FitchRatings

RATING ACTION COMMENTARY

Fitch Rates WMATA's Dedicated Revenue Bonds 'AA'; Outlook Remains Negative

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Fitch Ratings - New York - 12 Jan 2023: Fitch Ratings has assigned a rating of 'AA' to the Washington Metropolitan Area Transportation Authority's (the authority or WMATA) $392,000,000 of dedicated revenue bonds, series 2023A (green bonds - climate bond certified). The bonds are expected to price the week of March 6 via negotiation. Proceeds will finance a portion of the 2023-2028 capital program.

Fitch has also affirmed the 'AA' rating on WMATA's outstanding dedicated revenue bonds and pre-2018 gross transit revenue bonds, and the 'AA-' rating on the outstanding gross transit revenue bonds, series 2018 and Issuer Default Rating (IDR).

The Rating Outlook Remains Negative.

The rating distinction amongst the outstanding gross revenue transit bonds reflects the additional pledge of dedicated capital funds for the pre-2018 bonds (see below for more information on the bonds' security provisions).

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Washington Metropolitan Area Transit Authority (DC) [General Government]	LT IDR	AA- Rating Outlook Negative	Affirmed	AA- Rating Outlook Negative

Washington Metropolitan Area Transit Authority (DC) /Issuer Default Rating - General Government/1 LT	LT	AA- Rating Outlook Negative	Affirmed	AA- Rating Outlook Negative
Washington Metropolitan Area Transit Authority (DC) /Transportation Revenues - Dedicated Revenues/1 LT	LT	AA Rating Outlook Negative	Affirmed	AA Rating Outlook Negative
Washington Metropolitan Area Transit Authority (DC) /Transportation Revenues - Non Dedicated Revenues/2 LT	LT	AA- Rating Outlook Negative	Affirmed	AA- Rating Outlook Negative
Washington Metropolitan Area Transit Authority (DC) /Transportation Revenues/1 LT	LT	AA Rating Outlook Negative	Affirmed	AA Rating Outlook Negative

VIEW ADDITIONAL RATING DETAILS

SECURITY

The dedicated revenue bonds are backed by a lien on the dedicated capital revenues established under the 2020 bond resolution and payable to the authority pursuant to statutes enacted by the District of Columbia (the district), the Commonwealth of Virginia and the State of Maryland (collectively, the states), subject to annual appropriation.

The statutory dedicated capital funding revenue allocation is as follows: $178.5 million from the district payable from its general sales tax revenue, $167 million from Maryland payable from the Maryland Transportation Trust Fund (TTF), and $154.5 million from Virginia (approximately $30 million of which is not available for debt service) payable from various regional taxes on transient accommodations, wholesale fuel purchases, real property transfers, and sales and use taxes.

The pledge of the dedicated capital revenues is subordinate to approximately $617.6 million of outstanding gross revenue transit bonds, series 2017AB to the extent necessary to make up any deficiency in gross transit revenues pledged under the 2003 gross revenue bond resolution (which includes all transit system operating revenues and operating subsidies received from the states and participating local governments within the WMATA transit zone). No additional pre-2018 obligations (including refunding bonds) shall be issued under the 2003 gross revenue bond resolution with a lien on the dedicated capital revenues.

KEY RATING DRIVERS

Analytical Conclusion: The 'AA' rating on the authority's dedicated revenue bonds is based on a dedicated tax bond (DTB) analysis of the underlying revenue streams that support each state's capital funding commitment, and the general credit quality of the authority as expressed through its Issuer Default Rating (IDR).

Each state is allowed, but not required, to proportionally reduce its dedicated capital funding contribution if another does not pay its full amount. As such, the rating reflects a weak link approach to the dedicated tax analysis. Furthermore, each state's dedicated capital funding contribution is subject to appropriation establishing a cap at one notch below the lowest of the district and the states' IDRs. Fitch's IDR on the district is 'AA+'/Stable and Fitch rates both Maryland and Virginia 'AAA'/ Stable.

Rating Link to Authority IDR: The authority was created by an interstate compact through legislation passed by the district, Maryland, Virginia and the U.S. Congress, the effect of which, in Fitch's opinion, is to grant the authority sovereign-like powers and to make it ineligible for bankruptcy or other insolvency proceedings.

Fitch's criteria allow for the rating on the dedicated revenue bonds to be above the authority's 'AA-' IDR because the dedicated capital funding revenues are segregated from the authority's operations, statutorily restricted for "state of good repair" projects and prohibited from being used for operating expenses. However, the degree of notching above the IDR is limited given our view that the flow of dedicated capital funding revenues could become vulnerable to impairment in a fiscal emergency. The Negative Outlook on the dedicated revenue bonds reflects the Outlook assigned to the authority's 'AA' IDR.

Authority IDR Analysis: WMATA's Outlook remains Negative, reflecting risk associated with a sizable structural imbalance driven by improved but still low system ridership and passenger revenues and rising expenses. Approximately 30% of the nearly $2.3 billion FY23 (June 30 year-end) operating budget is supported by federal stimulus, with the remaining balance expected to be depleted in FY24 resulting in a FY25 forecasted budget gap of $738 million.

There is some downside risk to the FY25 budget gap projection as it assumes ridership improving to 75% of fiscal 2019 levels compared with the current 55% trend. A rating downgrade of one or more notches is probable within the next 12 months absent significantly higher levels of ridership and passenger revenue, which Fitch views as unlikely, or the enactment of a plausible gap closing plan including new recurring operating resources in order to stave off significant service cuts.

Credit strengths center on the 'stronger' revenue defensibility assessment underpinned by the strength and stability of financial support provided by highly rated participating jurisdictions, which are obligated (subject to certain restrictions) to cover the operating and capital costs of the transit system from its legally available funds, subject to annual appropriation. The assessment also reflects the authority's strong pricing characteristics including its full rate-setting authority, strong market position, and the essentiality of mass transit service within a large and diverse economy anchored by the federal government and ancillary private sector businesses.

The 'midrange' assessment of the authority's operating risk profile reflects its significant capital needs and track record of system performance and safety incidents, rapidly rising but still manageable pension costs, and constraints imposed by collective bargaining agreements and a labor framework featuring binding arbitration. Service reductions and layoffs represent the most meaningful of the authority's cost-cutting tools, but Fitch views these as difficult to implement given prospects for significant consumer, political and labor push back.

The authority's debt position will continue to rise sharply with incremental debt issuance funded via the dedicated capital funding commitment. The FY23-28 capital investment plan totals $14.0 billion, of which approximately $4.4 billion will be funded by dedicated revenue bonds including subordinated lien indebtedness. Fitch expects the ratio of overall net leverage (inclusive of the authority's net pension liabilities) to gross pledged revenues to increase from a low 2.2x in FY22 to approximately 5.8x in FY27 based on its forecast budget deficits, which would approach the upper range of the 'aa' category.

Fitch expects the authority will align the timing and amount of capital spend in response to available resources, but larger-scale reductions in capital investment would likely have adverse credit implications. WMATA's ability to successfully execute its capital plan and correct certain management and internal control deficiencies that have plagued it in the past is important to restoring and maintaining the confidence of its ridership base and the states and local jurisdictions that fund its operating and capital budget.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--For the dedicated revenue bonds, positive action on the authority's IDR (assuming sustained high resilience of the structure to Fitch revenue scenarios);

--For the IDR, the enactment of new recurring operating revenues in conjunction with other authority policy actions that sufficiently address its out-year budget gaps.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--For the dedicated revenue bonds, a decline in dedicated capital funding below the statutorily prescribed amounts, or a weakening in the overall credit profile of the authority;

--For the IDR, failure to enact new recurring operating revenues and other gap closing measures ahead of the development of the 2025 budget;

--For the IDR, a shift in Fitch's view of the mass transit system's essentiality to the regional economy, suggested by a lack of progress closing the ridership gap to pre-pandemic levels or evidence of weakened support for the authority's operating and capital budget by the states and/or participating jurisdictions;

--For the IDR, growth in long-term liabilities, including unfunded pensions, absent a commensurate increase in fiscal resources that constrains the authority's operating budget and spending flexibility.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CREDIT PROFILE

IDR Current Developments

The operating budget for FY23 totals $2.28 billion (an increase of 8.7% from the FY22 budget) and is funded $293.1 million in passenger revenue (44% of FY19), $1.2 billion in participating jurisdiction contributions (compliant with the 3% annual cap) and $672.8 million in federal stimulus. WMATA was allocated $2.57 billion in federal stimulus that has been used to avoid substantial service cuts and workforce reductions following the onset of the pandemic. Stimulus funds have also bolstered the authority's liquidity, which approximates $490 million in January 2023 excluding $350 million in undrawn capacity under separate lines of credit.

The authority reports FY23 passenger revenues are only $2.7 million below budget ytd notwithstanding the impact of service reductions stemming from the October 2021 derailment of a 7000-series railcar. The authority has gradually restored the 7000-series fleet to service and in November it launched the Silver Line Phase II service opening six new stations in Loudoun County and providing a new connection to Washington Dulles International Airport. Furthermore, the FY24 budget proposals target more frequent rail and bus service, a simplified fare system and discounts for low-income riders. These developments could provide a boost to ridership which had improved to 56% of pre-pandemic levels for the month of October compared with 32% in March. The FY23 budget assumed 53% ridership recovery followed by 65% in FY24 and 75% in FY25, which is consistent with other large U.S. mass transit agencies.

The proposed FY24 budget forecasts a $185 million gap the authority plans to close by using $139.1 million of Infrastructure Investment and Jobs Act funds (on top of $561 million in ARPA money) together with $10 million in cost savings from efficiencies and vacancy eliminations and approximately $35 million from improved passenger and non-passenger revenue performance.

The authority forecasts a worsening fiscal condition in FY25 with a budget gap estimated at $738 million, which reflects the depletion of federal stimulus, inflationary pressures, and contractually bargained wage and step increases. Passenger revenues are forecast to improve to $439 million (66% of FY19 or a $227.3 million gap). The authorization of additional operating revenues ahead of the FY25 budget is critical to rating stability given the scale of the authority's projected deficits in relation to reasonably anticipated and controllable cost saving measures, including service cuts.

Dedicated Revenue Bond Profile

Given the legislative condition by which the states can proportionately reduce their dedicated capital funding commitment based on a payment reduction of another, Fitch's dedicated tax analysis is based on a "weak link" approach applied to the underlying revenue streams that support each state's respective dedicated capital funding revenues. The dedicated capital funding revenues are non-reverting once appropriated and statutorily authorized exclusively for the authority's capital program and the payment of debt service (with the exception of approximately $30 million from Virginia not available to pay debt service). Pursuant to the resolution, the revenues will be deposited into a restricted account of the authority and segregated from its transit operating revenues and the operating and capital subsidies it receives from the states and the participating jurisdictions.

The dedicated capital funding revenues are derived from various sources identified in each state's dedicated capital funding legislation. Once appropriated, the dedicated capital funding revenues are non-reverting and statutorily authorized exclusively for the authority's capital program and the payment of debt service. The revenues will be deposited into a restricted account of the authority and segregated from its transit operating revenues and operating and capital subsidies.

The district has agreed to fund $178.5 million annually from its general sales tax revenue, payable semiannually on Oct. 1 and April 1, once appropriated. The district's general sales tax revenues are estimated at $1.66 billion in FY22, or 9.3x the required contribution. Maryland's legislation states that the governor is required to budget and seek an appropriation annually of $167 million from revenues in the TTF established to support the Maryland Department of Transportation. TTF revenues include a combination of fuel tax, motor vehicle titling tax, operating funds, motor fuel license and registration fees, and corporate income taxes, among other sources, are estimated at $3.6 billion in FY22 or 21.6x the required contribution.

Virginia Revenues Key Driver of Dedicated Tax Analysis

Virginia's legislation directs a combination of regional revenues to be paid into the state treasury and credited to a WMATA capital fund to be released to the authority on a monthly basis pending certification of various capital and financial audits of the authority. Virginia's WMATA capital fund is to be funded annually with local transportation sales tax revenues, a regional recordation fee equal to $0.10 for each $100 of value of the related real property, a regional transient occupancy tax (TOT) equal to 3c% on the amount of the charge for any dwelling or lodging room or space, and a regional wholesale fuel tax imposed on each gallon of fuel sold based on a rate established by the Commission of the Department of Motor Vehicles.

The local transportation sales tax revenues are fixed at $27.12 million per annum, whereas the other sources are variable. Fitch expects the regional taxes to narrowly cover Virginia's $154.5 million dedicated capital funding obligation (of which $30 million is restricted and unavailable for debt service). The authority reports that it has received all dedicated capital funding revenues in full and on time through 2022. However, in FY21, the commonwealth allocated bond proceeds to remedy an estimated

$17.6 million shortfall primarily due to declining TOT post-pandemic. The commonwealth also enacted a budget amendment to appropriate up to $32.4 million to address any deficiencies that might have materialize in FY22.

Any deficiency in Virginia's full share of the dedicated capital funding revenue would have entitled, but not required, the district and Maryland to proportionately reduce their contributions. Fitch views the commonwealth's actions to address realized and potential funding deficiencies as supportive to maintaining credit quality, without assuming a similar response in the future. Virginia is required to notify the authority if it determines at any time the amount held in its WMATA capital fund will not be sufficient to pay the contribution in full, and it will agree to meet with representatives from the authority, Maryland and the district to determine an appropriate course of action, but there is no other legal recourse available to the authority to ensure full payment of the dedicated capital funding revenues from the other two states.

Dedicated Revenue Growth Prospects

Fitch anticipates revenue growth consistent with long-run inflation (equivalent to an 'a' assessment) based on Fitch's view of Virginia's regional tax revenues, and more specifically the volatility inherent in the recordation and TOT revenues, pressure on fuel taxes from fuel efficiency technologies and regulatory standards, and the fixed dollar nature of the regional sales tax.

Dedicated Revenue Bond Resilience

Fitch's 'aa' resilience assessment reflects the significant cushion and tolerance for pledged revenue decline based on MADS coverage approximating the 4.0x ABT requirement following issuance of the series 2023 bonds. Fitch estimates the dedicated capital funding totaling $470 million ($500 million less the restricted portion of Virginia's annual contribution) could decline by 75% before reaching 1.0x MADS.

District general sales tax revenues and Maryland TTF revenues exhibited modest revenue volatility with the largest cumulative pre-pandemic declines dating back to FY05 registering just 4.5% and 5.3%, respectively. Fitch's analysis of Virginia's regional taxes is based on a proxy analysis due to insufficient historical data, yielding a high historical stress of nearly 28% driven by large declines in recordation tax revenues from FY07-FY10 due to the Great Recession. The 75% coverage cushion would approximate 2.7x the 28% revenue decline, which Fitch considers consistent with an 'aa' resilience assessment.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 04 May 2021) (including rating assumption sensitivity)

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 01 Sep 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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