBI at 162% of the national average.

For more information on the underlying county economies within BART's service area, please see the following articles on RatingsDirect:

- Alameda County, Calif., published Feb. 28, 2018;
- Contra Costa County, Calif., published July 20, 2015; and
- San Francisco City and County, Calif., published March 16, 2020.

Finances

BART originally adopted a balanced operating budget for fiscal 2020, with pre-COVID-19 anticipated declines in ridership to be offset by an increase in nonfare revenue, such as advertising, taxes, and grant funding. However, the onset of COVID-19 and the recession resulted in a more significant reduction in revenues and ridership. In response, BART implemented service reductions, including shortened hours of operation, which resulted in some cost savings to partially offset the revenue declines. Due to various cost containment measures and the anticipated receipt of Federal

Emergency Management Agency reimbursement and Coronavirus Aid, Relief, and Economic Security (CARES) Act funding, the district anticipates at least balanced operations at the end of fiscal 2020.

The fiscal 2021 adopted budget is also balanced, largely due to revenues being shored up by federal emergency funding. Key budget assumptions include farebox and parking revenues at 70% below original expectations, 16% lower sales tax revenue, and $251 million in CARES Act funding, with a 6% reduction in operating expenses. The fiscal 2021 budget additionally includes a $44 million placeholder for additional COVID-19-related expenses to be potentially incurred. To date, management reports that extraordinary expenses related to the pandemic have been relatively minimal and are largely reimbursable through emergency funding, including personal protective equipment-related items. Despite the declining revenue environment, BART has been increasing staffing levels to support track extension. While some capital expenses have been deferred, management reports that it has been using the system downtime during the shutdown to continue its Measure RR capital projects, some of which are now ahead of schedule. Finally, in 2019, the governing board approved a series of Consumer Product Index-based fare increases for 2022, 2024, and 2026, which are also reflected in current projections.

The system's operations are reliant on fare revenue, with revenue from passenger ticket purchases representing about 48% of operating expenses (net of capitalized costs) in fiscal 2019, followed by sales tax revenue at 28%, and property tax revenue at 12%. After peaking in 2016, the system's ridership declined slightly in the last three years, parallel to nationwide trends. As a result of social distancing efforts in an effort to slow the spread of COVID-19 and the onset of the global recession, the system's ridership dropped significantly in 2020. In 2020, the average weekday ridership fell 92% following shelter-in-place orders from its pre-COVID-19 trend, resulting in an annual average of 288,271 for all of fiscal 2020. The district has conducted passenger surveys to identify potential ridership recovery, and has implemented a 15-step plan to improve sanitation and social distancing to encourage ridership throughout the reopening stages.

Over the last three years, the district's sales tax revenue grew by an average annual rate of 6.5%. Current estimates reflect a 15% cumulative decline between fiscals 2020 and 2021 as a result of the slowdown in consumer spending, which management worked with external consultants to inform. We note that the sales tax is included in the overall sales tax rate on transactions within the three counties and is comparable to total tax rates within other counties in the state. BART includes sales tax bond debt service as part of its annual operating budget and relies on surplus revenue to help subsidize capital projects.

Inclusive of all operating and nonoperating revenues and expenditures, the district has reported positive changes in net position in each of the past five audited years, including its fiscal 2019 surplus of $218.3 million, or 21% of expenditures. After adjusting for the net pension liability and related inflows and outflows, the district's fiscal 2019 unrestricted net position was $694.4 million, equating to 67.4% of expenditures, a level we consider very strong. The governing board has adopted a policy of maintaining operating reserves equal to at least 15% of operating expenses, a level we consider very strong, among other reserve target levels for economic uncertainty. The system's unrestricted ending cash balances were $253.0 million in fiscal 2019, or 24.6% of total system expenditures.

We also note that the district's 2016 labor negotiations resulted in labor agreements with several unions through 2021. We understand that management will continue proactively meeting with union representatives on a regular basis to facilitate future negotiations and avoid future negotiation conflicts, following contentious negotiations that resulted in multiple strikes in fiscal 2013.

Debt

Capital plans for BART include a full fleet replacement, a new maintenance facility, and an updated train control system, as the district works to address its aging facilities and equipment. The most recent 15-year capital plan (adopted fiscal 2019) identifies BART's total capital investment need as $22.4 billion, with $12.4 billion of identified funding sources, including the Measure RR authorization (about $2.1 billion remaining), various federal, state and regional grants, and the system's operating allocations.

The district's overall net debt, 89% of which is made up of overlapping obligations, equates to $6,602 per capita, which we consider high, and 3.0% of market value, which we consider low. In fiscal 2019, debt service carrying charges were low, in our opinion, at 8.0% of total district expenditures. We consider amortization to be slower than average, with only 39% of the total debt due to be retired within the next 10 years. Management indicated that the current issuances should cover its capital plans for the next two years and it does not have established additional debt plans at this time.

Pension and other postemployment benefit (OPEB) highlights:

- In our view, the district's pension and OPEB liability carrying charges are somewhat elevated relative to its total system expenditures, indicating a longer-term budgetary pressure, heightened by our expectation of rising costs and the relatively low funded ratios.
- The district's pension funded status, combined with recent changes to assumed discount rate and amortization methods, will likely lead to accelerating costs in the medium term. However, in fiscal 2018, the district approved a Section 115 trust for its pension obligations, to which the district intends to contribute $10 million annually until the balance reaches $100 million, which we believe helps to offset future cost pressure.
- The district offers OPEBs, and it has been increasing its contributions toward its annual required contribution in recent years. The district established an OPEB trust in 2004, which currently maintains a balance of $306 million, and management expects the plan to be fully funded by 2034.

As of June 30, 2019, the district participates in the following plans:

- California Public Employees' Retirement System (CalPERS) miscellaneous plan, an agent multiple-employer defined benefit plan: $677.8 million net pension liability, 74.1% funded;
- CalPERS safety plan, an agent multiple-employer defined benefit plan: $154.9 million net pension liability, 59.4% funded; and
- Single employer OPEB plan: $263.3 million net liability, 56.4% funded.

BART's combined required pension and actual OPEB contributions totaled 11.4% of total governmental fund expenditures in 2019. Of that amount, 7.5% represented required contributions to pension obligations, and 3.9% represented OPEB payments. In fiscal 2019, the district made 100% of its actuarially determined contributions for the CalPERS plans, which fell short of both the static funding and minimum funding progress calculations, indicating growing liabilities. The plan's discount rates of 7.15% contribute to our view of likely payment volatility going forward, though we note plan administrators have been lowering rates in recent years.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020