S&P Global Ratings

One California Street, 31st Floor
San Francisco, CA 94111-5432
tel 415 371-5000
reference no.: 1636374

October 9, 2020

SMART
5401 Old Redwood Highway, Suite 200
Petaluma
San Rafael, CA 94939
Attention: Ms. Erin McGrath, Chief Financial officer

Re: ***US$123,260,000 Sonoma Marin Area Rail Transit District, California, Measure Q Salex Tax Revenue Refunding Bonds, Series 2020A, dated: Date of delivery, due: March 01, 2029***

Dear Ms. McGrath:
Pursuant to your request for an S&P Global Ratings rating on the above-referenced obligations, S&P Global Ratings has assigned a rating of "AA" . S&P Global Ratings views the outlook for this rating as negative. A copy of the rationale supporting the rating is enclosed.

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Please send hard copies to:
S&P Global Ratings
Public Finance Department
55 Water Street
New York, NY 10041-0003

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cc: ***Mr. Nick Jones, Senior Managing Consultant***
Public Financial Management

S&P Global Ratings

S&P Global Ratings
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Summary:

Sonoma Marin Area Rail Transit District, California; Sales Tax

Primary Credit Analyst:
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Summary:

Sonoma Marin Area Rail Transit District, California; Sales Tax

Credit Profile		
US$123.26 mil measure q salex tax rev rffdg bnds ser 2020A due 03/01/2029		
Long Term Rating	AA/Negative	New
Sonoma Marin Area Rail Transit District Measure Q sales tax rev bnds		
Long Term Rating	AA/Negative	Affirmed

Criteria Exception

One or more of the credit ratings referenced within this article was assigned by deviating from S&P Global Ratings' published criteria. The application of an exception from our criteria does not necessarily result in a rating change. We believe that for certain mass transit entities that receive a majority of their revenue from dedicated taxes that are protected from external interference, the financial flexibility risks inherent in low farebox recovery (i.e., the fraction of operating expenses met by the fares paid by passengers) are not as pronounced compared with the flexibility of entities without such characteristics. In this case, the Sonoma-Marin Rail Transit District receives over 50% of unrestricted revenue from locally generated tax sources. We therefore excepted this rating from certain provisions of our "Mass Transit Enterprise Ratings: Methodology And Assumptions," published Dec. 18, 2013, on RatingsDirect, by not applying two rating caps described within the criteria related to the financial flexibility risks. Specifically, we do not apply the rating cap of 'a+' associated with the financial flexibility score of '4' or worse, and we do not apply the rating cap of 'bb' associated with the combination of the financial flexibility score of '5' or '6' and management and governance score of '5', as specified in the abovementioned criteria. In this case, without the criteria exception, the 'a+' cap would have been applied, but the 'bb' cap would not have.

Rating Action

S&P Global Ratings assigned its 'AA' long-term rating on the Sonoma Marin Area Rail Transit District (SMART), Calif.'s anticipated $123.4 million Measure Q sales tax revenue refunding bonds (green bonds), series 2020A. S&P Global Ratings also affirmed its 'AA' long-term rating on SMART's parity series 2011A sales tax revenue bonds outstanding, which SMART plans to refund with the series 2020A bond proceeds. The outlook is negative.

The rating action reflects the application of our "Priority-Lien Tax Revenue Debt" criteria, published Oct. 22, 2018, which factors in both the strength and stability of the pledged revenue, as well as SMART's general credit quality.

SMART plans to apply the series 2020A bond proceeds to refund its series 2011A sales tax revenue bonds. In addition to bond proceeds, SMART plans to apply $17.1 million in funds from the series 2011A bonds' debt service reserve (DSR) fund to the refunding. SMART is not extending the bonds' final maturity through this refunding. The pro forma amortization schedule indicates SMART expects to reduce maximum annual debt service (MADS) requirements by approximately 23%, level out annual debt service requirements, and achieve significant debt service savings.

A gross first lien pledge of Measure Q sales tax revenue, net of an administrative fee paid to the California Department of Tax and Fee Administration (CDTFA), secures the bonds. Measure Q is a 0.25% sales tax charged on transactions within Sonoma and Marin counties. Voters of the two counties approved the tax in 2008, and Measure Q collections began April 1, 2009. The tax sunsets March 31, 2029, following final maturity on the bonds.

Credit overview

SMART's credit profile reflects the extremely high incomes and broad and diverse economic base of its two-county service area. The coverage protections of an additional bonds test (ABT) requiring historic revenue produce MADS coverage no lower than 1.5x for additional bonds to be issued, and the cushion between current and forecasted MADS coverage and this 1.5x threshold provide further credit support, in our view. The negative outlook reflects our opinion that credit pressure exists with respect to SMART's general creditworthiness, where plummeting ridership levels and declines in sales tax revenues spurred by the COVID-19 pandemic and related economic recession have presented substantial operational and budgetary challenges to the district.

The COVID-19 pandemic and related economic recession have presented budgetary challenges to mass transit operators across the country, including SMART. As detailed in our March 27, 2020 report, we revised the outlooks on bonds issued by mass transit agencies and secured by priority lien tax revenue pledges to negative, reflecting our view that the emerging recession and social distancing-driven declines in transit activity levels will likely place material pressure on the general credit profiles of these issuers through declines in pledged revenue and ridership, and accompanying budgetary strain. For more on our view of the challenges facing mass transit operators, see our report "Activity Estimates For U.S Transportation Infrastructure Show Public Transit And Airports Most Vulnerable To Near-Term Rating Pressure," published June 4, 2020.

For more information on the coronavirus' effect on U.S. Public Finance, see our reports "The U.S. Economy Reboots, With Obstacles Ahead," published Sept. 24, 2020, and "U.S. Economic Update: A Recovery At Risk As COVID-19 Surges" published July 22, 2020.

SMART was created in 2002 to oversee the development and operation of passenger rail service along an approximately 70-mile rail corridor extending from Cloverdale in Sonoma County to Larkspur in Marin County. The first phase of the rail line began operations in August 2017.

The rating reflects our view of:

- The very strong economic fundamentals of SMART's two-county district that spans two broad and diverse metropolitan statistical areas (MSAs),
- SMART's strong MADS coverage from pledged revenue and an additional bonds test (ABT) that requires 1.5x MADS coverage from historical revenue for additional bonds to be issued,
- The historically low volatility of nationwide sales tax revenue, a view that extends to our view of SMART's pledged sales tax revenue collected across its two-county district, and
- Our view that SMART's general creditworthiness does not currently constrain the rating on its sales tax bonds.

At fiscal year-end 2019, SMART had $157.1 million in total debt outstanding, consisting solely of its series 2011A bonds. In addition to refinancing its outstanding debt and realizing debt service savings, SMART anticipates reducing its total par amount outstanding by $13.6 million with the series 2020A revenue refunding bond issuance.

Environmental, social, and governance (ESG) factors

Our rating considers the ESG risks relative to SMART's Measure Q revenue bonds' economic fundamentals, revenue volatility, coverage and liquidity, and obligor's creditworthiness. Our ratings incorporate our view of the social risks related to the COVID-19 pandemic, which we believe present downside credit risks, to the extent that pledged revenue materially declines or budgetary challenges emerge that pressure SMART's general creditworthiness. We consider governance factors for this credit in line with the sector.

We consider the district's service area across both Marin and Sonoma counties exposed to heightened environmental risks relative to other mass transit priority lien debt issuers. In our view, the district's territory is particularly exposed to wildfires and seismic risks, the latter of which we consider somewhat mitigated by the state's strong building codes. In recent years, including the summer and early fall of 2020, numerous wildfires have burned throughout California. For the second time in three years, wildfires have forced evacuations for parts of Santa Rosa, the largest city in Sonoma County. We understand wildfires have not caused material declines in pledged revenue, although the Tubbs Fire in the fall of 2017 did contribute to a decline in ridership.

Negative Outlook

Downside scenario

If operational challenges, including persistently depressed ridership levels, or further material declines in sales tax revenue lead to a weakening in SMART's general creditworthiness, we could lower the rating on its Measure Q sales tax revenue bonds.

Return-to-stable scenario

We could return the outlook to stable if we come to expect stability in sales tax revenue and greater clarity surrounding the operational and financial effects of the ongoing period of depressed ridership levels.

Credit Opinion

Economic fundamentals: Very strong

SMART's district covers the counties of Sonoma and Marin, with a combined population of approximately 770,000 in 2019. Sonoma County, with a 2019 total population of approximately 507,000, is located within the broad and diverse Santa Rosa-Petaluma MSA and in the heart of Northern California's wine country. Local economic drivers include tourism and agriculture.

Marin County, with a 2019 population of 262,000, is located within the broad and diverse San Francisco-Oakland-Hayward MSA. Located across the Golden Gate Bridge from the City and County of San Francisco, Marin County's economic indicators reflect its proximity to the abundant and high-paying jobs in San Francisco and other Bay Area communities.

On a weighted average basis by population, district per capita effective buying income was 154% of the national level in 2019. In our view, the district's high income levels support the robust sales tax base that secures SMART's sales tax revenue bonds. The district's taxing base is diverse by taxpayer and by sector. With the top 25 sales tax remitters accounting for 23.6% of total sales tax revenue, there is no material sales taxpayer concentration.

Coverage and liquidity: Strong

SMART's $39.0 million in pledged revenue (per unaudited estimates) in fiscal 2020 produced 2.3x annual debt service coverage (DSC) and 1.8x MADS coverage. This represented a 5.5% decline in pledged revenue from fiscal 2019, though the fiscal 2020 estimated figure was still 5.0% higher than in fiscal 2018. We understand that administrative issues at the state level led to some undercounting of locally levied sales tax revenue for fiscal 2018 and some over-counting for fiscal 2019. For fiscal 2020, the district estimates it received an additional $1.4 million as a result of the South Dakota v. Wayfair, Inc. decision settled in 2018 that permitted the levy of sales taxes on goods sold to local purchasers by out-of-state sellers.

We believe SMART's dedicated sales tax revenue stream is exposed to additional declines, giving the ongoing pandemic and effects of the recent economic recession. Data provided by management indicate Measure Q revenue fell by 8% for the fourth quarter of fiscal 2020 from the same quarter during the prior year. SMART uses projections from an external consultant to inform its financial planning. SMART's current sales tax projection is for an additional 4.8% decline in pledged revenue for fiscal 2021, with about 2%-3% annual growth thereafter.

SMART's projected fiscal 2021 pledged revenue would produce MADS coverage of 2.2x. This is improved MADS coverage from the pre-refunding coverage level due to the anticipated 23% reduction in MADS achieved through the debt restructuring SMART is completing with this issuance, discussed above.

SMART's ABT requires that Measure Q collections in 12 consecutive months of the past 24 produce MADS coverage no lower than 1.5x on existing and proposed bonds. Given SMART's lack of additional borrowing plans and the legal constraints of the ABT, we expect coverage will remain strong. SMART indicates it has no plans to issue additional debt. With the pledged tax scheduled to sunset in March 2029, and given SMART relies on Measure Q revenue to fund its operations--Measure Q revenue accounted for 72% of total revenue in fiscal 2020--we believe it is unlikely SMART will bond down to the level permitted by its ABT. Though further declines in pledged revenue would erode coverage from current projected levels, pledged revenue would have to decline by 31% from fiscal 2021's projected level for MADS coverage to equal 1.5x on the post-refunding debt service schedule.

The series 2020A bonds will not benefit from the added security of a DSR. However, given our coverage and volatility assessments, we do not apply a liquidity factor adjustment to the coverage and liquidity assessment for the Measure Q sales tax revenue bonds.

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 do not believe internal or external influences materially improve or worsen SMART's revenue volatility assessment relative to our macro assessment. Measure Q collections began April 1, 2009. Annual growth has since been steadily positive, before fiscal 2020's estimated declines. Although Sonoma County's sales tax revenue declined 30% in fiscal years 2007 through 2010, Marin County's taxable sales were somewhat more resilient, falling about 17%.

Obligor linkage: Limited relationship

The California Department of Tax and Fee Administration (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 either one-sixth of semiannual or one-12th of annual principal requirements into a principal fund. Only after funding debt service requirements does the trustee remit surplus pledged revenue to SMART. Given the flow of funds and trustee intercept, we believe the pledged revenue is sufficiently removed from SMART's control to mitigate operating risk.

In addition, we consider SMART as having extraordinary expenditure flexibility as a mass transit operating entity that is primarily funded through nonoperating revenue sources. We believe that SMART can materially adjust expenditures by reducing service levels without proportionately reducing revenue. This flexibility further insulates the pledged revenue stream from SMART's operating risk as a mass transit operator.

Rating linkage to SMART's general creditworthiness

According to application of our "Mass Transit Enterprise Ratings: Methodology And Assumptions," SMART's general creditworthiness benefits from its high-income, broad, and diverse service area economic base. SMART's general creditworthiness is offset by the unprecedented pressures facing mass transit operators nationally, pressures that extend to SMART's enterprise and financial risk profiles. In our view, a prolonged period of depressed ridership levels, or further declines or a slow rebound in sales tax revenue could lead to a weakening of SMART's general creditworthiness.

In addition, we note that longer term funding challenges remain, as Measure Q is set to sunset in 2029, and SMART's voters rejected a ballot measure to extend Measure Q in March 2020. While the tax sunsets after the bonds reach final maturity, SMART's sustainability as a mass transit operator over the longer term likely depends on an extension of the sales tax levy or identification of a new primary funding stream.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020 action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.