S&P Global Ratings

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Summary:

San Diego County Regional Transportation Commission; Sales Tax

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Table Of Contents

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Credit Profile		
US$372.92 mil sales tax rev bnds (Limited Tax Bnds) ser 2019 A due 04/01/2048		
Long Term Rating	AAA/Stable	New
US$74.765 mil sales tax rev bnds (Limited Tax Bnds) ser 2019 B due 04/01/2048		
Long Term Rating	AAA/Stable	New
San Diego Cnty Regl Transp Com ser 2008D 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

Rationale

S&P Global Ratings assigned its 'AAA' long-term rating to San Diego County Regional Transportation Commission, Calif.'s sales tax revenue bonds, series 2019A and 2019B. At the same time, S&P Global Ratings affirmed its ratings on the commission's senior-, subordinate-, and junior subordinate-lien sales tax revenue bonds outstanding. 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 outlook on all ratings is stable.

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.

Security and use of proceeds

The commission anticipates issuing approximately $448 million between the series 2019A and series 2019B bonds. Subject to board approval, management expects the commission to issue about $70 million in new money, in early 2020, to fund project costs associated with its TransNet Early Action Program (EAP), including various bicycle and pedestrian improvements. The commission also plans to apply the remaining proceeds, approximately $348 million, to refund all or a portion of its series 2010B bonds and portions of its series 2012A and 2014A bonds.

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 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 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.

Our assessments also reflect our forward-looking expectations for coverage, and our expectations that coverage will remain above the levels required by the ABTs, to varying degrees. Supporting our coverage and liquidity assessments is our analysis finding that the commission's plans to issue approximately $100 million-$150 million in additional TransNet-secured debt through fiscal 2024 will not likely weaken coverage materially across the three liens.

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 1.8x MADS coverage from fiscal 2018 revenue and our expectation that the commission's additional borrowing plans would likely suppress the third-lien MADS coverage to just 1.6x.

- Our view that sales taxes nationally have historically demonstrated low volatility, and that the commission's TransNet sales tax similarly demonstrates low volatility.
- Our view that SANDAG's general creditworthiness does not constrain the credit quality of the commission's sales tax revenue bonds.

The commission has approximately $1.7 billion in senior-lien sales tax revenue bonds outstanding, and $567 million in subordinate-lien debt outstanding, including $537.5 million in series 2018 short-term notes and $29.4 million in parity commercial paper (CP) obligations.

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/or remote nature of the swap agreement events of default.

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.

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 fiscal 2018 collections.

Senior-lien coverage and liquidity: Very strong

Unaudited estimates for fiscal 2019 indicate the commission received $312.3 million in TransNet collections, producing 2.9x senior-lien MADS coverage. We understand that administrative issues with the state entity administering the collections led to some undercounting of fiscal 2018 pledged revenue, and some over-counting for fiscal 2019. Management estimates the over-counting for fiscal 2019 totaled around $7 million. Net of that $7 million, MADS coverage for fiscal 2019 would be 2.8x.

The commission's $294.5 million in pledged TransNet revenue in fiscal 2018 produced 2.7x MADS coverage, calculated for MADS post-issuance of the series 2019 bonds (MADS coverage was 2.8x for the debt service schedule before the series 2019 issuance). Applying the $7.0 million that management estimates was undercounted for fiscal 2018 back to that year, MADS coverage improves marginally to 2.8x. 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.

Currently, the commission estimates it will issue roughly $100-150 million in additional TransNet-secured debt from fiscal years 2022 through 2024, though the timing and lien status is indeterminate at this time. We estimate that MADS coverage would likely remain at or above 2.5x, from fiscal 2018 revenue, if the commission were to issue the full amount of planned additional debt in fiscal 2020, which we consider unlikely and a conservative assumption.

In addition to our sensitivity analysis of MADS coverage including the commission's additional borrowing plans, legal provisions also supporting our view that senior-lien coverage will remain very strong. The commission's senior-lien ABT that 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 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. Estimated fiscal 2019 pledged revenue produced 2.3x MADS coverage on existing and planned series 2019 second-lien obligations. Fiscal 2018 revenue produced 2.2x MADS coverage on the second-lien obligations. Based on the commission's additional borrowing plans described above, we estimate that its fiscal 2018 pledged revenue securing the second-lien obligations would likely produce MADS coverage of around 2.0x.

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, of which the commission currently has $29.4 million outstanding. 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

Estimated fiscal 2019 pledged revenue produced 1.9x MADS coverage on existing and planned series 2019 bonds. Pledged revenue produced 1.8x MADS coverage for the junior-subordinate lien in fiscal 2018. 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.

We estimate that the commission's additional borrowing plans would suppress junior-subordinate lien coverage to approximately 1.7x from fiscal 2018 revenue, conservatively assuming the commission issued in fiscal 2020 the full $150 million in additional obligations it is considering issuing through fiscal 2024. 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.

The commission has forecasted modest near-term TransNet revenue growth. Pledged tax revenue collections were 5% higher through the first four months of fiscal 2020 compared to the prior year, indicating a continuation of the recent growth trend. We believe additional near-term revenue growth is likely. Our economic growth forecast for state and local governments anticipates continued economic growth for the Pacific region in the near term, even if the pace of growth may slow compared to recent years.

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.

Outlook

The stable outlook reflects our expectation that the commission's coverage metrics will continue to support the ratings across the three liens, supported by the county's deep and diverse economy, and robust sales tax base. The outlook indicates that we do not expect to change the rating within our two-year outlook horizon.

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.

Downside scenario

We could lower the ratings if the additional borrowing plans or material unexpected declines in pledged revenue suppress coverage to materially weaker levels than our current assessments reflect.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Oct. 29, 2019
- Credit FAQ: Financial Management Assessment In U.S. Public Finance, June 27, 2006

Ratings Detail (As Of November 25, 2019)		
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 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 (Mid-coast Corridor Transit Proj) jr sub sales tax		
Long Term Rating	A+/Stable	Affirmed