U.S. Municipal Bond Market

Policy Solutions are Taking Shape for Mass Transit, as Expected

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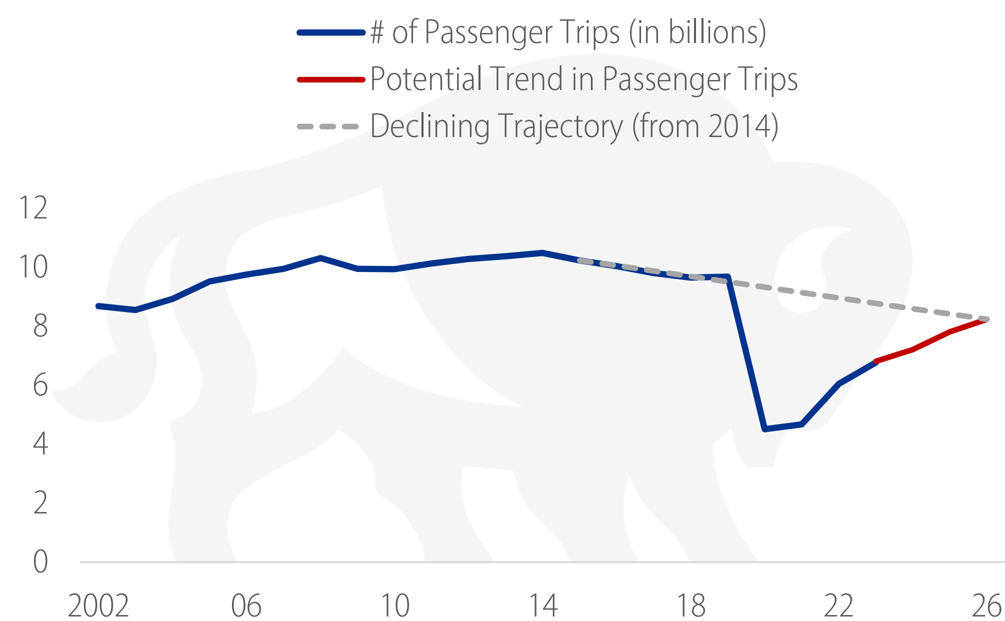
- Changing worker and consumer behavior is transforming many of the largest U.S. downtown business districts.
- Transit ridership has not returned to pre-pandemic levels, but ridership has been on a downward trend since 2015. Funding solutions not related to ridership and fare revenue were going to be needed even without the pandemic.
- The majority of transit funding does not come from fare revenue.
- This year funding support has emerged and will likely continue to come from increases in state and local government assistance as long as it is available and supported from a policy and public opinion perspective.
- State and local government assistance could become more difficult to attain if or when resources become scarce.
- We are closely watching public support of transit. If public support declines, so could state and local government assistance.

The Status of Mass Transit Ridership

Changing worker and consumer behavior is transforming many of the largest U.S. downtown business districts. The Kastle Systems Back-to-Work Barometer Average is still only 50% of pre-COVID activity as of Nov. 15. Total downtown activity remains only 80% of what it was before the pandemic and non-resident worker activity only 65% of what it was before Spring 2020. Mass transit ridership still lags pre-COVID levels, and many transit providers continue to expect budget uncertainty as a result. On Nov. 16 Moody's Investor Service reiterated their "Negative" outlook on the Mass Transit sector.

Transit Ridership Trended Lower Since 2014



Federal Transit Administration and HilltopSecurities.

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Structural and financial pressure is not new for transit agencies. This convergence of pressure has ebbed and flowed with changes in technology and economic prosperity not just over recent years but over the last several decades. Policy results over the past century have been collected and analyzed by historian Nicholas Dagen Bloom, basically Bloom maps out the large collection of obstacles the sector has had to overcome. Most recently we saw transit usage peak in 2014, then it began a mostly downward trend in 2015. The emergence of ride hailing services at the beginning of the past decade is the key reason transit ridership began to fall then. Other economic inputs also factored into dropping ridership. Therefore, even before the changing worker and consumer behavior we note above hastened by the COVID crisis, lower ridership and budget gaps were problems already requiring solutions.

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Political Solutions are Emerging, as Expected

We are seeing policy solutions take shape in support of mass transit, as we have expected. Increased levels of state and local support or financial assistance were (and are) the leading likely option to close budget gaps. We continue to expect these types of answers to the budget questions facing mass transit agencies in the near to medium term as well.

From the big-picture perspective we have seen constructive support from the state governments in California and New York. California's FY 2023-24 budget included $1.1 billion in flexible transportation funding and restored $4 billion for transit capital improvements. Meanwhile the State of New York provided $1.1 billion to support transit. The New York Metropolitan Transportation Authority's (MTA) budget is expected to be balanced until 2027 as a result but will be important to monitor how the revenues and expenditures develop over this period.

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It is also imperative to consider how realistic it is that more state aid will be available to meet future budget gaps should they arise. California and New York may be experiencing a different budget environment in a year or two from now relative to their existing health. Currently, State Reserves Remain Near Record Levels, State and Local Employment Still Rising and it is much easier for states to offer assistance now as a result. The possibility of increased or even continued assistance could fall if the resources available to state governments declines and or credit quality weakens.

Breakdown of Transit Revenue Sources

One of the reasons inexperts conjure-up doomsday scenarios when they read about transit ridership not returning to pre-COVID levels is because they do not understand where the majority of transit funding comes from. The majority of transit funding does not come from the farebox, so the importance of falling ridership is not as weighty of a pressure as some believe. Falling ridership is not an optimal scenario, but as we point out in our opening it is one that started even before COVID. Ridership started to fall in 2015. Federal assistance is probably not going to be increasing in a meaningful way in the near term. The precarious U.S. fiscal situation is the reason why the federal government may not be able to offer increased help. Therefore, state and local assistance (and/or taxes) is the most likely source that will need to increase.

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State and Local Funding is Transits' Major Revenue Source, Not Fares

Transit Revenue Source	2019 ($)	2020 ($)	2019 (%)	2020 (%)
State and Local Funding	$25	$24	32%	30%
Federal Grants	12	23	15%	29%
Taxes Levied by System or Local Govt.	20	19	26%	24%
Fares	16	9	21%	11%
Other System Revenues	5	5	6%	6%
Total	$78	$80	100%	100%

Source: Federal Transit Admin National Transit Database, Moody's, & HilltopSecurities, $ in billions.

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This relationship is not optimal from a credit perspective. This type of revenue reliance could bring about an increased level of uncertainty during some future budget cycles. It also means meaningful portions of transit agencies' budgets will continue to be in the hands of the related state and local governments they serve.

Public Support for Transit is Mixed

In the future popular and political support of transit will be increasingly important. If lawmakers are going to pay for an increased amount of transit budgets with state and local assistance then it makes sense that popular support for transit spending should be favorable. From a big picture perspective we are seeing general approval for transit. A 2020 poll showed that 77% of those who participated supported improved public transit.

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However, skepticism has grown where support for transit is concerned. For example, a 2023 poll of San Francisco Bay area counties found that only 56% say commuter rail is important even if it costs more money. Support for transit was higher in 2018 when voters approved a toll increase to pay for transit related expenditures. This relationship will be important to watch because if this skepticism grows, voter and taxpayer support falls then lawmaker support could flounder. That would not be a credit positive for transit.

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- State and Local Credit is Incredibly Resilient, and We Expect Only a Very Limited Credit Impact from Commercial Real Estate Weakness, Nov. 2, 2023
- U.S. State Fiscal Health: State Reserves Remain Near Record Levels, State and Local Employment Still Rising, Oct. 19, 2023

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