S&P Global
Ratings

RatingsDirect®

Summary:

San Diego County Regional Transportation Commission; Sales Tax

Primary Credit Analyst:
Rob M Marker, Denver + 1 (303) 721 4264; Rob.Marker@spglobal.com

Secondary Contact:
Kevin R Archer, San Francisco + 1 (415) 3715031; Kevin.Archer@spglobal.com

Table Of Contents

Summary:

San Diego County Regional Transportation Commission; Sales Tax

Credit Profile		
US$470.6 mil sales tax rev bnds (ltd tax bnds) (San Diego Associate of Governments) ser 2023A due 04/01/2048		
Long Term Rating	AAA/Stable	New
San Diego County Regional Transportation Commission, California		
San Diego Associate of Governments, California		
San Diego Cnty Regl Transp Comm (San Diego Assn of Govt) SALESTAX		
Long Term Rating	AAA/Stable	Affirmed
San Diego Cnty Regl Transp Comm (San Diego Assn of Govt) SALESTAX		
Long Term Rating	AA/Stable	Affirmed

Credit Highlights

- S&P Global Ratings assigned its 'AAA' long-term rating to the San Diego County Regional Transportation Commission's approximately $471 million senior-lien sales tax revenue bonds, series 2023A (The commission is a component unit of the San Diego Association of Governments, or SANDAG).
- We also affirmed the following ratings: 'AAA' long-term rating on the commission's senior-lien sales tax revenue bonds; 'AA' long-term rating on the commission's subordinate-lien sales tax revenue bonds; 'A+' long-term rating on the commission's junior subordinate-lien Transportation Infrastructure Finance and Innovation Act (TIFIA) loan; '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.

The short-term component of the ratings on the series 2008A, 2008B, 2008C, and 2008D bonds reflects 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 SBPA with JPMorgan Chase Bank N.A.;
- Series 20028C: the 'A-1' short-term component of the rating is based on the SBPA with Bank of America N.A.; and
- Series 2008D: the 'A-1+' short-term component of the rating is based on the SBPA with State Street Bank and Trust Co.

The commission anticipates refinancing all the series 2008 bonds as part of the series 2023 financing and terminating the entire swap portfolio.

Security

Gross revenue from 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 long-term obligation, with three lien positions: senior, junior, and junior subordinate. The commission is responsible for implementing and administering the San Diego countywide sales tax, known as TransNet, which was first collected in 1988, was reauthorized in 2004, and sunsets on March 31, 2048. All obligations mature before the sunset of the tax.

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, to be the obligor.

Bond proceeds will be used to refund all the series 2008 bonds and terminate the related interest rate swaps, refund a portion of the series 2019A bonds and fund a tender purchase of an additional portion of the 2019A bonds.

Credit overview

The bonds' credit profile benefits from the broad, diverse, and economically prosperous tax base of San Diego County. 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 2.00x (senior lien), 1.50x (junior lien), and 1.15x (junior subordinate lien) maximum annual debt service (MADS) coverage for additional debt to be issued.

Following a small 2.0% decline in pledged revenue in 2020 primarily related the COVID-19 pandemic and associated drop in economic activity, growth has accelerated, increasing 9.2% in fiscal 2021 and an extraordinary 21.5% in fiscal 2022 to $405.9 million. Recent growth was spurred by increases across all categories of sale taxes, especially in the general retail trade category that includes day-to-day items. In addition, the broader economic recovery from the brief recession in 2020, higher-than-expected impact from the Wayfair ruling (U.S. Supreme Court ruling that states have the right to tax online sales and broaden their ability to tax online sales when the seller is located in another state), and consumer spending on taxable items supported by public income assistance (federal pandemic-relief aid) all contributed to sales tax growth.

Pledged revenue growth remained resilient through the first 10 months of fiscal 2023 (through April); increasing 7% compared with the same fiscal 2022 period. As a result, we expect debt service coverage (DSC) ratios based on fiscal 2023 to be improved and see less risk of a significant drop in MADS coverage in the medium term. However, we continue to anchor our credit opinions on each lien's respective ABT on the assumption that SANDAG will eventually leverage one or more lien positions to fund future capital needs.

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 per capita effective buying income (EBI) at 112% of the national average;
- Bond provisions that require strong-to-very strong MADS ABT coverage for issuance of future debt at the first two lien positions, including 2.0x on the senior lien and 1.5x on the subordinate lien;
- Maintenance of annual MADS coverage well above the ABT on each lien, including 3.9x on the senior lien and 3.2x on the subordinate lien;

- A weak ABT of 1.15x MADS at the junior subordinate lien position, although we calculate current coverage as 2.3x.;
- Historically low volatility in sales taxes nationally, and similarly low volatility for the commission's TransNet sales tax; and
- SANDAG's general creditworthiness, which does not constrain the credit quality of the commission's sales tax revenue bonds.

The senior-lien bonds are eligible to be rated above the sovereign, because we believe 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 Nov. 19, 2013, U.S. local governments are considered moderately sensitive to country risk. Locally derived revenue is 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.

Environmental, social and governance

Our rating considers the environmental, social, and governance (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 and its tax base are exposed to heightened physical risks posed by the threat of wildfires and earthquakes, and, over the longer term, sea-level rise. The county maintains a hazard-mitigation plan as well as a countywide resilience program, which somewhat mitigate these risks to its tax base and other assets. Social and governance factors are overall neutral in our analysis.

Outlook

The stable outlook reflects our view that coverage will remain above the ABT on each lien, but that future debt issuances will likely limit the degree of improvement.

Downside scenario

We could lower the ratings on one or more liens if additional borrowings and declines in pledged revenue cause coverage to fall to levels below or, in the case of the junior subordinate third lien, approach their respective ABTs. The steepness of any decline in pledged revenue would be an important consideration.

Upside scenario

We do not expect to raise the ratings on the junior and junior subordinate liens, given our view that both liens' ABTs allow for significant dilution in coverage. If we expect that coverage will be sustained materially above levels that we consider extraordinarily strong, even when incorporating the commission's future borrowing plans we could raise the ratings.

Credit Opinion

SANDAG is the San Diego region's council of government created under state law to cooperatively manage regional issues (such as transportation planning) that go beyond the jurisdictional boundaries of the agency's 18 cities and county governments. Other federal, state, regional, and Mexican government agencies also serve as non-voting members of SANDAG. The SANDAG board of directors also serves as the regional transportation commission's board of directors. As a special district, the commission has limited operations beyond administering TransNet, including accumulating and dispersing the dedicated sales tax revenue to other entities that operate, construct, and maintain transportation services, infrastructure, and programs throughout the county.

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. The commission's service area population has increased 3.9% over the past decade, reaching 3.3 million in 2022. Despite a population decline of 1.00% in 2020, and smaller declines in 2021 (0.30%) and 2022 (0.04%), the California Department of Finance and Demographic Projections Unit forecast 0.30% annual growth from 2021-2050, which we view as conservative provided the area's diverse employment base highlighted by strengths in industries including biotechnology, innovation, life sciences, military, and tourism.

County-level per capita EBI remained very strong, in our view, at 112% of the national level in 2022. County unemployment was 3.7% in March 2023, below the 4.8% U.S. unemployment rate and only 0.1% higher than overall state unemployment.

Senior-lien coverage and liquidity: very strong

Based on the post-refunding, post-tender, projected debt service schedule, pledged TransNet revenue produced 3.85x MADS coverage on the senior-lien bonds in fiscal 2022. The commission's senior-lien ABT requires that pledged revenue collected during the most recent audited fiscal year produce MADS coverage of at least 2.0x on existing and proposed parity debt. Senior-lien bonds do not benefit from the additional security of funded DSRs (aside from the series 2008 bonds, which will be refunded with the series 2023 bonds). 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.

Commission noted they will issue up to $150 million in new money debt during the next 18 months on either the senior or subordinate lien.

Subordinate-lien coverage and liquidity: strong

We consider the commission's second-lien coverage and liquidity strong. Pledged revenue covered pro forma MADS by 3.2x in fiscal 2022 and has covered pro forma MADS at no less than 1.7x looking back to fiscal 2011. However, the commission is likely to issue future debt under either the junior or senior liens, which could lead to some deterioration from current coverage levels.

Repayment on the junior-lien obligations is subordinate to existing senior obligations that include the rated TransNet bonds, and on parity with draws under a $100 million commercial paper (CP) authorization and draws under a $100 million revolving note program. As of March 31, 2022, $46.6 million of CP and $1 million under the revolving line of credit was drawn and currently outstanding. The subordinate-lien obligations are also senior to credit and liquidity provider fees, and expenses and termination payments on existing swaps. As planned, the commission drew its entire

2017 TIFIA loan in October 2022 and used the proceeds to repay its 2021 junior-lien short-term notes reducing subordinate-lien debt outstanding by $537 million resulting in improved coverage.

In March 2022, SANDAG entered into a revolving credit agreement with U.S. Bank N.A. for up to an additional $100 million through September 2024 in support of various transportation facility and service improvements. SANDAG intends to repay any draws from its subordinate sales tax revenue revolving notes series I secured by other subordinate sales tax obligations.

The second-lien ABT requires that pledged revenue collected during the most recent audited fiscal year produced 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: weak

Fiscal 2022 pledged revenue produced 2.3x MADS coverage at the three lien positions combined. While current coverage of MADS is very strong, it could decline to levels that we consider adequate under provisions of the ABT. Repayment of the junior subordinate-lien obligations is subordinate to the senior- and subordinate-lien obligations, the commission's CP obligations and revolving notes, and to credit and liquidity provider fees and expenses and swap termination payments.

The junior subordinate-lien loan agreement dictates that the commission must fund a DSR, but only if annual DSC on the third lien falls to less than 1.35x, in which case 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.

Volatility: low

We assess the volatility of sales tax 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 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 approximately 18% from fiscal years 2007-2010 during and in the immediate aftermath of the Great Recession, from 2011-2022 revenues increased at a rapid 7.93% compound annual growth rate to their current level at $405.9 million.

Obligor linkage: limited relationship

The state administers the collection and disbursement of the TransNet sales tax revenue. As 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 semiannual interest requirements and one-twelfth of annual principal requirements before remitting the remainder to the commission.

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 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. Beside 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 Governments' general creditworthiness

We consider 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 stand-alone basis annually.

We apply our "GO Debt" criteria, published Oct. 12, 2006, to evaluate SANDAG's general creditworthiness. The commission's general operations are limited, given that it serves 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 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 in 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 at least one year's expenditures, support general creditworthiness, as does its 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 demand obligations outstanding totaling $383.7 million, all synthetically converted to fixed rate through five interest rate swaps. We do not believe these and other credit agreements pose material contingent liquidity risks to the commission or its bondholders. The swaps' aggregate mark-to-market value is approximately negative $11 million in favor of SANDAG'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. SANDAG drew $46.6 million of a $100 million CP note program. The commission anticipates refinancing all the series 2008 bonds as part of the series 2023 financing and terminating the entire swap portfolio.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Ratings Detail (As Of June 8, 2023)		
San Diego County Regional Transportation Commission, California		
San Diego Associate of Governments, California		
San Diego Cnty Regl Transp Comm (San Diego Assn of Govt) SALESTAX		
Long Term Rating	AAA/A-1/Stable	Affirmed
San Diego Cnty Regl Transp Comm (San Diego Assn of Govt) SALESTAX		
Long Term Rating	AAA/A-1/Stable	Affirmed
San Diego Cnty Regl Transp Comm (San Diego Assn of Govt) SALESTAX		
Long Term Rating	AAA/A-1+/Stable	Affirmed
San Diego Cnty Regl Transp Comm (San Diego Assn of Govt) SALESTAX		
Long Term Rating	AAA/A-1/Stable	Affirmed
San Diego Cnty Regl Transp Comm (San Diego Assn of Govt) SALESTAX		
Long Term Rating	A+/Stable	Affirmed
San Diego Cnty Regl Transp Comm (San Diego Assn of Govt) SALESTAX		
Long Term Rating	AAA/Stable	Affirmed