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INVESTORS SERVICE

Rating Update: Moody's affirms Aa2 on San Diego County Regional Transportation Commission CA's outstanding Sales Tax Revenues Bonds; The outlook is stable

Global Credit Research - 22 Sep 2014

Aa2 rating applies to approximately $1.14 billion in outstanding debt

SAN DIEGO COUNTY REGIONAL TRANSPORTATION COMMISSION, CA
Mass Transit
CA

Opinion

NEW YORK, September 22, 2014 --Moody's Investors Service affirms the Aa2 rating on $1.14 billion of San Diego County Regional Transportation Commission's (CA) outstanding sales tax revenue debt. The outlook is stable.

Summary Ratings Rationale

The rating reflects San Diego County's large and diverse economy with a diverse sales tax base, strong projected coverage levels and the absence of operating risk. Strong additional bonds test and the structural requirement to transfer pledged revenues from the state directly to trustee also figure favorably in the rating. These strengths largely offset the weakness posed by the absence of a debt service reserve fund in nearly ¾ of debt outstanding, a notable but manageable variable rate debt exposure and a sizable capital program.

The outlook on the rating is stable. We expect debt service coverage ratios to remain strong with continued revenue growth and moderate borrowing during periods of flat or declining revenues. The Stable outlook also assumes no significant increase in the overall share of variable rate debt.

Strengths

- Large and dynamic economy with diverse sales tax base

- Strong projected coverage levels

- No operating risk

- Gross pledge with revenues sent directly to trustee

- Strong Additional Bonds Test

Challenges

- No Debt Service Reserve for ¾ of debt outstanding

- Notable but manageable variable rate exposure

STRONG DEBT SERVICE COVERAGE; SALES TAX REVENUES HAVE RECOVERED TO PRE-RECESSION HIGH

The Commission's fiscal year 2014 sales tax revenues grew to a high $260.1 million, or 5.2% over the prior year. The 2014 revenues surpassed the pre-recession high achieved in fiscal year 2007 of $247.9 million. Sales tax revenues have grown for four consecutive years, averaging 6.25% growth annually. These four consecutive years of growth are a credit positive and improvement over three consecutive years of decline from 2008 to 2010. The deepest decline was experienced in 2009 posting a 9.2% drop from the prior year. Despite the impact of the recession, the Commission's twenty and ten year annual growth rates are 4.33% and 2.01% respectively.

Maximum annual debt service coverage has come down slightly to a still strong 3.10 times after the issuance of $350 million in 2014 Sale Tax Revenue Bonds, this compares to the 2012 MADS coverage of 3.5 times. The

Commission anticipates an approximate $600-$900 million in additional sales tax revenue bonds through 2020, depending on needs and opportunities. Through this projection period, the Commission assumes a 4% CAGR in sales tax revenues and we would anticipate the Commission would still maintain strong debt service coverage comparable to current levels.

IMPROVING OVERALL COUNTYWIDE ECONOMY

After two consecutive years of declines in 2010 and 2011, the countywide assessed values (AV) have posted three consecutive years of growth, 0.3%, 0.2% and 2.6% from 2012 through 2014 to a robust $403.1 billion. Much of this growth is attributable to increasing residential property values. According to Moody's Economics.com, the San Diego metro gross product has recovered the losses experienced in 2009 and grew 3% in 2012 and 2.2% in 2013. Growth is expected to accelerate growth through 2015.

San Diego County, located on the Mexican border, is the second most populous county in the state with a population of approximately 3.1 million. The county's economy is diverse, built upon long standing and stable sectors of defense, technology-producing industries, trade and tourism, and also benefits from the growing high technology and biotechnology sectors. Wealth levels in the county are varied, ranging from higher income coastal cities to lower income border communities. The county's median family income of 116% of the US median is consistent with the rating category and solid for a large, urban county.

The county's historic position as a naval center tends to dampen the median income levels, but is a positive credit factor as it continues to support growth. Shipbuilding and aerospace, in particular, receive funding from defense contracts. The county's economy also benefits from the biotechnology sector, and from the research activities of the University of California at San Diego and other institutes. Travel and tourism remain mainstay economic activities.

LIMITED FINANCIAL OPERATIONS

The Commission's financial operations are limited to the expenditure plan of the sales tax ordinance. In 2013, sales tax receipts accounted for 93.5% of Commission's revenues of $267 million. According to the expenditure plan, much of the sales tax receipts are intended to be transferred to local entities for transit services, local streets and roads, and rail operations. According to the Commission, Major Highway & Transit Capital Projects (38% of expenditures) and Environmental Mitigation Program (6.2%, Major Corridor EMP and Local EMP) are expenditures which the Commission is likely to incur directly and is likely to fund, at least in part, by debt. Our very high rating for the Commission's sales tax supported debt depends heavily on our expectation that debt service coverage levels will remain strong.

LEGAL STRUCTURE OFFERS STRONG ADDITIONAL BONDS TEST WITH NO RESERVE REQUIREMENT

The sales tax securing these bonds will be collected by the State Board of Equalization and deposited monthly with the trustee for the benefit for bondholders. Once the principal and interest have been deposited, the reserve requirement is satisfied, subordinate obligations (if any) paid, and the trustee's fees/expenses paid, the sales tax receipts are released to the Commission. The additional bonds test requires that the sales tax revenues of the preceding fiscal year cover maximum annual debt service by 2.0 times. The series 2010, 2012 and 2014 bonds are not supported by a debt service reserve.

VARIABLE RATE DEBT COMPRISES A MODERATE BUT MANAGEABLE PORTION OF THE COMMISSION'S OUTSTANDING DEBT

Three variable rate to fixed rate swaps, each with a notional amount of $134.1 million, hedge the Commission's variable rate debt. The swap counterparties are Goldman Sachs and Bank of America. Although the Commission is not required to post collateral under any circumstance, as of June 30, 2014 these three swaps have a combined value of negative $69.4 million for the Commission. There would be an Additional Termination Event (ATE) if either the Commission's or counterparties' ratings fell below Baa2.

The currently outstanding variable rate bonds are enhanced with JP Morgan Chase (50% of total, expiring in March 2017), Mizuho Bank, (25% of total, expiring in September 2017); and State Street/CALSTERS (25% of total, expiring in September 2015). With respect to the SBPAs, in case of failed remarketings, and Bank ownership of the bonds, the Commission would have five years to repay the banks. Given the gross pledge of sales tax revenues for repayment of the bonds, annual sales tax receipts would provide sufficient coverage of the accelerated repayment of the bank bonds, which would afford the Commission ample time to refund the bonds. The Commission's substantial cash reserves, of approximately $390 million of unrestricted cash at the end of fiscal year 2014, would provide additional flexibility in addressing interest rate basis risk and repayment of bank bonds. The Commission also has authorization for $100 million of commercial paper (CP) of which only $30.7 million is outstanding. The CP also benefits from the gross pledge of the sales tax revenues, although its claim is subordinate to the long term debt. Although the term-out period for repayment of the standby facility for the CP is only three years, annual sales tax receipts would be sufficient to meet the requirements in addition to the term-out requirements of the long term debt mentioned above.

What could change the rating UP

Significant transformation of the county economy resulting in significantly higher wealth and income levels.

What could change the rating DOWN

Debt service coverage falling below 2.0x

KEY STATISTICS

Population (County): 3.21 million

2010 Per capita income: $30,715 (112.4% of US)

2010 Median family income: $73,560 (116.8% of US)

Estimated maximum annual debt service (MADS): $84.113 million

MADS coverage as provided by 2014 pledged revenues: 3.1 times

Sales Tax Revenue Bonds Outstanding: $1.488 billion

Series 2008 Bonds, $402.3 million

Series 2010 Bonds, $347.8 million

Series 2012 Bonds, $388 million

Series 2014 Bonds, $350 million

The principal methodology used in this rating was US Public Finance Special Tax Methodology published in January 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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