S&P Global
Ratings

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Summary:

San Diego County Regional Transportation Commission; Sales Tax

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Credit Profile		
US$537.484 mil jr sub sales tax rfdg rev bnds (ltd tax bnds) (Mid-coast Corridor Transit Proj) ser 2021 due 10/01/2045		
Long Term Rating	A+/Stable	New
San Diego Cnty Regl Transp Com sales tax		
Long Term Rating	AAA/Stable	Affirmed
San Diego Cnty Regl Transp Com ser 2008C SALESTAX		
Long Term Rating	AAA/A-1/Stable	Affirmed
San Diego Cnty Regl Transp Com ser 2008D SALESTAX		
Long Term Rating	AAA/A-1+/Stable	Affirmed
San Diego Cnty Regl Transp Com ser 2008 A&B SALESTAX		
Long Term Rating	AAA/A-1/Stable	Affirmed
San Diego Cnty Regl Transp Com ser 2008 A&B SALESTAX		
Long Term Rating	AAA/A-1/Stable	Affirmed
San Diego Cnty Regl Transp Com Sub Sales Tax Rev S-T Nts		
Long Term Rating	AA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'A+' its long-term rating to San Diego County Regional Transportation Commission, Calif.'s $537,484,439 Transportation Infrastructure Finance and Innovation Act (TIFIA) loan for the Mid-Coast Corridor Transit Project. (The commission is a component unit of the San Diego Association of Governments, or SANDAG) S&P Global Ratings also affirmed the following ratings on existing sales tax revenue obligations outstanding:

- 'AAA' long-term rating on the commission's senior-lien sales tax revenue bonds;
- 'AA' long-term rating on the commission's series 2018A subordinate sales tax revenue short-term notes;
- 'AAA/A-1' rating on the commission's series 2008A, 2008B, and 2008C senior-lien sales tax revenue bonds; and
- 'AAA/A-1+' rating on the commission's series 2008D senior-lien sales tax revenue bonds.

The outlook, where applicable, is stable.

A gross pledge of a 0.5% sales tax levied throughout San Diego County, net of an administrative fee paid to the California Department of Tax and Fee Administration, secures each obligation, with three lien positions: senior, junior, and junior subordinate. The tax, known as TransNet, began in 1988, was reauthorized in 2004, and sunsets on March 31, 2048. All obligations mature prior to the sunset of the tax.

This TIFIA loan will replace an identically sized but unexercised loan with the U.S. Department of Transportation in 2017 and will enable the commission to draw at a lower interest rate. Including the TIFIA loan and following a planned second-lien issuance in early 2021, the commission will have about $1.8 billion in principal outstanding on the senior lien, $623.2 million on the subordinate lien and the $537.5 million in TIFIA obligations.

Under our "Priority-Lien Tax Revenue Debt" criteria (published Oct. 22, 2018), we factor in both the strength and stability of the pledged revenue, as well as an obligor's general credit quality. In this case we consider SANDAG, of which the commission is a component unit, the obligor.

The short-term component of the ratings on series 2008A, 2008B, 2008C, and 2008D bonds reflect our view of their respective standby bond purchase agreement (SBPA) liquidity providers, specifically:

- Series 2008A and 2008B: The 'A-1' short-term component of the rating is based on the rating on the SBPA with JPMorgan Chase Bank N.A., which expires March 2021;
- Series 2008C: The 'A-1' short-term component of the rating is based on the SBPA with Bank of America N.A., which expires October 2021; and
- Series 2008D: The 'A-1+' short-term component of the rating is the SBPA with State Street Bank and Trust Co., which expires June 2024.

Credit overview

The commission, which shares a governing board with SANDAG, was created by the state and is charged with administering the TransNet sales tax to provide for transportation infrastructure improvements in San Diego County. As a special district, the commission has limited operations beyond administering TransNet and accumulating and dispersing the dedicated sales tax revenue to other entities that operate, construct, and maintain transportation services, infrastructure, and programs throughout the county.

The bonds' credit profile benefits from broad, diverse, and economically prosperous economic base of San Diego County, the fifth-most populous county in the nation and second-most populous in California. In addition, the ratings across the three liens reflect a combination of the relative strengths and weaknesses of the additional bonds tests (ABTs) that require 2.0x (senior lien), 1.5x (junior lien), and 1.15x (junior subordinate lien) maximum annual debt service (MADS) coverage in order for additional debt to be issued.

The rapid recession that took hold in the first half of 2021 has yet to materially push pledge revenues downward, with fiscal year (ending June 30) 2020 revenues effectively even with fiscal 2019 and year-to-date performance up an annualized 1.6%. We continue to see risks to the U.S. economy related to the COVID-19 pandemic, with our downside scenario envisioning a 0.8% real GDP increase vs. our baseline 4.2% increase after a 3.9% drop in 2020. This suggests that pledged revenues are unlikely to grow significantly during our two-year outlook period but we have yet to see evidence in local economic conditions that augurs a major drop in maximum annual debt service coverage that would approach each lien's respective additional bonds tests, which anchor our view of coverage at each lien.

The ratings further reflect our view of:

- San Diego County's very strong economic fundamentals, supported by a very large population of 3.3 million and capita effective buying income (EBI) at 111% of the national average;

- Bond provisions that require strong-to-very strong MADS coverage at issuance of future debt at the first two lien positions;
- A weak ABT of 1.15x MADS at the junior subordinate-lien position and a likelihood of additional issuance at the junior-lien position in the coming decade--this analysis anticipates one planned for early 2021--although we calculate current coverage for all three liens combined at a strong 1.8x;
- Our view that sales taxes nationally have historically demonstrated low volatility, and that the commission's TransNet sales tax similarly demonstrates low volatility; and
- Our view that SANDAG's general creditworthiness does not constrain the credit quality of the commission's sales tax revenue bonds.

Environmental, social, and governance factors

Our rating considers the ESG risks relative to the commission's sales tax revenue bonds' economic fundamentals, revenue volatility, coverage and liquidity, and obligor's creditworthiness. Parts of San Diego County are exposed to heightened environmental risks posed by the threat of wildfires and earthquakes, and, over the longer term, sea level rise. We consider social and governance factors for this credit in line with the sector.

Stable Outlook

Downside scenario

We could lower the ratings at one or more lien positions if substantial additional borrowings, or a combination of additional borrowings and declines in pledged revenue, cause coverage to fall below the respective ABTs with the trajectory of any decline in pledged revenue an important consideration.

Upside scenario

We do not expect to raise the ratings on the junior and junior subordinate liens, given our view that those liens' ABTs allow for significant dilution in coverage. Should legal provisions strengthen, or should other factors strengthen our view that coverage will remain materially stronger than the levels we have currently assumed in our forward-looking analyses, as the commission proceeds with its additional borrowing plans, we could raise the ratings.

Credit Opinion

Economic fundamentals: Very strong

The taxing area is coterminous with San Diego County, which encompasses its namesake city and an area stretching from the U.S-Mexico border to Marine Corps Base Camp Pendleton. With a state-estimated population of 3.3 million for 2020, the commission's service area population has grown by 8% in the past decade. The county is the second-most populous in California. Although the COVID-19 pandemic has curtailed business travel and tourism we anticipate that the county's climate and amenities will enable such activity to bounce back in the coming year. The county also retains strengths in high human capital industries, such as biotechnology, information technology and communications. County-level per capita EBI was 111% of the national level in 2019.

The trajectory of the county's unemployment rate has been favorable in recent months, with a preliminary 7.7% unemployment rate in October following a jump to 15.0%. We expect the effect of the recent recession and slow recovery to correspond to national patterns, with high-income residents who are able to work remotely generally able to transition to a different environment with limited disruption, with some relocating to less-dense areas within the county from the city center. Moreover, anecdotal evidence suggests high-income residents have kept household spending at a similar level overall by shifting to home improvement and similar goods purchases as they pulled back on travel and restaurant spending. We think this could have been a factor in the recent buoyancy in pledged revenues. By contrast, residents in the service industry appear likely to remain at risk of economic stress until widespread vaccinations allow restaurants and other in-person businesses to reopen at full capacity.

Senior-lien coverage and liquidity: Very strong

Pledged TransNet revenue produced 2.9x MADS coverage on the senior lien in fiscal 2020. Based on the current debt service schedule, senior-lien pledged revenue has produced MADS coverage no lower than 2.1x since fiscal 2011, owing to strong pledged revenue performance and growth since the Great Recession.

The rapid onset of the recession in the second half of fiscal 2020 was not sufficient to cause an outright decline in pledged revenues, as management anticipated six months ago. Instead revenues ticked up by 0.2% from fiscal 2019 to $305.9 million. Annualized data so far for fiscal 2021 suggest growth in excess of 1% and SANDAG's projections anticipate a 3% revenue increase for fiscal 2022 relative to our annualized calculation for fiscal 2021.

The commission's senior-lien ABT requires pledged revenue collected during the most recent audited fiscal year produce MADS coverage of at least 2.0x on existing and proposed parity debt. The series 2008 variable rate bonds have dedicated debt service reserves, funded to 50% of MADS. The other senior-lien bonds do not benefit from the additional security of funded debt service reserves (DSRs). However, given our view that senior-lien coverage is very strong and revenue volatility is low, we do not apply a liquidity factor adjustment to the senior-lien coverage and liquidity assessment.

Junior lien coverage and liquidity: Strong

We consider the commission's second-lien coverage and liquidity strong. Fiscal 2020 pledged revenue produced 2.4x MADS coverage on combined senior and junior lien obligations, inclusive of an approximately $85 million "new money" and refunding issuance at this lien position planned for early 2021. Pledged revenue has produced MADS coverage at level no lower than 1.7x since fiscal 2011, although management anticipates that the commission will use this lien as the active position (in lieu of the senior lien) for the foreseeable future when not drawing on the junior subordinate (TIFIA) loan.

Repayment on the second-lien obligations is subordinate to existing senior obligations that include the rated TransNet bonds, and parity to draws under a $100 million CP authorization. The second-lien obligations are also senior to credit and liquidity provider fees, and expenses and termination payments on existing swaps. Management anticipates the commission will eventually replace its notes at this position (due Apr. 1, 2021) with draws under the new TIFIA loan, although current plans are to issue replacement notes maturing in fall 2022.

The second-lien ABT requires that pledged revenue collected during the most recent audited fiscal year produce 1.5x MADS coverage on existing and proposed parity and senior debt. The second-lien obligations do not benefit from the additional security of funded DSRs. However, given our view that second-lien coverage is strong and revenue volatility is low, we do not apply a liquidity factor adjustment to the second-lien coverage and liquidity assessment.

Junior subordinate lien coverage and liquidity: Adequate

Fiscal 2020 pledged revenue produced 1.8x MADS coverage of debt service at the three lien positions combined using management-provided assumptions regarding debt service following draws on the TIFIA loan. Repayment of the junior subordinate lien obligations is subordinate to the senior- and second-lien obligations, the commission's CP obligations, and to credit and liquidity provider fees and expenses and swap termination payments. As our calculation of MADS coverage at this position reflects the likely full exercise of the TIFIA loan in the coming decade and a planned junior lien issuance in early 2021, we see the primary intermediate-term influence on credit quality at this position the direction of pledged revenues, with recent data pointing to stability. In the long-term we think the pace of issuance at the junior lien presents the larger downside credit risk, although we note that the junior lien is subject to a higher 1.50x ABT that provides a measure of protection at the junior-subordinate position.

The junior subordinate-lien loan agreement dictates that the commission must fund a DSR, but only if annual DSC on the third lien falls below 1.35x. If coverage falls below the threshold, the reserve must be funded at 50% of MADS requirements. Despite a weak 1.15x ABT and lack of a funded reserve, we do not apply a negative liquidity factor adjustment. Rather, we view the credit limitations of the junior subordinate lien's initial coverage and liquidity assessment as somewhat mitigated by the strength of current MADS coverage on the lien and its ability to maintain coverage materially stronger than the 1.15x ABT as the commission proceeds with its additional borrowing plans.

Volatility: Low

We assess the volatility of revenue to determine the likelihood of the availability of revenue during 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 future volatility.

On a micro level, we do not view pledged sales tax revenue as having demonstrated materially more or less volatility than sales taxes nationally. Although pledged revenue declined a total of 18% from fiscal years 2007-2010 during and in the immediate aftermath of the Great Recession, TransNet revenue growth has been very strong since the fiscal 2010 nadir. After hitting its low point in fiscal 2010, pledged revenue recovered over a four-year period, surpassing fiscal 2007's pre-recession level by fiscal 2014. SANDAG's projections point to annual increases in the low-single-digit-percentages through 2025.

Obligor linkage: Limited relationship

The state administers the collection and disbursement of the TransNet sales tax revenue. Per the indenture, the state remits the TransNet revenue directly to the trustee each month, after deducting its administrative fee. Each month, the trustee deposits revenue sufficient to cover one-sixth of semi-annual interest requirements and one-12th of annual principal requirements before remitting the remainder to the authority.

Because the revenue flows directly from the state to the trustee, we consider the flow of pledged revenue substantially removed from the obligor's direct control. Under our criteria, this mitigates the linkage between the priority lien pledge and the obligor's creditworthiness, lessening the degree of exposure of the pledged revenue stream to operating risks of the obligor.

Furthermore, we believe the pledged revenue stream is further insulated from operating risk, given SANDAG's limited scope of operations. Besides its toll-road projects, which (as explained below) we believe are separate from the general government and the commission's priority lien revenue stream, SANDAG serves as a capital planning and funding entity with limited operations.

Rating linkage to the San Diego Association of Government's general creditworthiness

We consider the SANDAG the obligor under our criteria. The SANDAG board of directors is the commission's board of directors, and the commission is a blended component unit of SANDAG, with financial reporting for the commission released on a standalone basis annually.

We apply our GO debt criteria (published Oct. 12, 2006) to evaluate the SANDAG's general creditworthiness. The commission's general operations are limited, serving primarily as a capital planning and funding entity charged with accumulating and dispersing funds to support a host of transportation projects and programs constructed, maintained and operated by other entities in the county.

In addition to its capital funding activities, the commission and SANDAG as a whole engage in a variety of other transportation and public infrastructure capital funding activities in the county. These other capital funding activities are primarily funded through federal and state grant receipts. SANDAG also operates two toll-road projects, SR-125 and I-15 FasTraks. We have not included these self-supporting toll-road operations into our analysis of the obligor's creditworthiness, as we believe they are separate from the obligor's general operations.

We believe the large and diverse economic base underlying SANDAG's service area, along with TransNet-related reserves generally approximating one years' expenditures, support general creditworthiness, as does it's demonstrated success in accumulating and dispersing funds to support capital projects, transportation programs, and service debt.

Variable-rate obligations and swaps

The commission has several series of variable-rate obligations outstanding, all synthetically converted to fixed rate through interest rate swaps. We have analyzed the commission's interest rate and basis swaps, and do not consider these as posing material contingent liquidity risk to the commission or its bondholders. The swaps' aggregate mark-to-market is currently approximately negative $113 million in aggregate in favor of the commission's counterparties, and we believe that termination risk is remote, given the standard and remote nature of the events of default identified in the swap agreements.

The local ratings' relationship with the U.S. sovereign

The senior-lien bonds are eligible to be rated above the sovereign, because we believe the SANDAG can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above the Sovereign--Corporate and Government Ratings: Methodology and Assumptions" (published on Nov. 19, 2013), U.S. local governments are considered to have moderate sensitivity to country risk. Locally derived revenue are the source of security for the bonds, and the institutional framework in the U.S. is predictable, with significant U.S. local government autonomy. In a potential sovereign default scenario, U.S. local governments would maintain financial flexibility through the ability to continue collecting locally derived revenue and U.S. local governments have independent treasury management.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- Economic Research: Staying Home For The Holidays, Dec. 2, 2020