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CREDIT OPINION
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Washington Metropolitan Area Transit Auth. DC

Update to credit analysis following upgrade to Aa3

Summary

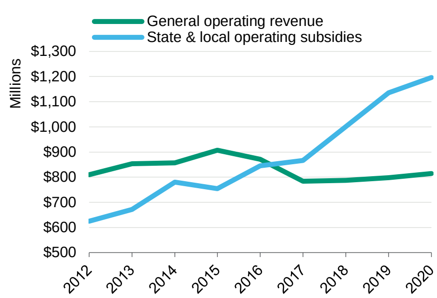
The Washington Metropolitan Area Transit Authority (WMATA; Aa3 stable) is the mass transit system serving the nation's capital region, which consists of the District of Columbia (Aaa stable) and several communities in Maryland (Aaa stable) and Virginia (Aaa stable). WMATA derives significant credit strength from the size and scope of its base, and from its operating environment, which is grounded in continued financial support from the district and the states. Last year, the District and the states agreed to new capital funding commitments that will help finance crucial infrastructure investments.

Because WMATA is reliant on operating subsidies and those subsidies are set to cover expenses not covered by primary operating revenue such as fares, the authority's operating margins tend to be very narrow. Subsidies from WMATA's governmental partners make up a growing share of its revenue and the steady governmental support mitigates challenges posed by the authority's negative ridership trend and weak, and at times negative, net revenue coverage of debt service. Debt service coverage on a gross revenue basis is very strong and liquidity, after improving in fiscal 2018, is satisfactory.

WMATA's debt burden is low, but it will likely rise as the authority embarks on its updated capital improvement plan. Still, given how modest the current debt burden is, we do not expect new borrowing will result in a substantial burden in coming years. A high unfunded post-employment liabilities burden, however, will remain a long-term credit challenge and could be a source of rising expenses in years to come.

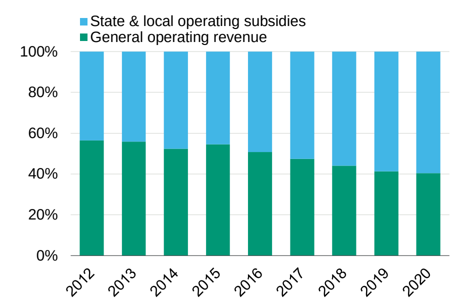
On June 14, we upgraded WMATA's bond rating to Aa3 and assigned a stable outlook.

Exhibit 1
State and local operating subsidies continue to rise...



Source: WMATA; 2019 and 2020 are budgeted

Exhibit 2
...and now make up 60% of WMATA's revenue



Source: WMATA; 2019 and 2020 are budgeted

Credit strengths

» Essential transportation system that serves the District of Columbia metropolitan area, which is home to the nation's capital

» Operating revenue consists largely of subsidies from highly rated state and local governments

» Capital funding commitments from the District of Columbia, State of Maryland and Commonwealth of Virginia will aid WMATA's financing of crucial infrastructure investments

Credit challenges

» Falling ridership that incorporates general changes in transit utilization across the US, but also WMATA's own recent capital maintenance campaign that required facility closures and service changes

» Elevated capital needs will push WMATA's leverage upwards

» High unfunded pension and OPEB burden

Rating outlook

The stable outlook reflects the strong financial support from the authority's state and local partners and the expectation that addressing outstanding capital needs will not place a substantial burden on WMATA's resources.

Factors that could lead to an upgrade

» Stabilized ridership that increases predictability of passenger fare revenue and enhances WMATA's operating flexibility

» Moderated pension and OPEB burdens coupled with capital improvement plan progress without a substantial increase in debt

Factors that could lead to a downgrade

» Diminished financial commitment from the authority's state and local government partners to WMATA's long-term operating and capital needs

» Budgetary imbalance that intensifies downward pressure on available liquidity

» Continued downward trend in ridership

Key indicators

Exhibit 3

Fiscal Year	2014	2015	2016	2017	2018
Annual Ridership (000)	340,601	341,536	321,061	301,071	289,370
Annual Ridership Growth	-0.7%	0.3%	-6.0%	-6.2%	-3.9%
Utilization (Trips/Population)	56	56	52	49	47
Farebox Recovery Ratio	50%	44%	45%	41%	38%
State and Local Subsidies as % of Revenues	47%	48%	50%	47%	53%
3-Year Average Fixed Costs as a % of Operating Expenditures	13%	13%	13%	13%	14%
Net Debt/Revenues (x)	0.46	0.48	0.51	0.42	0.50
3-Year Average Annual Debt Service Coverage by Net Revenues (GAAP) (x)	0.31	-2.08	-2.33	-1.38	0.58
Annual Debt Service Coverage by Net Revenues (GAAP) (x)	-0.08	-6.78	-0.11	2.75	-0.88
Annual Debt Service Coverage by Gross Revenues (Indenture) (x)	44.7	57.9	67.0	49.8	17.1
Days Cash on Hand (Including Unused Lines of Credit)	78	66	70	62	119
Days Cash on Hand (Excluding Unused Lines of Credit)	10	9	9	-10	54

Source: WMATA's annual financial statements and Moody's Investors Service

Profile

WMATA operates the second largest heavy rail system and sixth largest bus system in the US. It serves the Washington DC metropolitan area, which is home to 6.2 million people.

Detailed credit considerations

Size and market position

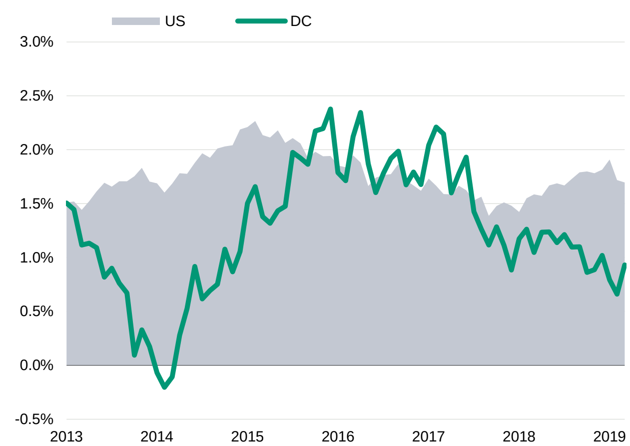
WMATA serves the vibrant and growing Washington DC metropolitan area. In addition to the District, the authority's service area largely consists of the affluent counties of Montgomery (Aaa stable) and Prince George's (Aaa stable) in Maryland, and Arlington (Aaa stable) and Fairfax (Aaa stable) in Virginia, but also portions of other communities. Since 2000, the population within the DC metro area grew at a compound annual rate of 1.5%. With a currently estimated population of 6.2 million, the metro area is the sixth largest in the US.

Over 2016 and 2017, job growth in the metro area was very strong and surpassed that of the nation (see Exhibit 4). Job growth has since slowed, but remains steady. While still very heavily concentrated in the federal government, the regional employment base has diversified. In fact, the change in federal employment over the past couple years has been negative, but more than offset by gains in private sector employment. Still, a large share of private sector employment is very closely tied to federal spending.

Exhibit 4

Employment growth in DC remains solid despite slowing relative to the US

Year-over-year growth in monthly nonfarm employment

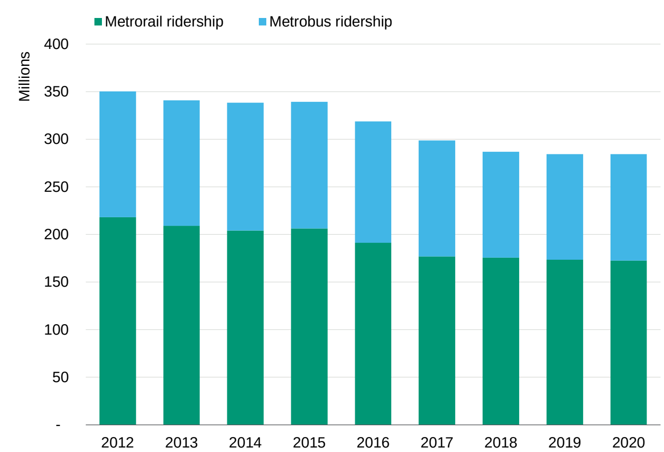


Source: US Bureau of Labor Statistics

Exhibit 5

Ridership across the two major modes of service is down over the past several years

Annual WMATA ridership



Figures for 2019 and 2020 are estimated and budgeted, respectively.
Source: WMATA

Despite the strengths of the underlying economic profile, WMATA's ridership has yet to completely stabilize (see Exhibit 5). This partly reflects a negative trend in transit utilization nationwide due to increased competition from other modes of transportation (taxis, ride sharing, bicycles) and service disruption as enterprises throughout the country engage in systemwide improvements.

More specific to WMATA, the authority undertook a very aggressive maintenance campaign in late fiscal 2016 to address critical safety issues. The initiative, known as SafeTrack, was completed in June 2017 and successfully consolidated three years of planned capital improvements into one year. However, the closure of stations and disruption in the normal travel schedule had a negative impact on ridership, particularly on rail services.

In both 2016 and 2017, rail ridership declined just over 7%, while bus ridership fell just over 4%. The 2018 drop in rail ridership was under 1%, but bus ridership fell almost 9%. The authority's amended fiscal 2019 budget assumes a 1.4% drop in rail ridership and a 0.3% drop in bus ridership. Through the third quarter of this fiscal year (March 2019), total ridership trailed budgeted assumptions by a modest 1.5%.

The continued fall in ridership may be due to residents sticking with other modes of transportation in the wake of SafeTrack's completion. The District of Columbia, in particular, has been very active in encouraging bike riding and sharing programs, and has established a large network of dedicated bicycle lanes.

Like the district and Maryland and Virginia, WMATA's geographic location exposes it to certain environmental risks, most notably flooding and rising heat. Rail stations have experienced flooding in past storms. The authority has incorporated flood proofing critical parts of its system into its long-term capital improvement plan. Further improvement may be made in conjunction with the district's Climate Ready DC plan.

Financial flexibility and metrics

With ridership down, the majority of WAMTA's revenue now consists of operating subsidies from its state and local partners. Positively, these partners consist of the fiscally strong District of Columbia and the states of Maryland and Virginia.[1] In addition to retaining their own financial strengths, the three partners continue to display commitment to supporting the operations of WMATA. The commitment of these jurisdictions to WMATA results in a strong operating environment for the authority.

The operating subsidy from WMATA's state and local partners grew, on average, 8% per year from fiscal 2012 through fiscal 2018. The amended 2019 budget increased the state and local subsidy 13.5% and the fiscal 2020 budget increases it 5.4% (see Exhibit 1 above). Whereas the operating subsidy made up 44% of WMATA's total operating revenue in fiscal 2012, the fiscal 2020 budget assumes it will make up 60% of revenue (see Exhibit 2 above). The state and local operating subsidy includes debt service costs allocated by the authority to its state and local partners.

Passenger fares make up 95% of WMATA's non-subsidy operating revenue. These non-subsidy operating revenues fell 4% in 2016 and another 10% in 2017. Operating revenue was stable in 2018 and the authority anticipates modest growth in the current 2019. Passenger revenue was trailing the budget 5% as of the third quarter of this year. But, this has been offset by spending also coming in 5% under budget.

In 2018, the District of Columbia, Maryland and Virginia passed legislation dedicating additional funds to WMATA. Starting in WMATA's fiscal 2020, which begins July 1, 2019, it will receive $500 million, in total, annually from the district and the two states. The new funding will play a crucial role in WMATA's capital investment strategy.

As part of their 2018 legislation to increase dedicated capital funding to WMATA, both Maryland and Virginia authorized their respective distribution agencies to withhold certain funding if WMATA adopts a budget that increases the aggregate baseline state and local operating subsidy more than 3%. This constraint does not apply to certain excluded expenses, new initiatives, or debt service. Because these exclusions are components of the fiscal 2020 increase in the state and local subsidy of 5.4%, the increase does not violate the 3% constraint.

WMATA has the authority to increase fares in an effort to boost revenue, but has not raised its fares for several years. Effective for fiscal 2020, the authority is restructuring some fares that will reduce the cost of some services, mostly bus service, for many commuters. The reduced costs may help retain current riders and stabilize ridership.

DEBT SERVICE COVERAGE

With a gross revenue pledge on outstanding bonds, WMATA's annual bond ordinance debt service coverage is very strong. Before an increase in debt service in fiscal 2018, the authority's gross pledged revenue covered debt service an average 55x over fiscal 2014-2017. Coverage fell to 17x in fiscal 2018. Debt service on outstanding bonds is fairly level at just over $71 million through fiscal 2035. Fiscal 2018 gross pledged revenue covers this amount of debt service nearly 25x.

On a net revenue basis, annual coverage of debt service has been much weaker (see Exhibit 2 above). Because WMATA is reliant on operating subsidies and those subsidies are set to cover expenses not covered by primary operating revenue, the authority's operating margins tend to be very narrow. This risk is mitigated by the strong source of the subsidies and those governments' continued commitment to the authority. However, narrow net operating margins result in very low coverage of debt service by net revenue. Assessment of coverage on a net revenue basis is consistent with our methodology for all mass transit enterprises and also recognizes that the authority could not operate if it did not cover its operating and maintenance expenses.

We also adjust reported net revenue to account for changes in reported net pension liabilities and other post-employment benefit obligations that are recorded as expenditures on a full accrual basis of accounting under GASB standards. These adjustments, which replace certain expenditures recognized on a full accrual basis with those actually made on a cash basis, result in negative adjusted net revenue for WMATA in some years. Though we view this as a credit weakness of the authority, this is another element that is mitigated by the direct operating support provided by the authority's governmental partners.

LIQUIDITY

WMATA's liquidity improved significantly in fiscal 2018 after hitting a low point in fiscal 2017 and we expect the authority will maintain satisfactory reserves. The authority's audited fiscal 2018 financial statements show current cash and investments of $383 million. With a reported $94 million of this balance in the form of unspent bond proceeds, WMATA closed fiscal 2018 with unrestricted cash and investments of $289 million. This was up from $101 million at the close of fiscal 2017, at which time the authority also owed $150 million on its short-term lines of credit.

WMATA has access to a total of $350 million in external liquidity via four 364-day revolving line of credit agreements with Bank of America, N.A. (Aa2(cr)/P-1(cr)), PNC Bank, N.A. (A1(cr)/P-1(cr)), SunTrust Bank (A2(cr)/P-1(cr)) and Wells Fargo Bank, N.A. (Aa1(cr)/P-1(cr)). The agreements mature in May 2020. The authority did not borrow from its revolving credit lines in fiscal 2018 or fiscal 2019.

Debt and legal covenants

WMATA's debt burden is modest, but may grow to accommodate capital investments. Current long-term debt is equivalent to 0.5x fiscal 2018 gross revenue. The authority's fiscal 2020 budget includes a six-year capital improvement plan (CIP) valued at $9.2 billion. WMATA anticipates financing $2.9 billion of these improvements with federal grants and the remaining $6.3 billion with state and local funding. This includes the new commitments from the District of Columbia, Maryland and Virginia to provide a total of $500 million per year in new capital funding. The authority has not yet determined how much of its CIP will be addressed with debt.

DEBT STRUCTURE

All of WMATA's long-term debt is fixed rate. WMATA's long-term bonds are secured by a senior lien on gross operating revenue of the enterprise. Bonds issued prior to 2018 were issued under an indenture that defines gross revenue as all of WMATA's general operating revenue (e.g. passenger fares) and state and local operating subsidies. It excludes from the pledge federal subsidies and capital contributions from state and local partners. The authority issued its 2018 bonds under a revised indenture that excludes from the gross revenue pledge the new dedicated capital funding from the district and the states. WMATA is not required to maintain a debt service reserve fund in support of its outstanding revenue bonds.

DEBT-RELATED DERIVATIVES

WMATA is not party to any debt-related derivatives.

PENSIONS AND OPEB

WMATA carries a heavy unfunded post-employment benefit liability burden, especially relative to other rated transit enterprises. Moody's adjusted net pension liability (ANPL), our measure of a public entity's pension burden, was $3.6 billion as of fiscal 2018. This was a high 2.0x fiscal 2018 gross revenue. As of fiscal 2018, WMATA also reported an unfunded OPEB liability of $2.1 billion, equivalent to another 1.2x fiscal 2018 gross revenue.

Eligible authority employees are members of one of five defined benefit pension plans administered by WMATA. Across the five plans, the authority's reported net pension liability in fiscal 2018 was $900 million. We calculate the ANPL by using a market-based interest rate to value accrued pension liabilities.

Given the modest amount of debt currently outstanding, post-employment benefit expenses comprise the majority of WMATA's annual fixed costs. In fiscal 2018, pension contributions and pay-go OPEB costs were 11.4% of operating expenses. Debt service was another 5% of operating expenses.

Operating environment and governance

WMATA is governed by a 16-member board of directors consisting of representatives of the District of Columbia, Maryland, Virginia and the federal government. The board is split into eight voting directors and eight alternate directors. As discussed above, more than half of WMATA's operating funding now comes from subsidies appropriated by its state and local partners. Recent action by the district, Maryland and Virginia to commit new capital funding to WMATA illustrates regional support for the transit enterprise.

Though the new capital funding is accompanied by a constraint on annual growth in operating subsides from Maryland and Virginia, we expect WMATA will make the necessary operating adjustments to maintain financial stability. The authority recently initiated a multiyear bus service study to identify potential route and schedule adjustments. Increasing the efficiency of services could positively impact ridership while simultaneously controlling growth in operating costs. Progress along the authority's CIP could achieve the same. During fiscal 2017, the authority cut its workforce 6% to better align spending with its revenue intake.

Endnotes

1 Virginia distributes its funding to WMATA through its local governments that are served by the authority - Arlington County, Fairfax County, and the cities of Alexandria (Aaa stable), Fairfax (Aaa stable) and Falls Church (Aaa stable).

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