S&P Global Ratings

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## Summary:

# Bay Area Rapid Transit, California; General Obligation

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| Credit Profile | | |
|---|---|---|
| US$300.0 mil GO bnds (Election Of 2016) ser 2017 A-1 & A-2 due 08/01/2047 | | |
| *Long Term Rating* | AAA/Stable | New |
| US$90.975 mil GO rfdg bnds (Election Of 2004) ser 2017 E due 08/01/2037 | | |
| *Long Term Rating* | AAA/Stable | New |
| Bay Area Rapid Transit GO bnds | | |
| *Long Term Rating* | AAA/Stable | Affirmed |

## Rationale

S&P Global Ratings assigned its 'AAA' rating to the San Francisco Bay Area Rapid Transit (BART) District, Calif.'s 2017 series A-1 (Green Bonds; election of 2016), [taxable] 2017 series A-2 general obligation (GO) bonds (Green Bonds; election of 2016), and 2017 series E GO refunding bonds (election of 2004). At the same time, S&P Global Ratings affirmed its 'AAA' rating on BART's GO bonds outstanding. The outlook is stable.

The bonds are secured by an unlimited ad valorem property tax levied on taxable property within BART's three-county service area. The San Francisco, Contra Costa, and Alameda 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. Additionally, we understand that BART has obtained third-party green bond verification that the bonds comply with the Climate Bond Standards Board's Low Carbon Land Transport Standard. The series 2017 A-1 and series A-2 bonds are the first issuance of the Measure RR, and proceeds will be used to finance various acquisition, construction, and improvement projects. The series 2017E refunding bonds will be used to current refund a portion of BART's 2007 series B GO bonds (election of 2004) 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 revenues are 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.

The rating reflects our view of BART's:

- Exceptionally deep and diverse regional economic base that is home to 3.6 million residents, or nearly half of the San Francisco Bay Area population;

- Leading regional economy in terms of industrial diversity, job growth, and affluence;
- Large and very diverse tax base, with very strong incomes and extremely strong wealth indicators;
- Prudent management, demonstrated by very strong formalized reserve policies and its willingness and ability to adjust its budget; and
- Maintenance of a very strong financial position, supported by formal reserve policies.

## Economy

BART serves a very substantial and diverse service area, which spans three counties of the San Francisco Bay Area--The City and County of San Francisco, Contra Costa County, and Alameda County--with each county representing a nearly equal portion of the total service area. The BART system consists of 109 miles of double track, 46 stations, and more than 49,000 parking spaces across the three counties and portions of San Mateo County. The combined assessed value (AV) of the three BART counties has exhibited strong annual growth since 2012, growing by a cumulative 31.7% over the last six years, which is reflective of the rebounding residential market in the greater Bay Area. Mostly recently, AV increased by 7.3% in fiscal 2017 to $646.1 billion, equating to an extremely strong $178,574 per capita, in our view. Management anticipates continued growth over the near term, consistent with our expectation of real GDP growth in the Pacific U.S. states. 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 137% of the national level and per capita EBI at 140% of the national average.

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

- Contra Costa County, Calif., published July 20, 2015;
- San Francisco City and County, Calif., published Jan. 9,2017; and
- Alameda County, Calif., published Dec. 23, 2016.

## Finances

The single largest source of the system's revenue is passenger ticket purchases, which represented about 54% of total revenue in fiscal 2016. BART's average weekday ridership has grown year-over-year following the recent recession, increasing by an aggregate 18% in the last five audited fiscal years; however, management reports that ridership trended down in the first half of fiscal 2017, with the average total weekday trips decreasing 1% from the same period in fiscal 2016, which management attributes to congestion, lower gas prices, and the increased use of transportation alternatives such as app-based services. Management anticipates ridership to increase in coming years following the completion of its capital improvements, but has budgeted for ridership to remain stable. Sales tax revenues account for approximately 27% of total system revenues. 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.

The district has posted operating surpluses in each of the past five audited years, including its fiscal 2016 surplus of $162.3 million, which is 30% of operating revenue alone. The system adopted GASB 68 for pension accounting in fiscal 2015, which resulted in a $499.2 million restatement due to the recognition of the net pension liability and related deferred inflows and outflows. After adjusting for deficits introduced because of GASB 68, the unrestricted net position for fiscal 2016 is about $541.2 million, or 58.7% of total system expenditures, which we consider very strong. The system's unrestricted ending cash balances were $265 million in fiscal 2016, or 41.5% of operating expenditures. The board has adopted a policy of maintaining operating reserves equal to at least 15% of operating expenses, a level we consider very strong.

For fiscal 2017, BART has adopted a balanced operating budget. However, the system's first-quarter financial report shows that revenues are tracking slightly under budget by about 3%. Consequently, management has implemented steps to alleviate any potential budgetary pressure through staff reductions, hiring freezes, and the addition of a surcharge on paper tickets. The fiscal 2017 budget also includes a full year of increase in fares based on automatic fare increase by the Consumer Price Index every other year through 2020. The first inflation-based fare increase took effect in January 2006, and the most recent increase in January 2016. Management estimates that these combined increases will generate about $35 million in fiscal 2017, all of which is dedicated by board policy to fund capital projects. Looking ahead, management expects near-balanced operations in fiscal 2018, after originally budgeting for an operating deficit, as a result of management's aforementioned steps and an expected increase in state funding.

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. The current capital plan requires an additional $9.6 billion during the next 10 years, $3.5 billion of which was recently authorized by voters in November 2016 as Measure RR. The current measure was authorized for safety enhancements, overcrowding and traffic relief, and infrastructure replacement and upgrades. We understand that BART management has identified funding for about half of these capital needs, including state and federal grants and BART's own $45 million in operating set-asides for 12 years. BART GO debt outstanding consists of $600.2 million from a $980 million authorization for earthquake safety projects that was approved by voters in November 2004, of which the district has $240 million in authorized but unissued principal. We understand that the district intends to issue the remaining $240 million within the next two to three years. The district also has $595.1 million in principal outstanding in sales tax revenue bonds.

The district's overall net debt, 93% of which is made up of overlapping obligations, equates to $5,763 per capita, which we consider high, and 3.3% of market value, which we consider moderate. In fiscal 2016, debt service carrying charges were moderate, in our opinion, at 10% of total system expenditures. We consider amortization to be slower than average, with only 38% of the total debt due to be retired within the next 10 years.

### Pensions and other postemployment benefits (OPEBs)

The district contributes to the California Public Employees' Retirement System under the Miscellaneous Plan and the Safety Plan, funding its annual required contribution (ARC) in each of the last three fiscal years. In fiscal 2016, the district's combined contribution totaled $50.4 million or 5.5% of operating expenditures. As of June 2015, the Miscellaneous Plan was 80.2% funded and the Safety Plan was 63.3% funded, and its combined unfunded actuarial accrued liability was $514.8 million. The district offers OPEBs, and it has been increasing its contributions toward its ARC in recent years, including its 2016 contribution of $27.3 million, which was 92.9% of its ARC. As of June 2016, the district's actuarial accrued liability was $237.4 million.

## Outlook

The stable outlook reflects our view of BART's very strong financial position and large and very diverse tax base, which we expect will continue to grow over the next two years. The outlook further reflects our expectation that the district will continue to make adjustments to its budget as needed to maintain its very strong financial position and meet its current capital plan. We do not anticipate changing the rating within the two-year outlook horizon.

### Downside scenario

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

## Related Research

- U.S. State And Local Government Credit Conditions Forecast, July 27, 2016
- Credit FAQ: Financial Management Assessment In U.S. Public Finance, June 27, 2006

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.