Community Finance Brief

Public Transportation & New York's Path Strong in Short Term

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The way in which people move around urban and suburban communities in the United States has changed dramatically in the last four years and has had a generally negative impact on mass transit systems around the country. Both Moody's and Standard & Poor's have the public transport sector on 'negative outlook' citing concerns regarding low ridership and the phasing out of COVID-19 relief. On the federal aid, most transit agencies have leveraged the $70 billion received as part of pandemic aid and the funds from the Infrastructure Investment and Jobs Act of 2021 are not geared towards plugging operating budgets as the COVID relief was. Instead, they are designed to help agencies pay for new projects, which implies for municipal bond debt issuance.

All in all, relying on federal aid for these mass transit systems is untenable and in the last year, states such as New York have stepped in to support local transportation systems, which will likely be needed for other systems to continue to operate on a consistent level. The correlations of economic growth and a healthy public transportation system - especially as it services those of lesser financial means - are important to understanding the long-term stability of American communities. As reliance on federal aid is not tenable long-term, **CSG** points to state governments in New York (and Minnesota) that have provided additional funding for local transit agencies, which could serve as a model for other communities to follow.

Quick Takes

National ridership on public transportation systems have recovered only about two-thirds of pre-COVID levels (**see chart on page 2**)

COVID relief funds are scheduled to **phase out** in 2024

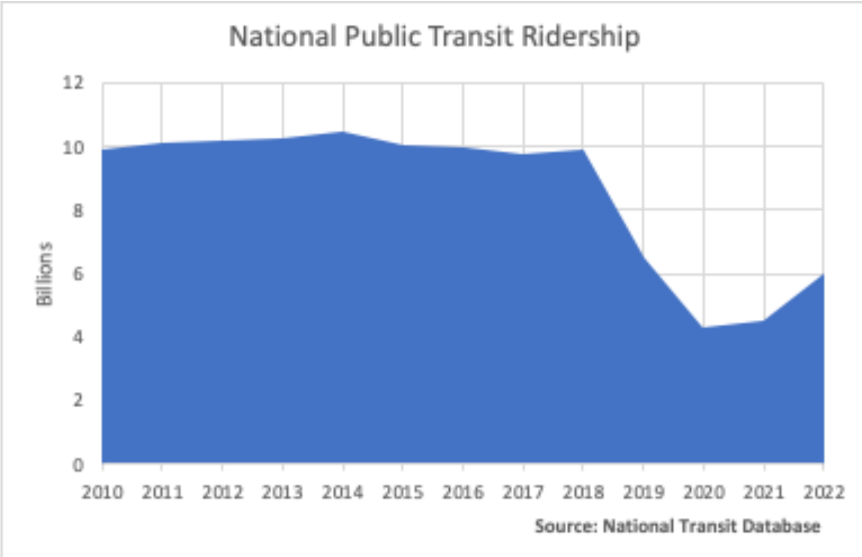
Public transportation systems in New York, Chicago, Los Angeles, San Francisco and Washington, D.C. were all downgraded by at least two rating agencies in the second half of 2020

Looking ahead, **New York is leading the way** in state support of local transportation systems, relying on progressive tax regimes and excise taxes to support the City's MTA

"The choice was just wait and see what happens, kick the can down the road or launch a bold strategy of sustainability to show up and ensure viability of MTA for years to come," NY Governor Kathy Hochul. "Working hard, we rolled up our sleeves again and came up with a plan to generate additional revenue for the MTA through a minor increase in the [PMT] for New York City's largest business."

New York State

The case can be made for MTA as the most economically important engine for the city and relatively for the entire country when it comes to public transportation. The state of the subway at the heigh of the pandemic was well documented. It was a crucial milestone to see the state government step up this year to support the agency, which theoretically helps the



agency have a balanced budget out to 2027. The state essentially used a somewhat populist approach to the funding - progressive taxes on the wealthy (top rate of the payroll mobility tax), excise taxes (casino), a one-time direct state subsidy (to offset ridership fees), and support for disabled access. As a result, the MTA was upgraded to positive outlook by Moody's.

This passed political muster in New York and could very well be a template for other states to follow. The positioning of the fiscal budget politically was very much a populist one. By leveraging a progressive tax such as PMT and look at excises to allow for additional state funds to the local agency, the state walked down a well worn taxing path. Still, it is somewhat concerning to see the state have such a high dependence on taxes, which makes up 43% of all its revenue, according to MTA budget documents. It is also heavily reliant on casino revenues, which could not materialize if the economy were to turn south.

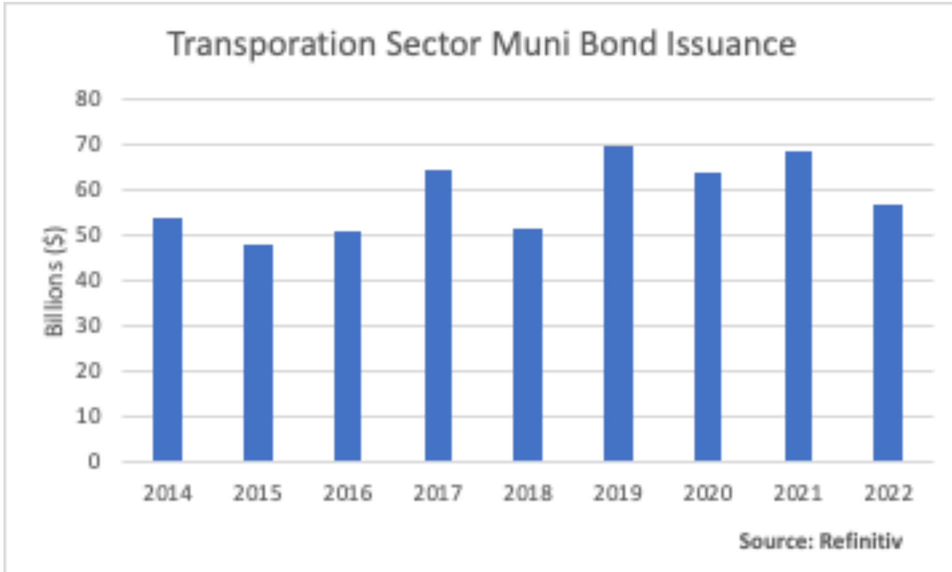
Aside from the financial support from the state, recently negated a labor contract with the Transit Works Union, which included a 9.8% wage raise over the next three years, a bonus and increased maternity and paternity leave. This new contract provides clarity on labor expenses through 2026, which is a massive upside for financial modeling on behalf of MTA. Labor-related expenses constitute over half of the annual budget expenditure and stability here should be seen as an overall positive.

LOOKING AHEAD

The decline in ridership and the decrease in revenue as a result has made it difficult for agencies to cover their operating expenses, and it has also led to a decline in their credit ratings (see **Quick Takes**, above). With no state government level action, lower outlooks and credit ratings are to be expected and will make it more expensive to borrow from the market over the long term.

The current supply/demand dynamic in the municipal market is mitigating the impact of these downgrades. With that said, Federal legislation dollars will make their way into the municipal bond market and we expect supply to increase by the fourth quarter of 2023 (it was reported today that September volume was the first year-over-year monthly increase). The transportation sector generally constitutes between 12% and 15% of the entire annual volume of the marketplace and this was consistent throughout the pandemic years (**see chart below**).

This is an important sector for public finance, specifically for urban areas as the way in which citizens move throughout each city has broader implications for the way in which cities can operate in general. Major urban centers such as the five above are likely to see further downgrades as the expected recession comes to fruition with no state-level support. Commercial leases in major urban centers will be up for renewal in coming years and the outlook is negative.



In our discussions with several major municipal bond investors that are not mutual funds, they are overwhelmingly trimming holdings to transit bonds, and major urban centers. Mutual funds, beholden to their weekly flows do not always have this luxury.

As for public unions, while there is no definitive data on their investments in municipal bonds, we do not expect any changes in their historical behavior when it comes to the transportation sector. This creates an underlying bid for bonds that will be supportive of construction of new transportation projects and improvement of existing transportation system along with the support of 4Q2022 Federal legislation.