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Ratings

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Summary:

San Diego County Regional Transporation Commission, California; Sales Tax

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Credit Profile		
San Diego Cnty Regl Transp Com sales tax		
Long Term Rating	AAA/Stable	Affirmed
San Diego Cnty Regl Transp Com Sub Sales Tax Rev S-T Nts		
Long Term Rating	AA/Stable	Affirmed
San Diego Cnty Regl Transp Com (Mid-coast Corridor Transit Proj) jr sub sales tax		
Long Term Rating	A+/Stable	Affirmed

Rating Action

S&P Global Ratings affirmed its long- and short-term ratings on San Diego County Regional Transportation Commission, Calif.'s senior-, subordinate-, and junior subordinate-lien sales tax revenue bonds outstanding. The outlook, where applicable, is stable. Specifically, the affirmed ratings include the:

- '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 (limited tax bonds);
- 'AAA/A-1' rating on the commission's series 2008A, 2008B, and 2008C senior-lien sales tax revenue bonds;
- 'AAA/A-1+' rating on the commission's series 2008D senior-lien sales tax revenue bonds; and
- 'A+' long-term rating on the commission's junior subordinate-lien sales tax Transportation Infrastructure Finance and Innovation Act (TIFIA) loan.

The ratings reflect the application of our "Priority-Lien Tax Revenue Debt" criteria (published Oct. 22, 2018, on RatingsDirect), which factors in both the strength and stability of the pledged revenue, as well as the obligor's general credit quality. In this case, per our criteria, we consider the San Diego Association of Governments the obligor.

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

Specifically:

- The series 2008A and 2008B '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 November 2020; 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.

A gross first-lien 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 (CDTFA), secures the senior-lien bonds. A second- and junior-subordinate (third) lien pledge of the same tax secures the second- and junior-subordinate lien obligations, respectively. The tax is known as TransNet. TransNet collections began in 1988, and voters reauthorized the tax in 2004, extending it through its current sunset date of March 31, 2048.

Credit overview

The commission 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 commission is a component unit and shares the governing board of the San Diego Association of Governments (SANDAG).

The commission's priority revenue 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 (second lien), and 1.15x (junior-subordinate lien) maximum annual debt service (MADS) coverage in order for additional debt to be issued.

Although our outlook is generally for two years, we see significant downside risks due to the COVID-19 pandemic and developing recession over the next six to 12 months. While we expect pledged revenue to decline in the near-term, given the economic recession spurred by the COVID-19 pandemic and governments' efforts to control the spread of the virus, the stable outlook reflects our expectation that coverage levels to remain no lower than the levels required by the ABTs across the three liens. For more on our view of COVID-19 and the recession's influence on the U.S. economy and credit conditions across U.S. public finance, see our reports "The COVID-19 Outbreak Weakens U.S. State And Local Government Credit Conditions" published April 2, 2020, and "An Already Historic U.S. Downturn Now Looks Even Worse", published April 16, 2020, on RatingsDirect.

Key credit considerations include:

- San Diego County's very strong economic fundamentals, supported by a very large and rapidly growing population of 3.4 million with per capita effective buying income (EBI) figures 9% higher than the national level;
- ABTs that require 2.0x MADS coverage on the senior lien and 1.5x MADS coverage on the second lien;
- A junior-subordinate lien rate covenant requiring just 1.15x MADS coverage for additional debt issuance. The weak ABT is somewhat mitigated but the junior-subordinate lien's materially stronger 1.9x MADS coverage from fiscal 2019 pledged revenue;
- 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.

At fiscal year-end 2019, the commission had approximately $1.7 billion in senior-lien sales tax revenue bonds outstanding, and $566.2 million in subordinate-lien debt outstanding, including $537.5 million in series 2018 short-term notes, and $28.7 million in parity commercial paper (CP) obligations. The commission secured a $537.5 million TIFIA loan agreement with the U.S. Department of Transportation in 2017. The TIFIA loan agreement entitles the commission to $537.5 million in loan proceeds, which the commission intends to apply to repay short-term obligations incurred in financing its Mid-Coast Corridor Transit Project. As of fiscal year-end 2019, the commission had not yet made any draws under its TIFIA loan.

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 posing material contingent liquidity risk to the commission or its bondholders. Though the swaps' aggregate mark-to-market is currently approximately negative $85 million, in favor of the counterparties, we believe that termination risk is remote, given the standard and remote nature of the events of default identified in the swap agreements.

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. We believe the pledged revenue stream is exposed to downside risk related to the economic recession that has been triggered by the COVID-19 pandemic, and the social distancing measures implemented to protect the populations' health and safety. As a result of the economic recession and sharp declines in certain sectors that count as important sales tax revenue generators, we believe pledged revenue will decline in the near-to-intermediate term, and we have incorporated this into our rating. Parts of San Diego County are exposed to heightened environmental risks posed by the threat of wildfires and, over the longer term, sea level rise. We consider governance factors for this credit in line with the sector.

Stable Outlook

Downside scenario

Though we understand the commission does not currently anticipate issuing additional debt within the next five years, we could lower the ratings if substantial additional borrowings, or a combination of additional borrowings and declines in pledged revenue, cause coverage metrics to fall below the ABT for the senior and subordinate lines, or below levels we consider adequate for the junior subordinate lien.

Upside scenario

We do not expect to raise the ratings on the second- and junior-subordinate liens, given our view that those liens' ABTs limit their coverage and liquidity assessments. 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

With a population of approximately 3.4 million, San Diego County is the second-most populous county in California and fifth-most populous in the nation. From 2013 through 2018, its population grew by 5.1%, outpacing the state (3.9%) and national (3.7%) growth rates during that period. The county remains a major regional economic hub and counts tourism, military, international trade, and high-technology manufacturing as important economic generators.

We expect the local economy, like the national economy, to face significant challenges related to the economic recession that has emerged due to the spread of and government efforts to control the new coronavirus. We note that a prolonged downturn in economic activity and other impacts of the recession could adversely affect countywide income levels and perhaps population growth, which could have negative implications for our economic fundamentals assessment. Currently, however, we expect the credit's economic fundamentals to remain very strong, supported by an extremely large and broad countywide sales tax base.

County-level per capita EBI was 109% of the national level in 2018. The county's unemployment rate remains below the state and national levels, and was just 3.3% in 2018. The county's sales tax base is highly diverse, with the top-100 sales tax remitters accounting for 34.4% of collections in calendar year 2018.

Senior-lien coverage and liquidity: Very strong

Pledged TransNet revenue produced 2.9x MADS coverage on the senior lien in fiscal 2019. Our calculations net out approximately $7 million in TransNet revenue that was under-collected by the state in fiscal 2018 and reported in fiscal 2019. Net of this over-collection, the commission received $305.3 million in pledged revenue in fiscal 2019. 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.

Management's current projections indicate an estimated 2.4% decline from adjusted fiscal 2019 pledged revenue in fiscal 2020, and a further 4.0% decline in fiscal 2021. We note that TransNet collections for the June reporting period, which reflect collections that occurred in April 2020, indicate marginal 0.2% growth from the same month during the prior year. This indicates that fiscal 2020 actual pledged revenue may be somewhat higher than the 3.0% decline from fiscal 2019 that management has estimated. Based on management's fiscal 2020 estimates and fiscal 2021 budget, senior-lien MADS coverage would be 2.8x for fiscal 2020, and 2.7x for fiscal 2021.

The commission previously indicated plans to issue roughly $100 million to $150 million in additional TransNet-secured debt from fiscal years 2022 through 2024. However, as the economic recession has emerged, management indicates it has pushed out certain planned projects and does not currently anticipate issuing any new TransNet-secured debt over the next five years. We view the commission's flexibility and demonstrated willingness to adjust its capital plan during periods when the local economy and TransNet revenue stream are pressured as a positive credit factor supporting our coverage assessments.

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.

Second-lien coverage and liquidity: Strong

We consider the commission's second-lien coverage and liquidity strong. Fiscal 2019 pledged revenue (adjusted as discussed above) produced 2.3x MADS coverage on second-lien obligations. Based on the current debt service schedule, pledged revenue has produced MADS coverage no lower than 1.7x since fiscal 2011. Estimated fiscal 2020 pledged revenue indicates subordinate lien MADS coverage of 2.3x, while budgeted fiscal 2021 revenue indicates 1.8x MADS coverage.

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 parity to credit and liquidity provider fees, and expenses and termination payments on existing swaps.

The bonds are structured with interest payments through note maturity, in 2021, and repayment of note principal from draws on the series 2017 junior-subordinate TIFIA loan obligation. The commission entered into the TIFIA loan agreement with the U.S. Department of Transportation on June 27, 2017, in an amount not to exceed $537.48 million.

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 2019 pledged revenue (adjusted) produced 1.9x MADS coverage. Pledged revenue produced 1.8x MADS coverage for the junior-subordinate lien in fiscal 2018. MADS coverage indicated by pledged revenue estimated for fiscal 2020 and budgeted for fiscal 2021 suggests junior subordinate lien MADS coverage of 1.8x and 1.7x, respectively. 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.

Per our analysis, the commission could likely issue approximately $4.0 billion to $5.0 billion in additional TransNet-secured debt without reducing junior subordinate lien MADS coverage below the 1.15x ABT. This analysis and our understanding of the commission's additional borrowing plans somewhat mitigate the credit weakness of an ABT that requires historic revenue collected during 12 consecutive of the most recent 18-month period produce just 1.15x MADS coverage on existing and proposed parity and senior obligations.

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. To determine our view of the volatility of sales taxes, we used total retail food and service sales data from the U.S. Census Bureau for the period 1993-2014.

On a micro level, we believe the commission's pledged sales tax revenue has not demonstrated materially more or less volatility than sales taxes nationally. Though 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.

Our analysis has incorporated our view of estimated and budgeted pledged revenue declines due to the recently emerged economic recession (see coverage and liquidity section above).

Obligor linkage: Limited relationship

The California Department of Tax and Fee Administration (CDTFA) administers the collection and disbursement of the TransNet sales tax revenue. Per the indenture, the CDTFA 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 CDTFA 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 any operating risk of SANDAG 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

Per our criteria, we consider SANDAG the obligor. Its board of directors is the commission's board of directors, and the commission is a blended component unit of SANDAG. The association's financial statements include the commission as a governmental fund of SANDAG. As stated above, we believe the obligor linkage to the priority-lien revenue stream is limited.

We apply our GO debt criteria (published Oct. 12, 2006) to evaluate SANDAG's general creditworthiness. We assess the SANDAGs general operations because we view overall creditworthiness as a key determinant of an obligor's ability to pay all of its obligations, including bonds secured by a special tax. As discussed above, SANDAG's general operations are limited, serving its primary functions 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, SANDAG engages 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 county's economic indicators support SANDAG's general creditworthiness, as does it and the commission's demonstrated success in accumulating and dispersing funds to support capital projects, transportation programs, and service debt.

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

The commission's senior-lien bonds are eligible to be rated above the sovereign, because we believe the commission 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. The commission's 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

- Credit FAQ: Financial Management Assessment In U.S. Public Finance, June 27, 2006
- The COVID-19 Outbreak Weakens U.S. State And Local Government Credit Conditions, April 2, 2020
- An Already Historic U.S. Downturn Now Looks Even Worse, April 16, 2020
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of June 25, 2020)		
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

Ratings Detail (As Of June 25, 2020) (cont.)		
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