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Ratings

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Summary:

Washington Metropolitan Area Transit Authority; Transit

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Washington Metro Area Transit Auth gross rev transit bnds		
Long Term Rating	AA-/Stable	Affirmed
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Long Term Rating	AA-/Stable	Affirmed
Washington Metro Area Transit Auth ICR		
Long Term Rating	AA-/Stable	Current

Rationale

S&P Global Ratings has affirmed its 'AA-' long-term rating and on Washington Metropolitan Area Transit Authority (WMATA), D.C.'s gross revenue transit bonds outstanding. S&P Global Ratings 'AA-' issuer credit rating (ICR) on WMATA and the 'aa-' stand-alone credit profile (SACP) on the authority are unchanged. The outlook is stable.

The ratings reflect our view of WMATA's:

- Very low industry risk, with low cyclicality and volatility of earnings during economic cycles, and very low competition;
- Extremely strong economic fundamentals, with high per capita income and good growth in population and employment;
- Very strong financial flexibility, with a farebox recovery ratio of approximately 44%; and
- Very strong liquidity levels, although we consider unrestricted cash without access to external liquidity and lines of credit only adequate.

These strengths are partially offset by the authority's:

- Adequate market position due to declining ridership in recent years with projected further declines;
- History of fluctuating debt service coverage (DSC; S&P Global Ratings-calculated); and
- Large capital plans that could include further debt if funding sources are insufficient.

Securing the existing bonds are gross WMATA revenues, including operating revenue (excluding lease revenue); each jurisdiction's operating subsidy, known as the stable and reliable funding sources; and all other authority revenues that can lawfully be pledged. Capital contributions from participating jurisdictions are not pledged. The bonds do not have a debt service reserve fund. Under the resolution, WMATA has covenanted to fix and establish transit system fees, with jurisdictional subsidies and proceeds from bonds, notes, or other obligations such that the resulting amount pays all debt service (including related parity debt and subordinated debt or contract obligations) and all transit system operating costs. We are expecting WMATA to issue new debt in the near term and have incorporated that into our analysis in this review.

WMATA is responsible for developing, financing, and operating mass transit facilities in the Washington, D.C., metropolitan area. This includes a heavy rail (Metrorail), bus (Metrobus) and paratransit (MetroAccess) system. The authority is an agency and instrumentality of the Commonwealth of Virginia, the State of Maryland, and the District of Columbia (D.C.), and depends on these governments and the local jurisdictions for financial support in addition to farebox revenues and other operating revenues. Ridership has fallen in recent years: The 301 million trips in fiscal 2017 was down 6.2% from fiscal 2016.

The authority requires operating subsidies to balance its budget, as is typical for U.S. transit agencies. The system has a comparatively high cost recovery, in our view, with operating revenues covering 43% of operating expenses (excluding depreciation) in fiscal 2017 based on audited financials. Most of the remaining revenue represents subsidies from the participating jurisdictions, which include D.C.; Montgomery and Prince George counties in Maryland; Arlington and Fairfax counties in Virginia; and the cities of Alexandria, Fairfax, and Falls Church, also in Virginia. The jurisdictional subsidies are subject to annual appropriation, although federal law requires each participating jurisdiction to identify a stable ongoing revenue source to finance the contributions to WMATA. We view the participating jurisdictions' history of continued support as a credit strength.

In May 2018, D.C., Maryland, and Virginia each passed legislation providing a dedicated funding source of totaling approximately $500 million annually for the authority's capital programs. In our view, this permanent funding is credit favorable, given WMATA's large capital needs. D.C. will provide approximately $178.5 million annual from its general retail sales tax revenue. Maryland will provide approximately $167 million from a dedicated annual appropriate from the state's Transportation Trust Fund. Virginia will provide approximately $154.5 million from various transportation-related user fees and taxes.

WMATA's transit system, and more generally the mass transit industry as a whole, is mature and has historically demonstrated only minor cyclicality (including ridership trends); therefore, we characterize the cyclicality and volatility of operating earnings as low risk. We also characterize competition and the threat of substitute products or services as very low. Barriers to entry are very high, given the system's size and its large infrastructure. Given the above, we characterize WMATA's industry risk as very low.

In our view, the underlying strength of WMATA's catchment area--which includes the D.C. metropolitan area as well as parts of Virginia and Maryland--helps provide stable demand for transit services. Gross population growth for the D.C. area from 2012-2017 was 4.6%, to about 4.1 million residents in 2017. Employment growth also increased approximately 5.7%. Projections from IHS Markit indicate employment growth will continue. Regional per capita income levels are strong at approximately 146% of the national average. Given these factors, we consider the authority's economic fundamentals as extremely strong.

WMATA is the primary transit provider in the region, representing about 83% of all transit trips, according to management. The remaining trips are largely through local bus and regional commuter rail operators. The authority competes with the regional rail operators for some longer trips, but many commuters also rely on WMATA to reach their final destination. It largely does not compete with local bus operators, but instead works in cooperation with them. Ridership has fluctuated somewhat during the past five years, declining 14.6% from 2012-2017, including drops of 6.2% in 2017 and 6.0% in 2016. Through third-quarter 2018, rail ridership was 128.0 million trips, down 1.2%, or 1.6 million trips, compared with the same period a year earlier. Ridership was down largely across the board and is attributable to service interruptions, general reliability issues, and market factors. For 2019, total rail ridership is projected at approximately 173.4 million trips, down approximately 5.1 million (2.8%). Total bus ridership is projected at approximately 110.9 million, off approximately 6.1 million (5.2%). MetroAccess ridership is forecast to increase slightly. This results in a total ridership decline of 3.7%. With WMATA's status as a virtual public transit monopoly somewhat offsetting the continued declines, we view the authority's market position as adequate.

WMATA has adopted a strategic plan that covers both near-term (through 2025) and long-term (30-year) strategies. The strategic plan is referenced throughout the budget and is a planning tool. It includes goals related to safety, service, regional mobility, and financial stability. The authority tracks objectives and benchmarks in its quarterly reporting, annual budget, and annual reports. We view management as having good depth and breadth across its business lines. WMATA's 16-member board is independent of management, providing oversight and independent decision-making. The authority's recent safety-related issues and previous need for additional revenue for effective operations indicate some lack of foresight to anticipate issues. However, while plans to upgrade the system's safety and reliability are now in place and a new funding proposal has been agreed upon, large-scale challenges exist and will for some time. Given these factors, we view WMATA's management and governance as strong.

In summary, our analysis of the four factors that comprise the authority's enterprise risk profile results in an enterprise risk profile score of very strong.

WMATA maintains prudent financial policies in our view. Multiyear financial and capital projections are developed as part of the annual budget process. The authority has a debt management policy that outlines its use of debt for capital projects. We understand it does not have a specific unrestricted cash and investment target, but monitors its cash levels regularly to ensure they are at a level we view as adequate. Jurisdiction funding requirements are funded in advance quarterly with invoices sent 45 days in advance, and there have historically been no funding issues from the jurisdictions. We view WMATA's financial polices as strong.

The authority funds its operations mainly through farebox revenue, state and local funds, and federal operating and capital grants. It has adjusted fares periodically in recent years with the most recent taking effect July 1, 2017. In that year, the most recent audited fiscal year (ended June 30), operating revenues totaled $789.2 million, down 8% from 2016. Operating expenses, excluding depreciation, were down 1% in 2017, totaling $1.8 billion. WMATA is required to annually adopt a balanced operating budget where operating revenues and subsidies equal expected operating expenses for the fiscal year. For 2017, the authority's debt service coverage (S&P Global Ratings-calculated) was 3.26x. However, this is somewhat overstated because federal grant money funded routine maintenance expenses at a higher rate than historical levels in 2017 to keep the jurisdictional subsidy lower. Management indicates this more of a one-time increase and not a material change in operations, because its receiving future federal subsidies is uncertain. We expect coverage to be near 1x for 2018 and 2019 based on our understanding of Metro's Compact, which requires an annual budget that generates revenue equal to expected operating expenses including of O&M and service payments. With coverage above 1x in 2017 and near sufficiency in 2018 and 2019, we view DSC as good.

WMATA's unrestricted cash balance, which included $101.3 million of cash plus the unused portion of its line of credit for audited fiscal 2017, was $301.2 million, or 62 days' cash on hand. We expect the authority to maintain liquidity at or above $150 million annually in additional to the available balance on its line of credit. Cash-to-debt service was 9.5x in 2017 and is forecast to decrease slightly to 8.9x by 2019. In our view, WMATA has exceptional external liquidity, with well-tested access to capital markets. It maintains a line of credit for liquidity currently at $350 million, of which there are no draws outstanding. Given these factors, we view the authority's liquidity as very strong, but unrestricted cash without the external liquidity and lines of credit is what we consider only adequate.

WMATA's bus and rail systems operate at a deficit prior to receiving non-operating subsidies, as is typical for U.S. transit systems. The farebox recovery ratio was 44% in fiscal 2017 and is projected to be 46% in 2018 and 2019. The debt service carrying charge was 1.7% in 2017, and projected to fall to 1.2% in 2018 before increasing to 2.9% in 2019. Overall, we view financial flexibility as very strong.

The authority's debt-to-net revenues in 2017 was 14.7x and we expect it to decline in the next two years to 16.4x in 2019. Debt-to-total revenues was 0.27x in 2017 and is forecast to increase to 0.53x in 2018 before falling to 0.48x in 2019. The six-year capital improvement plan (CIP) for 2019-2024 totals approximately $8.5 billion, with no additional debt plans. Overall, we view WMATA's debt burden as low.

In summary, our analysis of the five factors that comprise the authority's financial risk profile result in a financial risk profile score of very strong.

Our view of both the enterprise and financial risk profile scores of very strong results in a final SACP of 'aa' or 'aa-', as per our criteria. We choose the 'aa-' SACP due to WMATA's declining ridership trends, large capital needs in their six-year CIP, and liquidity that depends on market access and lines of credit. Based on peer comparisons, we did not apply a notch of flexibility in arriving at the final SACP of 'aa-', nor did we apply rating caps. Given our view that WMATA is not a government-related entity (GRE) under S&P Global Ratings' GRE criteria, our ICR on the authority is also 'AA-'.

Based on our analysis of WMATA's bond provisions, our issue-level rating on the revenue bonds is also 'AA-'. Bond provisions include an additional bonds test (ABT) of 4x pledged revenues. Although it is industry standard, an ABT based on a gross pledge is weak, in our opinion. The authority did not fund debt service reserves on its debt outstanding or this current issuance.

Outlook

The stable outlook reflects our expectation that WMATA will set fares and manage expenses to maintain near 1x DSC over the next two years.

Upside scenario

Material improvements in WMATA's DSC balanced against a stabilized ridership trend could lead to a positive rating action.

Downside scenario

If WMATA's liquidity position were to materially erode or if systemwide operating performance experienced significant additional challenges, we could lower the rating. We could also lower the rating to the extent that the authority's debt burden increases significantly.