FitchRatings

FITCH RATES PENN TURNPIKE'S SENIOR SERIES 2016A-1 & A-2 BONDS 'A+'; AFFIRMS OUTSTANDING BONDS

Fitch Ratings-New York-31 May 2016: Fitch Ratings has assigned 'A+' ratings to the Pennsylvania Turnpike Commission's (PTC) approximately $269.8 million in senior series 2016A-1 fixed- rate bonds and $140.8 million in senior series 2016A-2 floating rate notes.

In addition, Fitch has affirmed PTC's outstanding $4.5 billion in senior lien turnpike bonds at 'A+' and $4.5 billion in subordinate lien turnpike bonds at 'A-'. The Rating Outlook on all bonds is Stable.

KEY RATING DRIVERS

The ratings reflect PTC's strong traffic profile, improving underlying economic trends, ability and willingness to raise tolls and history of prudent cost management, all of which somewhat mitigate its sizeable debt burden. Although the average senior rating case debt service coverage ratio (DSCR) of over 2.0x is strong in relation to 'A' category rating criteria guidance and peers, its rating reflects PTC's dependence on sustained toll rate increases to meet its entire cost base. The average subordinate rating case DSCR is low over the next 10 years relative to peers and criteria at around 1.30x, although this should markedly improve following the partial sun-setting of its $450 million Act 44 transfer obligations in 2022. The wide differential between senior and subordinate DSCRs reflects the relatively elevated subordinate debt burden, largely explaining the two-notch rating difference between the two liens.

Revenue Risk: Volume - Stronger Essential Route with Some Commercial Exposure: PTC plays a vital role in serving the state's major population centers and as a key part of the country's interstate system, evidenced by its relatively stable historical traffic and revenue performance. Dependence on commercial traffic is relatively high, with 14% of commercial traffic contributing 43% of net toll revenues in 2015, reflecting its critical position in the interstate system. PTC benefits from economic ratemaking flexibility, and traffic has demonstrated relatively low elasticity to the toll increases applied since 2005.

Revenue Risk: Price - Midrange Rate-making Flexibility: While the current toll rates are moderate, there may be political risk associated with implementing toll rates above inflation for multiple years, as is expected in PTC's financial plan.

Infrastructure Development/Renewal - Midrange Sizable Capital Program: While PTC's capital plan is large at approximately $5.8 billion, the Commission's decision to adopt a prioritized capital plan, which focuses primarily on preservation of the asset, has decreased expected capital costs by roughly $900 million. Additionally, PTC's goal of increasing pay-go funding to approximately 32% of the capital plan has further relieved some of the need for senior lien debt issuances. Fitch considers the current capital plan adequate to accommodate majority of PTC's needs over the next several years while ensuring acceptable operating conditions. Nevertheless, additional debt issuances will continue to put pressure on the Pennsylvania Turnpike, particularly when viewed together with the expected $2.7 billion in subordinate lien borrowing to subsidize transit capital and operations under Act 44 through 2022.

Debt Structure Risk - Stronger (Senior Lien - revised from Midrange); Midrange (Sub Lien) Reasonable Debt Structure: While PTC's turnpike debt is sizable at approximately $10.0 billion and is expected to increase, bondholders benefit from PTC's adequate covenant protections and limited variable rate exposure, with currently 6% of debt bearing an unhedged variable rate.

Financial Metrics: Elevated Leverage but Strong Financial Performance: PTC's total leverage is currently elevated at approximately 14x net debt-to-cash flow available for debt service (CFADS) and is expected to remain at a relatively high level for some time. Senior DSCRs are expected to remain at or above 2.0x, subordinate DSCR at or above 1.3x, and all-in coverage including Motor License Fund (MLF) enhanced bonds at or above 1.2x, per management's internal policy. While pressure remains, particularly on subordinate lien DSCR, for the next several years, PTC's capital structure beyond 2022 will benefit from reduced leverage and increased flexibility under Act 89's partial sunset of Act 44 payments, improving the longer term credit profile of the subordinate lien.

Peers: PTC's peers include New Jersey Turnpike Authority (rated 'A'/Outlook Stable) and Maryland Transportation Authority (rated 'AA-'/Outlook Stable). All three form essential components of the interstate highway network, serve sizeable local populations, and provide vital long distance and commuter links. Maryland's rating largely reflects its stronger debt metrics, while ratings for New Jersey and PTC reflect elevated debt profiles as a result of high capital needs and significant required cash transfers to support non-system projects.

RATING SENSITIVITIES

Negative - Traffic Growth profile: Should traffic growth stagnate after multiple years of toll increases, PTC may need to pursue toll increases higher than the forecasted 3% - 6% in order to maintain coverage levels, which may face political opposition.

Negative - Higher Costs: Management's ability to control expenses and manage its sizable capital program may affect the rating.

Negative - Weaker Coverage Ratios: Should PTC be unable to meet its coverage policies (2x senior/1.3x subordinate/1.2x MLF bonds) the ratings may be pressured.

Negative - Debt Structure Risks: A rising interest rate environment could result in lower financial flexibility as PTC issues debt to fund its $5.6 million capital plan over the next 10 years.

Positive - Given PTC's sizable and ongoing borrowing plans for the future, upward rating action is not likely at this time.

SUMMARY OF CREDIT

PTC expects to issue approximately $269.8 million in senior series 2016A-1 bonds to finance various capital expenditures set forth in the PTC's current 10-year capital plan. Proceeds will also cover the costs of issuance and funding of the debt service reserve account. Obligations are all fixed rate and will be on parity with existing senior lien bonds, amortizing through FY2047.

Concurrent with the issuance of the new money turnpike senior revenue bonds, PTC is also issuing approximately $140.8 million in senior series 2016A-2 floating rate notes, which will remarket certain maturities of PTC's series 2012-B, 2014B-1, and 2014B-2 subordinate floating rate notes. Obligations will be on parity with existing senior lien bonds, amortizing through FY2019.

PTC's traffic was up 1.9% in fiscal 2015 (year ended May 31) reaching 192.3 million. This reflected an improvement on the essentially flat growth achieved in previous years, with recent growth largely attributed to improved economic conditions and lower gasoline prices. Traffic is up 3.3% for the first 11 months of fiscal 2016 based on year-to-date figures through April. Gross toll revenues increased 7.9% for fiscal 2015, and have increased 10.7% for the first 11 months of fiscal 2016, reflecting toll increases, reductions in commercial discounts and improving economic conditions. The aforementioned increases build upon previous revenue increases of 4% to 6% seen over the 2011 - 2014 period.

Continued revenue growth coupled with stable traffic volume demonstrates PTC's resilience despite eight consecutive years of toll increases. As a result of the most recent toll changes in January 2016, the average cash toll equals 12.9 cents per mile, and the average E-ZPass toll is 9.2 cents per mile (up from 7.4 cents per mile for both cash and E-ZPass after the first increase in 2009). This reflects a full-length trip on the Turnpike Mainline, and is considered to be competitive with other major, mature, domestic toll facilities. Cash tolls are now 40% higher than E-ZPass tolls on a per-lane-mile basis as a result of growing discounts for E-ZPass trips compared to cash trips.

PTC's $5.6 billion 10-year capital program features capital initiatives to improve and maintain the turnpike in a state of good repair, ensure customer safety and convenience, and address capacity constraints. The commission has recently adopted a prioritized capital plan for the upcoming years, which focuses on the protection of its existing asset base and closer management of spending. As a result, some non-critical projects have been deferred, expected capital program costs have decreased by $900 million from the prior year, and funding of the plan has been restructured from nearly all debt-funded to roughly 32% pay-go funding and 68% debt. In Fitch's view, while some projects may need to be deferred, the proposed capital plan appears adequate to accommodate the majority of PTC's needs over the next several years and ensure acceptable operating conditions. PTC is projected to issue $4.1 billion in senior revenue bonds for its capital program and $2.7 billion for Act 44 on the subordinate lien through 2026.

Despite increasing leverage in the medium term, PTC intends to maintain senior and subordinate DSCRs above 2.0x and 1.3x respectively, and 1.2x for MLF-enhanced debt. In order to maintain these coverage levels, PTC's traffic consultant forecasts that annual toll rate adjustments ranging from 3% - 6% will be required through fiscal 2027, with 3% increases thereafter. This assumes average traffic growth of 1.3%, resulting in an average net revenue growth rate of 5.2% after discounts and adjustments. Fitch's sensitivity cases contemplate more modest traffic growth (average growth of 0.5% - 0.9%), reflecting some reaction to continued toll increases. Under these scenarios, higher annual toll increases (average of about 6% over the next decade) are necessary to maintain senior and subordinate coverage at 1.3x. While elevated leverage and relatively low coverage on the subordinate lien is a concern, Fitch takes comfort in the reduced overall leverage requirements under Act 89 from 2023 onwards, which is expected to allow leverage to evolve down and coverage levels to strengthen.

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Applicable Criteria
Rating Criteria for Infrastructure and Project Finance (pub. 28 Sep 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=870967
Rating Criteria for Toll Roads, Bridges and Tunnels (pub. 29 Sep 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=870170