S&P Global Ratings

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Summary:

San Francisco Bay Area Rapid Transit District, California; Sales Tax

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Table Of Contents

Summary:

San Francisco Bay Area Rapid Transit District, California; Sales Tax

Credit Profile		
US$220.750 mil sales tax rev bnds ser 2019A due 06/30/2045		
Long Term Rating	AA+/Stable	New
US$80.005 mil sales tax rev bnds ser 2019B due 06/30/2037		
Long Term Rating	AA+/Stable	New
San Francisco Bay Area Rapid Transit District Sales Tax Rev Bnds		
Long Term Rating	AA+/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating on San Francisco Bay Area Rapid Transit District (BART), Calif.'s 2019 series A sales tax revenue bonds and 2019 series B refunding bonds (green bonds). At the same time, S&P Global Ratings affirmed its 'AA+' long-term rating on BART's sales tax revenue bonds outstanding. The outlook is stable.

The rating reflects the application of our priority-lien tax revenue debt criteria, published Oct. 22, 2018, on RatingsDirect, which factors in both the strength and stability of the pledged revenue, as well as the general credit quality of the district, where taxes are distributed and collected (the obligor's creditworthiness, or OC). In our opinion, the priority-lien rating reflects the strength of the pledged revenue and legal provisions and is not constrained by our view of the district's underlying creditworthiness.

Security and purpose

The bonds are secured by BART's sales tax revenue, consisting of 75% of revenue from a 0.5-cent sales tax collected within the district (the remaining 25% is distributed to the Metropolitan Transportation Commission). The California Department of Tax and Fee Administration (CDTFA) collects the district's sales tax along with the state and other local sales taxes, and distributes the sales tax to the bond trustee prior to releasing it for BART's operating and capital funds. 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 2019 bonds will not have a debt service reserve fund, similar to the district's existing sales tax revenue bonds.

The 2019 series A bonds will be issued in an approximate par amount of $220.8 million, and proceeds will finance the acquisition and renovation of the district's new administrative headquarters. The series B refunding bonds will be issued in the par amount of approximately $80.0 million, and proceeds will be used to refund on a taxable basis the district's 2012 series A bonds for savings.

Credit overview

BART's credit profile benefits from the large, prosperous, and diverse economy of its three-county district covering the City and County of San Francisco, and Alameda and Contra Costa counties. An economic hub of national and international importance, the local economy thrives as a major center for technology and financial services firms, among many other industries. The strength of the district's economy continues to support a pledged revenue stream that demonstrates low volatility and produces very strong debt service coverage (DSC) on a consistent basis. Although BART faces some challenges with respect to maintaining and improving its heavy-rail rapid transit system, as reflected through an extremely large $22.4 billion, 15-year capital improvement plan (CIP), we believe BART's general creditworthiness will continue to support the credit quality of its sales tax revenue bonds.

The rating further reflects what we view as:

- The very strong economic fundamentals of BART's three-county district, which lies in the heart of the large and prosperous San Francisco Bay Area economy;
- Maximum annual debt service (MADS) coverage that is consistently very strong and that we expect will remain so, despite an additional bonds test (ABT) that requires MADS coverage of just 1.5x for additional debt issuance, which we consider adequate;
- The historically low volatility of nationwide sales tax revenue, a view that extends to our opinion of BART's pledged sales tax revenue; and
- BART's strong operational and financial management, and favorable all-in coverage and liquidity metrics, supporting our view of the obligor's creditworthiness.

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

- Adequate ABT that requires 1.5x MADS coverage from historical revenue, and
- Very large CIP.

Economic fundamentals: Very strong

The district covers three counties: San Francisco, Contra Costa, and Alameda. The combined three-county population of approximately 3.7 million continues to grow. Even as high housing costs have led to some out-migration, strong in-migration, especially from international destinations, has contributed to positive population growth in recent years. Employment growth in the district has been exceptionally strong in recent years, reflecting its continued presence as a major national and international hub, particularly for the technology and financial services industries, along with various heavy industries.

Reflecting the high level of economic prosperity within the district, the three-county overall per capita effective buying income (EBI) was 54% higher than the national level in 2018, per our calculations based on each county's contribution to the total district EBI figures according to weighted average by population. Using a similar approach, we calculated unemployment for the three BART counties at approximately 2.9% for 2018, remaining below the state and U.S. rates. Overall, we consider BART's economic fundamentals very strong, providing a robust taxing base supporting its pledged revenue stream as well as a robust base of demand for its transit services.

Coverage and liquidity: Very strong

Based on fiscal 2018 collections, the district's pledged revenue of $257.9 million provides 4.4x MADS coverage on the lien, which we consider very strong. BART's unaudited actuals for fiscal 2019 reflect an 8.7% increase in pledged revenue to $280.4 million, equating to 4.8x MADS coverage. For fiscal 2020, BART has budgeted for a slight, 1.2% decline in pledged revenue, which we view as likely conservative, given the continued strong economic growth within the three-county area.

We understand that BART has no plans to issue additional sales tax revenue bonds, and we expect its coverage will remain above the threshold for what we consider very strong. However, BART's ABT allows for additional debt to be issued, so long as historical revenue would produce 1.5x MADS coverage on existing and proposed bonds. Although we believe MADS coverage will likely remain very strong, the possibility that BART could issue additional debt to a level that materially suppresses coverage somewhat tempers the very strong coverage assessment.

Noting the ABT provisions as an offsetting factor, we cite several factors that inform our view that coverage will likely remain very strong. After the trustee funds annual debt service requirements from pledged revenue, it releases the remainder to BART to support operating and capital needs. In fiscal 2018, the pledged revenue represented 26% of BART's total revenue. In our view, BART's reliance on pledged revenue to cover a significant portion of its expenses, after debt service, somewhat reduces the incentive to issue debt down to the level of the ABT.

In addition, given the exceptional strength of BART's coverage, either an extreme downturn in pledged revenue, a very large debt issuance, or some combination thereof would be required to reduce coverage to a level we no longer consider very strong. We estimate that a 150% increase in MADS would still likely translate to 2x MADS coverage from fiscal 2018 revenue, according to our sensitivity analysis.

BART's sales tax bonds do not benefit from the additional security offered by debt service reserve funds. However, given the very strong coverage and a low revenue volatility assessment, there is no downward adjustment to the very strong coverage score that would indicate potential liquidity pressures.

Revenue volatility: Low

We assess the volatility of pledged revenue to evaluate the likely availability of revenue across different economic cycles. We have two levels of volatility assessment: macro and micro. Our macro volatility assessment begins with an assessment of the historical volatility of the economic activity being taxed, and includes an analysis of societal, demographic, political, and other factors that could affect these activities. We use the variance of national economic activity that we believe most closely represents the taxing base over multiple economic cycles to inform our expectations of volatility. To determine our view of the volatility of sales taxes, we used total retail food and service sales data from the U.S. Census Bureau for the period 1993 to 2014.

On a micro level, we see no internal or external influences that improve or worsen our assessment of BART's pledged revenue volatility. Based on historical trends, we expect BART's sales tax revenue collections to remain relatively stable across different economic cycles, supported by the broad and diverse nature of the tax base, and by the district's robust and prosperous economy.

BART's pledged revenue increased each year from fiscal years 2011 through 2018, at a compound average annual rate of 4.5%. Although pledged revenue declined by nearly 18% over two years during the Great Recession, the rebound was relatively swift, with pledged revenue fully rebounding by fiscal 2013, just three years after its nadir.

The BART sales tax revenue does not sunset. The taxable transactions within the three counties span several categories and are not heavily concentrated within a single category. Motor vehicle and parts dealers, food services and drinking places, and gasoline stations typically represent the largest categories, each at less than 15% of total taxable transactions.

Obligor linkage: Limited relationship

The CDTFA administers the collection and disbursement of the pledged sales tax revenue. Per the indenture, the CDTFA collects the pledged revenue and remits it directly to the trustee, after deducting its administrative fee. Each month, the trustee deposits one-sixth of semiannual interest requirements into an interest fund, and one-12th of annual principal requirements into a principal fund, before remitting surplus pledged revenue to BART.

As a mass transit operating entity, BART has demonstrated a willingness and ability to adjust operating expenses as it deems necessary, such as in times of budgetary and/or economic expenses. In our view, mass transit entities are generally unique compared with other issuers of priority-lien debt, in that they have the ability to scale back overall expenditures to make room for debt service payments without otherwise reducing pledged revenue.

Although BART derives a larger portion of total revenue from fares (48.6% in fiscal 2018) than do many tax-backed transit systems, we believe BART maintains the ability to adjust its operating expenses without proportionately reducing its revenue. Labor, benefits, maintenance, and general operations of transit service make up the vast majority of BART's expenses. Even though nearly 50% of revenue comes from fares, we believe BART is able to preserve financial flexibility by reducing service, if needed, given the nature of its operations and very strong nonoperating revenue sources.

Rating linkage to BART's general creditworthiness

We assessed BART's general creditworthiness using our "Mass Transit Enterprise Ratings: Methodology And Assumptions," published Dec. 18, 2013.

In addition to the three counties that make up the district, BART also provides rail transit service to a portion of San Mateo County. BART's ridership levels followed a similar trend to its service area's economic activity in the years following the Great Recession. The growth continued through fiscal 2016, when ridership peaked at 433.4 million. However, total ridership declined over the past three years to 410.8 million in fiscal 2019. Overall, the past six-year trend (2.9% total growth) is more positive than that for many transit systems across the country. We believe the service area economy, especially the continued employment growth and rising road congestion, will continue to support BART's market position.

We consider BART well managed, with its managerial and financial policies credit supportive. Similarly, BART's strong ridership demand and robust nonoperating revenue streams have produced strong financial metrics in recent years, including all-in DSC and liquidity metrics. By our calculations, BART produced all-in DSC of 1.5x and days' cash on hand of 316 in fiscal 2018. Notwithstanding BART's many positive credit factors, we note that BART's history includes periods of labor strife that have disrupted operations, and we believe labor relations will remain a credit consideration for the district. However, we understand that management has proactively met 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.

Although several factors support BART's general creditworthiness, we believe financial metrics may face some pressure in the coming years as BART funds its large CIP. The current 15-year capital plan identifies BART's total capital investment needs at $22.4 billion, with $12.4 billion of identified funding sources, including the Measure RR authorization; various federal, state, and regional grants; and the system's operating allocations. The largest portions of the CIP include a rail car replacement program to replace BART's aging rail car fleet, and a program to implement a large number of rail station upgrades. Under Measure RR, approved by voters in 2016, BART retains $2.8 billion in general obligation (GO) debt capacity. We expect that, as BART issues debt to fund its CIP, its already high debt burden will increase materially. However, we expect BART will maintain an overall credit profile that supports the rating, benefiting from the various factors discussed above in this report.

Outlook

The stable outlook reflects our expectation that BART's general creditworthiness will be maintained at a level that does not constrain the rating on its sales tax bonds, even as its financial metrics may be pressured somewhat as the district funds its CIP. Furthermore, the outlook reflects our expectation that pledged sales tax revenue will continue to generate very strong MADS coverage on the bonds, materially stronger than required by its 1.5x ABT. We do not expect to raise or lower the rating within the two-year outlook period.

Upside scenario

We do not expect to raise the rating, given our view that BART's adequate ABT and that, although unlikely, BART could issue additional sales tax bonds to a level that could suppress coverage to a level we no longer consider very strong.

Downside scenario

Although we do not expect to lower the rating, we could do so if BART issues additional sales tax bonds to an extent that suppresses DSC to a level below what we consider very strong, or if BART's financial metrics materially worsen as it issues additional GO debt to fund its CIP, causing the OC rating to deteriorate by multiple notches.

Ratings Detail (As Of October 3, 2019)		
San Francisco Bay Area Rapid Transit District sales tax rev rfdg bnds ser 2016A due 07/01/2036		
Long Term Rating	AA+/Stable	Affirmed
San Francisco Bay Area Rapid Transit District SALESTAX		
Long Term Rating	AA+/Stable	Affirmed