FitchRatings

Fitch Rates WMATA's $236MM Gross Rev Transit Bonds 'AA-'; Outlook Stable

Fitch Ratings-New York-05 November 2018: Fitch Ratings has assigned a 'AA-' rating on the following revenue bonds to be issued by the Washington Metropolitan Area Transit Authority (the Authority or WMATA):

-- $236,390,000 gross revenue transit bonds, series 2018.

Fitch has also affirmed the 'AA-' rating on approximately $694 million of outstanding gross revenue transit bonds, series 2017A-1, 2017A-2, and 2017B.

The Rating Outlook is Stable.

The series 2018 bonds are expected to price on November 29. Proceeds will be used to finance various capital projects and pay capitalized interest on the bonds.

SECURITY

The series 2018 bonds are backed by a pledge of the trust estate established pursuant to the 2003 gross revenue bond resolution on parity with the Authority's outstanding gross revenue transit bonds, except that the series 2018 bonds and all other bonds issued under the resolution on or after Nov. 15, 2018 will not have a lien on "future dedicated revenues" as described below.

The trust estate generally includes all transit system operating revenues (fares, rents, etc.) and amounts received from the District of Columbia and the participating local governments within the WMATA transit zone in respect of the Authority's operating budget, not including future dedicated revenues. The participating local governments, within the Commonwealth of Virginia, are the cities of Alexandria, Falls Church and Fairfax, the counties of Arlington and Fairfax, and political subdivisions located within those counties, and within the State of Maryland the counties of Montgomery and Prince George's, and political subdivisions of the state located within those counties (collectively, the Participating Jurisdictions).

Future dedicated revenues are defined as all amounts to be received by the Authority pursuant to legislative enactments by the District of Columbia, the Commonwealth of Virginia, and the State of Maryland in March 2018, which established an aggregate $500 million annual funding commitment for Authority capital projects, and any other funding sources paid to the Authority by the District, Virginia, Maryland, or any political subdivision under any legislative enactment taking effect on or after Nov. 15, 2018.

ANALYTICAL CONCLUSION

Analytical Conclusion: The 'AA-' rating reflects the Authority's strong legal and regulatory framework resulting from its creation through an interstate compact, which grants it sovereign-like powers and exemption from all laws and orders of its signatories, with limited exceptions related to the inspection of equipment and facilities, safety and testing, use of streets, highways, and vehicular facilities, traffic control and regulation, zoning and signs and buildings.

The 'AA-' rating also reflects the Authority's relatively low leverage despite an uptick in expected issuance, as it has mostly financed its capital investments on a pay-go basis historically. Under fairly conservative debt issuance assumptions, Fitch expects the ratio of net debt and other long-term liabilities to pledged gross revenues to remain comfortably within a range considered satisfactory for the 'AA-' rating. The Authority's leverage profile is considered in the context of its overall risk profile, with a revenue defensibility assessment of 'strong' and operating risk assessment of 'midrange' (see below for more information). Given this holistic approach, combined with the Authority's legal framework and bondholders' gross lien on revenue, Fitch does not make a rating distinction between the outstanding bonds and the current offering despite the absence of a lien on future dedicated revenues for the new bonds.

KEY RATING DRIVERS

Revenue Defensibility: Stronger
The Authority's revenue framework is underpinned by the financial support provided by highly rated Participating Jurisdictions, which are obligated to cover the operating and capital costs of the transit system from its legally available funds, subject to annual appropriation. If a Participating Jurisdiction were to fail to timely make a required subsidy payment, the Authority board could decide to hold a public hearing as to whether to terminate the provision of transit system service within the Participating Jurisdiction. The Participating Jurisdiction's operating subsidies are paid on a quarterly basis and its proportionate share is determined pursuant to a formulaic calculation incorporating transit mode, ridership, revenue miles, and other system measures.

The remainder of the Authority's operating revenues is largely derived from passenger fares over which it has full legal rate control. Periodic fare increases have been adopted by the Authority and fares remain reasonable in the context of comparable U.S. mass transit systems and the income characteristics of the service area. Fare revenues are likely to be sensitive to political and passenger resistance as the Authority addresses deferred capital investment that will likely necessitate additional cuts to service. Recent ridership trends have been very weak in large part due to service quality and reliability concerns but Fitch believes demand growth will be marginally positive over the long-term based on the region's significant congestion problems and favorable economic and demographic projections.

Operating Risk: Midrange
Labor and fringe benefit costs are the main drivers of the Authority's operating budget. The Authority retains full legal control to reduce its workforce but it is otherwise constrained by collective bargaining agreements and a labor framework featuring binding arbitration, which increases the potential volatility of the Authority's operating costs over time. Pension costs have risen very rapidly during the prior decade but still remain at a manageable level. However, continued escalation of pension costs represents a risk to the Authority's operating margins and financial flexibility, particularly in the context of the weak fare revenue environment and a new 3% cap on the Participating Jurisdictions' operating subsidy that was instituted as part of the March 2018 dedicated revenue legislation.

Capital needs are significant at roughly $15 billion over 10 years, albeit more tenable following the establishment of the dedicated revenues. The capital plan is weighted toward projects to improve the system's reliability and safety, which Fitch views as less flexible with respect to the timing of delivery. The Authority's ability to successfully execute its capital plan and correct certain management and internal control deficiencies that have plagued it in the past should help determine the extent to which it can restore and maintain both service reliability and ridership going forward.

Financial Profile: Stronger
Fitch's financial profile assessment reflects the protection afforded bondholders from the gross lien on revenue and the Authority's status as an interstate compact, the effect of which, in Fitch's opinion, is to make the Authority not subject to bankruptcy or other insolvency proceedings. Current financial leverage is fairly low, particularly for a mature transit system, which translates to a solid capacity for the Authority to incur additional indebtedness to fund its capital program going forward. Net debt and other long-term liabilities (inclusive of the Fitch-adjusted net pension liability or NPL) are measured at 1.6x fiscal 2018 gross revenues of approximately $1.8 billion (unaudited). The Authority's financial leverage remains below 4x in Fitch's rating case scenario. The coverage of MADS from gross fiscal 2018 revenue is estimated at almost 25x following issuance of the series 2018 bonds.

Asymmetric Additive Risk Factors
There are no asymmetric additive risk factors applied in this rating determination.

RATING SENSITIVITIES

Revenue Defensibility: A change in the Authority's revenue defensibility assessment to 'midrange' from 'stronger' would pressure the rating. A change in the assessment could result from a shift in Fitch's view of the mass transit system's essentiality to the regional economy, suggested by sustained declines in ridership or loss of political support, for example.

Operating Risk: A change in the Authority's operating risk assessment to 'weaker' from 'midrange' could pressure the rating. A change in the assessment could result from a rapid escalation and volatility in system costs in the absence of a concomitant increase in resources, or a decline in the operating margin and debt service coverage ratio. Another key consideration is the Authority's ability to fund and execute its substantial capital program and maintain the system in an ongoing state of good repair.

CREDIT PROFILE

The Washington Metropolitan Area Transit Authority was created in 1967 through an interstate compact or matching legislation passed by the District, Virginia, and Maryland and then ratified by the U.S. Congress. The Authority is responsible for the development, financing, and operation of mass transit facilities, consisting of a rapid rail system (Metrorail), a bus transit system (Metrobus), and a paratransit service (MetroAccess) in the national capital area. The Authority uniquely exists as an agency and instrumentality of the District, Virginia, and Maryland, each of which, along with the federal government, appoint two voting directors and two alternate directors to the WMATA board of directors. The WMATA operating and capital budgets are primarily funded from a combination of operating revenues, mostly passenger fares, and subsidies received from the Participating Jurisdictions.

Revenue Defensibility
The WMATA ridership in fiscal 2017 (June 30 year-end) was 301.1 million passengers or roughly 1.16 million average weekday riders. Rail and bus service accounted for close to 59% and 40% of total system ridership, respectively. The WMATA serves an integral role within the capital region, given the lack of mass transit alternatives and severe congestion problems that have long plagued the area. System ridership had been characterized by fairly stable but low growth. However, ridership began to contract in fiscal 2013 and current trends remain weak. Ridership is down more than 15% since fiscal 2013 and is reportedly at its lowest point in more than 20 years. Ridership is down broadly across all time periods, days of the week, and individual stations.

Lower demand is attributed to a myriad of factors, including a series of serious rail incidents, some of which resulted in passenger and employee fatalities and serious injuries and a number of safety directives and recommendations actions by the Federal Transit Administration and the National Transportation Safety Board. The WMATA initiated its SafeTrack program in June 2016 to achieve safety and state of good repair of basic track structure by accelerating the completion of three years of maintenance investment in 12 months, which triggered an expansion of track-work hours and line segment shutdowns during off-peak hours where the bulk of ridership losses occurred.

The WMATA is reporting an uptick in system performance metrics and customer satisfaction in fiscal 2018 and a more moderate 1.1% decline in system ridership on the year. Rail was up almost 1% offset by a 4% decline in bus, which Authority officials attribute to congestion problems rather than price or service. The WMATA reports its bus system's average age of fleet at five years, which is below the nearly eight-year average for U.S. public transportation systems reported by the American Public Transportation Association.

The Authority has recently installed Wi-Fi connectivity in all underground stations, installed new lights on platforms to increase visibility, and funded a 'Rush Hour Promise' that will automatically credit rail customers for trips that are delayed more than 15 minutes as part of a broader plan to improve the overall customer experience. Ridership is expected to decline further in fiscal 2019 (a projected decline of 3.7%) and gradually stabilize over the next several years as the Authority implements capital repairs and improvements. Fitch believes the WMATA ridership projection could still be optimistic despite some favorable momentum, given pressures stemming from growth in the popularity of ride-sharing platforms like Uber and Lyft, online shopping, and telecommuting, among other factors.

Fitch believes the Authority holds a quasi-monopolistic position in regard to mass transit service within the capital region, notwithstanding some competition from private bus operators which the Authority estimates hold a roughly 20% market share. The WMATA has made a significant investment in its capital infrastructure with non-current capital assets reported at almost $15 billion in fiscal 2017. The rail system spans 118 miles, 91 stations, and over 1,144 rail transit vehicles in operation. Rail operation began in 1976 but the originally planned 103-mile system was not completed until 2001. The Blue Line (3.2 miles) and Silver Line Phase I (11.6 miles) extensions to the system were completed in 2004 and 2014, respectively. Rail operations are scheduled to expand with the opening of phase II of the Silver Line in April 2020 (11.4 miles) and Potomac Yard in April 2021. Construction of the Silver Line, with an estimated price of nearly $6 billion, is largely supported by a full-funding grant agreement with the FTA, toll revenues, and contributions from other funding partners including Loudoun County, VA (AAA/ Stable), which will become a Participating Jurisdiction with the opening of phase II.

Over the long term, Fitch would expect to see a return to moderate ridership growth given the strength of the underlying economy. The Authority's service area lies at the center of the Washington D.C. metro area, one of the strongest regional economies in the U.S. The capital region has proven resilient to federal volatility, including sequestration and a federal government shutdown. Continued private sector expansion, supported by robust population growth and favorable demographic trends (including a high concentration of skilled labor and high median household income), offsets the exposure to federal spending.

The WMATA has full independent legal authority to adjust transit fares. Rail fares vary by time of day and the distance between stations, while bus fares are fixed throughout the day but are higher for express service. Fares are typically adjusted every other year with the current rail and bus fare of $2.25 and $2.00, respectively, in effect since fiscal 2018. Fitch believes rail and bus fares remain reasonable relative to comparably sized U.S. mass transit systems.

Fare revenues were equivalent to 40% of operating expenses and annual debt service in fiscal 2017 (audited fiscal 2018 information is not available yet). Ridership declines have had a very negative impact on fare revenue, which had fallen more than $110 million or 13% in fiscal years 2016 and 2017 in aggregate. As ridership is expected to remain challenged in the near term, the Authority will remain constrained in its capacity to recover cost increases through higher base fares, limiting the fiscal benefit of this budgetary tool. For fiscal year 2018, the WMATA estimates a loss of approximately $46.7 million in operating revenues (less than 3%) as a result of service reductions.

Growth in the jurisdictional subsidies, which has historically been open-ended, began to rise sharply in recent year in order to offset weaker fare revenues and increased system costs. However, the dedicated capital funding legislation adopted by the District, Virginia, and Maryland in March 2018 limits increases in the jurisdictional operating subsidy to 3% per year beginning with the Authority's fiscal 2020 budget. The 3% cap is subject to certain exclusions, for court orders and compliance actions, for example, and spending growth associated with new service provision would also be exempt from the 3% cap. The 3% cap will place pressure on the Authority to stabilize its ridership base and/or control its expense line. The fiscal 2019 budget increases spending by 2.3% over the prior year, and includes a 3.6% increase in the jurisdictional operating subsidy. The Authority has taken action in its fiscal 2019 budget to stay within the 3% cap going forward, including $25.5 million in base cost reductions, $5 million in overtime cost controls, and an $8 million increase in non-transit revenues (including advertising revenue and greater utilization of parking assets).

Fitch views the jurisdictional subsidies as a stable revenue stream and a credit positive. The jurisdictional contributions are subject to annual appropriation; however, Fitch considers the risk to non-appropriation as very low. The Participating Jurisdictions are effectively represented by the respective state appointees to the WMATA board of governors, and therefore have some influence on the annual subsidy amount. An event of non-appropriation would risk termination of service, which the agency views as a significant incentive to appropriate. Since 1970, when the Participating Jurisdictions first had funding obligations to the WMATA, no Participating Jurisdiction has failed to make (either on time or within a few days of the payment date) a required quarterly operating subsidy payment with the exception of one instance in 1993 in which the District was one month late in making a payment.

Jurisdictional subsidies are budgeted at almost $1.06 billion in fiscal 2019 (net operating subsidy and debt service). The District (IDR: AA+/Stable) is the largest single contributor at $393.2 million followed by Prince George's County (AAA/Stable) at $223.1 million, Montgomery County (AAA/Stable) at $181.1 million, and Fairfax County (AAA/Stable) at $145.4 million. Operating subsidies to the WMATA currently represent a modest portion of the Participating Jurisdiction's general fund budget (roughly 5% or lower).

Furthermore, as a condition of receiving federal funds to finish construction of the rail system a 1980 federal law (the Stark-Harris Act) required that each Participating Jurisdiction identify an ongoing source of revenue to finance its contributions to the Authority. In many cases the amounts used by the Participating Jurisdictions to fund the WMATA operating and capital needs are derived from gas taxes or restricted state aid allocations, and not discretionary general fund resources.

Operating Risk

Employee wages and benefits account for more than 70% of the WMATA operating budget, and the Authority estimates that 85% of that amount is set forth within the terms and conditions of its five separate collective bargaining agreements. The WMATA has a workforce of approximately 12,100 positions, roughly 7,600 of which are categorized as bus and rail operators and maintenance and construction staff. Headcount is down about 6% in fiscal years 2017 and 2018 mostly due to the elimination of vacant positions following cost-saving initiatives instituted. The Authority operates within a fairly rigid labor environment, albeit one that is common to many public enterprise systems within the U.S. More than 80% of the WMATA workforce is represented by one of five labor unions. Union representation and bargaining conditions are governed by the WMATA compact and the collective bargaining agreements are subject to final and binding arbitration. The WMATA has not experienced an employee strike or work stoppage since 1979.

In recent years, growth in the Authority's operating costs have outpaced its operating revenue by a considerable margin, even though recent wage increases reached via negotiation and arbitration award, have been in a reasonable range relative to the operating budget. Wage increases have also been offset by increases in the employee contribution for healthcare coverage. The more pressing item from a credit perspective is the WMATA's failure to achieve reform to its pension system. Annual pension contributions have risen by a CAGR of 19% from $25 million in fiscal 2006 to $168 million in fiscal 2017. Pension costs were lower at $144 million in the fiscal 2019 budget (8% of operating spending) due to the aforementioned reduction in personnel.

Going forward any meaningful change to the WMATA's pension systems would likely require legislative action given the existing labor-related arbitration process. The WMATA may also explore outsourcing as an alternative measure to control its pension-related liabilities. In a declining ridership and fare revenue environment, rapidly escalating pension costs could potentially constrict the Authority's operating margins and liquidity, and consume resources that would have otherwise been available to fund capital investment or other system service initiatives.

The Authority operates within one of the largest economies and labor markets in the U.S. There are no apparent supply constraints for labor, commodities, or equipment, and excellent transportation/utility infrastructure exists to service its operating and capital needs.

The Authority's capital investment outlook has improved significantly with the establishment of the new dedicated revenues -- a $500 million annual commitment shared between the District, Virginia, and Maryland specifically for capital projects. The Authority was previously the lone major mass transit system in the U.S. without a dedicated long-term funding source for operations and/or capital.

The dedicated revenues, which the Authority will begin to receive in fiscal 2020, will help fund the $8.5 billion adopted capital improvement plan (CIP) for fiscal years 2019-2024. The CIP includes more than $1.5 billion for a program to refurbish and replace its older series rail cars. The Authority reports approximately 50% of its railcars were placed into operation between 2015 and 2018 (although many are scheduled to be rotated out of service already to address wiring defects), and has recently solicited proposals for up to 800 new railcars for delivery starting in 2024, which would leave it with a very low average age of fleet. The CIP also funds $1.7 billion for bus and paratransit acquisition, overhaul, and facilities, $860 million for signals, communication, and propulsion systems, and $1.2 billion for rail and track structures.

The dedicated revenues will not replace, but are additional to, the existing capital subsidies paid by the Participating Jurisdictions pursuant to the terms of the WMATA compact and certain capital funding agreements. The Participating Jurisdiction's contribution to the CIP is projected at more than $6.1 billion in total, including required matches to federal grants, and unmatched capital funds related to locally requested and funded investments. Current active jurisdictional projects include the development of the Purple Line in Maryland and Union Station improvements. Other funding sources for the CIP include federal formula grant funding (assumed at current levels or $1.9 billion over the five-year program) and PRIIA funding at $150 annually through fiscal 2020 (coinciding with the termination of the current authorization period).

The Authority has taken several measures to improve its capacity to deliver capital projects implementing changes in its procurement and project management processes. The Authority reports spending 96% and 99% of its capital budget in fiscal 2017 and fiscal 2018, respectively, compared to a spend rate of roughly 60% in the preceding five-year period.

Financial Profile

Unrestricted cash and investments are fairly modest with just $101 million or about 20 days of operating expenses reported at the conclusion of fiscal year 2017. The Authority's unrestricted cash and investments in fiscal 2017 were down from the prior five-year average of almost $240 million due to certain capital and maintenance outlays, and efforts to limit the increase in the jurisdictional subsidy requested. The Authority has certain available lines of credit (LOC) with Wells Fargo, PNC Bank, Bank of America, and SunTrust Bank in the aggregate amount of $350 million to supplement short-term working capital needs to a level Fitch views as satisfactory. There is no balance drawn against the LOCs, which were renewed in May 2018 for a one-year term.

The Authority's debt service coverage ratio is also considered in the context of its liquidity profile and volatility of cash flows. Coverage has been solid registering at 1.89x in fiscal 2015, 1.66x in fiscal 2016, and 5.7x in fiscal 2017. These debt service coverage ratios are based on information presented by the Authority adjusted for costs funded from non-operating sources and other non-cash payments. The large increase in fiscal 2017 coverage was due to preventative maintenance and other non-capitalized costs funded by federal grants.

Fitch's analysis of the Authority's financial profile reflects a through-the-cycle analysis to evaluate shifts in demand and consequent revenue stress and financial leverage changes that the Authority may be expected to experience in an economic downturn of reasonable depth and duration (the rating case). The rating case considers the Authority's 10-year revenue history through fiscal 2017; there are no adjustments to historical revenue increases driven by policy action, as the strategic importance of the WMATA system to the regional economy underlies an expectation for continued public support in the form of jurisdictional subsidies and periodic fare increases to sustain operations and solvency.

The Authority's expected future financial leverage (net debt and the net pension liability or the NPL) is evaluated through the rating case. The Authority has approximately $759 million in total debt outstanding prior to the issuance of the series 2018 bonds, and its NPL was reported at $1.1 billion in fiscal 2017 (or a 76.5% ratio of assets to liabilities). The Fitch-adjusted NPL, which assumes a 6% investment rate of return, is $2.1 billion (and the funded ratio is 62.6%). The Authority's net debt and Fitch-adjusted NPL approximates a low 1.6x projected fiscal 2018 gross revenues of $1.8 billion. Coverage of MADS on all outstanding debt inclusive of the series 2018 bonds (an estimated $71 million) is almost 25x on a gross basis.

The Authority's future borrowing plans are somewhat unclear at this point, as it is evaluating alternatives to optimize its capital structure in light of the new dedicated capital funding source. Whereas the CIP adopted by the Authority last year identified roughly $1 billion in long-term financing over the 2018-2024 plan period, the current adopted CIP does not specify future debt issuance beyond the series 2018 bond offering. The legislation adopted by the District, Virginia, and Maryland clearly signals an intention to leverage this revenue stream to help finance the Authority's capital needs. Fitch's rating case analysis assumes an additional $2 billion in additional issuance over the next five years (in addition to the series 2018 bonds) reflecting an aggressive ramp-up in spending to meet system capital needs and the potential for cuts in other assumed CIP sources, particularly federal grants and program funds.

In the rating case the Authority's financial leverage is maintained below 4.0x which is consistent with a 'AA'-category rating based on a revenue defensibility assessment of 'stronger' and an operating risk assessment of 'midrange'.

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Additional information is available on www.fitchratings.com

Applicable Criteria

Rating Criteria for Public-Sector, Revenue-Supported Debt (pub. 26 Feb 2018) (https://www.fitchratings.com/site/re/10020113)

Additional Disclosures

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