FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms San Diego County RTC, CA's Senior Sales Tax Revs at 'AAA'; Outlook Stable

Mon 29 Jun, 2020 - 2:47 PM ET

Fitch Ratings - San Francisco - 29 Jun 2020: Fitch Ratings has affirmed the following San Diego County Regional Transportation Commission (the commission), CA ratings:

--Senior sales tax revenue bonds at 'AAA';

--Subordinate sales tax revenue short-term notes at 'AA'/'F1+';

--Transportation Infrastructure Finance and Innovation Act (TIFIA) loan junior subordinate sales tax revenue bonds at 'A'.

The Rating Outlook is Stable.

SECURITY

The senior sales tax revenue bonds are payable from a first lien on the half-cent retail transactions and use tax (sales tax) authorized by the voter-approved TransNet extension ordinance and levied throughout San Diego County (the county), net of California Department of Tax and Fee Administration (CDTFA) collection charges. The TransNet sales tax expires on March 31, 2048 (coinciding with final maturity of all notes and bonds).

The subordinate notes are secured by a second lien on the half-cent sales tax. The commission has pledged to repay the subordinate notes from any available source of financing and expects to take the notes out with the proceeds of a to-be-issued junior subordinate TIFIA loan.

The junior subordinate TIFIA bonds are secured by a third lien on the pledged sales tax revenues.

ANALYTICAL CONCLUSION

The dedicated tax bond ratings reflect the strength of the pledged sales tax revenue cash flows, solid growth prospects for revenues and the resilience to economic downturns given leveraging expectations at each lien level.

KEY RATING DRIVERS

Growth Prospects for Revenues: Fitch expects post-pandemic revenue growth to exceed inflation due to San Diego County's consistent population growth and long-term trends in employment, personal income and taxable sales.

Resilience and Sensitivity: Resilience to economic downturns is very strong at the senior and subordinate lien levels at expected leverage levels and solid at the junior subordinate lien levels. Fitch does not expect the commission to leverage to the maximum amount allowed under the additional bonds tests on any of the liens. Debt service coverage remains well above 1x over the next three years in Fitch's standard coronavirus retail stress scenarios.

No Issuer Default Rating: The commission does not have material exposure to operating risk. As such, Fitch has not assigned an Issuer Default Rating (IDR).

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--The junior subordinate lien TIFIA loan rating could rise if the commission's borrowing plans remain below prior expectations.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A sustained and material reduction in revenue growth prospects or a significant expansion of borrowing.

--An economic contraction extending well into the second half of 2020 or beyond, consistent with Fitch's coronavirus downside scenario, which triggers sustained and deep revenue declines and materially erodes the bonds' resilience cushion.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

CURRENT DEVELOPMENTS

The ongoing outbreak of coronavirus and related government containment measures worldwide creates an uncertain global environment for U.S. state and local governments and related entities in the near term. While the commission's most recently available fiscal and economic data may not fully reflect impairment, material changes in revenues and expenditures are occurring across the country and likely to worsen in the coming weeks and months as economic activity suffers and public health spending increases. Fitch's ratings are forward-looking in nature, and Fitch will monitor developments in state and local governments as a result of the virus outbreak as it relates to severity and duration, and incorporate revised expectations for future performance and assessment of key risks.

In its baseline scenario, Fitch assumes sharp economic contractions to hit major economies in the first half of 2020 at a speed and depth that is unprecedented since World War II. Sequential recovery is projected to begin from the third quarter of 2020 onward as the health crisis subsides after a short but severe global recession. GDP is projected to remain below its fourth quarter 2019 level until mid-2022. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the report titled, "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update" (https://www.fitchratings.com/site/re/10120570), published on April 29, 2020 on www.fitchratings.com.

The commission has seen a significant decline in sales tax collections in the final months of fiscal 2020 due to coronavirus and shelter-in-place restrictions that began in March. Management estimates that sales taxes declined to about $305.3 million in fiscal 2020 from about $312.3 million in fiscal 2019. Fiscal 2019 revenues included about $7 million of catch up payments from 2018 due to delays in state sales tax remittances. The projected 2020 totals are roughly in-line with fiscal 2020 receipts before the catchup payments and down about 2% from actual disbursements in 2019. Before the pandemic, sales tax collections were well ahead of budget due to a strong holiday season and a jump in internet sales tax collections following the U.S. Supreme Court's South Dakota v. Wayfair decision, which allowed local taxation of internet sales. While the California economy has begun to re-open in May and June, the commission is budgeting for a further 6.6% decline in sales tax revenues in fiscal 2021, reflecting lingering weakness in consumer spending and continued efforts at social distancing. The commission is well positioned to withstand temporary changes in sales tax collections, given its flexibility to adjust capital funding commitments and recent strong coverage of its sales tax revenue bond debt service. A sustained decline in revenues could force a more difficult re-examination of the commission's long-term capital spending plans. Fitch expects the commission to adjust spending to match available resources and to limit borrowing in line with historical performance, but a failure to adjust spending in a protracted downturn could pressure the ratings, particularly if it led to greater leverage metrics.

ECONOMIC RESOURCE BASE

San Diego County is the nation's fifth-most populous county with over three million residents and 18 incorporated cities. The economy benefits from consistent population growth and above average income levels. The regional economy has diversified away from its traditional reliance on defense, and the county is now home to large higher education, health care, information technology, and biotechnology industries as well as a robust tourism industry.

DEDICATED TAX CREDIT PROFILE

The commission allocates funding for public transit systems and oversees the construction and improvement of roads, highways, and other transit projects in San Diego County. The commission does not own or operate a public transit system. Due to the limited nature of the system's operations, Fitch does not assign an IDR to the commission.

The bonds and notes are supported by a sales tax collected on all taxable sales in a large county with a growing economy and diverse mix of sales taxpayers.

Growth prospects are solid despite expected near-term pressures due to the coronavirus. The 10-year CAGR of revenues was above inflation at

3.5% in fiscal 2019. The fiscal 2019 metric is somewhat inflated by a catch up in prior year tax disbursements and may exaggerate growth somewhat. Fitch expects future growth to continue to exceed inflation due to consistent population growth and the overall strength of the local economy.

Pledged revenue coverage was very strong at 2.9x maximum annual debt service (MADS) at the senior lien level in fiscal 2019. To evaluate the sensitivity of the dedicated tax revenue stream to cyclical decline, Fitch considers both a revenue sensitivity scenario (using a moderate national GDP decline scenario) and the largest consecutive decline in revenues over the period covered by the revenue sensitivity analysis. The largest cumulative revenue decline historically was 17.6% during the collapse of the housing sector from 2008 to 2010.

Assuming issuance up to the 2x additional bonds test (ABT), the senior structure could tolerate a 50% drop in revenues. Based on the commission's capital and debt plans, which incorporate the referendum spending allocations that devote more than half of revenues to non-capital purposes, Fitch does not expect the commission to leverage to the ABT on any of the liens. The commission does not have any borrowing plans over the next five years. At expected leverage, MADS coverage for the senior lien would remain at 2.5x or higher. At this leverage level, the senior lien bonds could withstand a 60% drop in revenues before reaching 1x coverage. That is 3.4x the worst consecutive decline. Based on these results, Fitch assesses financial resilience of the senior lien at the 'aaa' level.

Coverage also remains meaningfully above 1x at all lien levels in Fitch's coronavirus stress scenarios, which include at 34% decline in taxable sales. Fitch's 34% stress is based on its nation forecast of retail discretionary spending, which incorporates a 40%-50% decline in first-half 2020 and a slow rate of improvement expected through year end based on a gradual reopening of the economy and progress with respect to the public health crisis.

ASYMMETRIC RISK CONSIDERATIONS

No asymmetric risks identified for senior lien bonds.

The subordinate structure could tolerate a 33% drop in revenues, assuming issuance up to the 1.5x ABT. Fitch does not expect the authority to leverage to the ABT. At expected leverage levels, MADS coverage would remain 2.1x or higher, and the subordinate lien bonds could withstand a 52% drop in revenues. That is 3x the worst consecutive decline. Fitch assesses financial resilience of the subordinate lien at the 'aa' level. This analysis assumes that the 2018 notes remain in the subordinate lien only temporarily before being taken out with the approved TIFIA loan in 2021. The subordinate coverage calculations include three years of interest on the notes but exclude the bullet principal payment at note maturity, which is expected to be taken out with the TIFIA loan rather than 2021 sales tax revenues.

ASYMMETRIC RISK CONSIDERATIONS

No asymmetric risks identified for subordinate lien bonds.

Assuming issuance up to the 1.15x ABT, the junior subordinate structure could only tolerate a 13% drop in revenues. Fitch does not expect the authority to leverage to the ABT. At expected leverage levels, MADS coverage would remain at 1.7x or higher, and the junior subordinate lien bonds could withstand a 41% drop in revenues. That is 2.3x the worst consecutive decline. Fitch assesses financial resilience of the junior subordinate lien at the 'a' level. The assessment incorporates the fact that MADS is far in the future and Fitch's belief that the revenue stream is likely to grow over time.

ASYMMETRIC RISK CONSIDERATIONS

No asymmetric risks identified for junior subordinate lien TIFIA loan.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

RATING ACTIONS

ENTITY/DEBT	RATING		
San Diego County Regional Transportation Commission (CA) [General Government]			
• San Diego County Regional Transportation Commission (CA) /Sales Tax Revenues - Junior Subordinate	LT	A Rating Outlook Stable	Affirmed

ENTITY/DEBT	RATING

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

San Diego County Regional Transportation Commission (CA)	EU Endorsed

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