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Toll facility ratings: A credit perspective

Toll agencies that understand ratings factors can gain a competitive edge in new facility construction and expansion.

WHITE PAPER | 2019

Developing and implementing viable funding and financing is one of the most challenging aspects of toll facility project development. Understanding financial market expectations can help decision makers lay the foundation for delivering new projects and sustaining capital investment in existing systems.

In this white paper:

- How rating agencies work
- Anticipating and planning for key rating considerations
- Special considerations for greenfield projects
- Differences between public and private tolling projects

A look inside the rating agency process
The number of new and expanded tolling facilities is increasing nationwide as public agencies seek to relieve congestion and provide funding to support growing infrastructure needs. Most agencies issue debt by leveraging future toll revenues to finance new construction and roadway rehabilitation projects. And that debt issuance is highly dependent on the credit perspective provided by rating agencies.

This white paper is designed to:

- Help tolling agencies better understand rating factors and promote more informed project planning that can help to revive stalled projects
- Accelerate project delivery and foster innovation

It's delivered by financial market specialists from the HNTB Advisory team who have backgrounds in investment banking and rating agencies.

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Rating agency role
Credit rating agencies, such as the three primary agencies Moody's, Standard & Poor's and Fitch, provide an independent assessment of a toll road debt borrower's ability and willingness to make full and timely principal and interest payments on their bonds. They have established criteria and analytical frameworks to make credit judgments and determine ratings. Toll facility long-term ratings could span the spectrum from high-investment-grade categories (identified as AAA/Aaa to BBB/Baa) to below investment-grade or speculative (Identified as BB/Ba to C) or below BBB/Baa. The rating agencies publish the details of their approaches and methodologies on their respective websites.

Demand risk
Generally, rating agencies view a toll facility's financial viability to be largely dependent on ongoing traffic and revenue performance. Unless other revenue sources are available, the toll facility or system of toll roads where all revenues are pledged for the repayment of the bonds, needs to generate sufficient toll-paying traffic to support its operations, maintenance, capital improvements and debt costs. To assess the potential for toll revenue generation, rating agencies evaluate the demand for the facility or a roadway system in the context of the tolling framework, including:

- Historical performance and future expectations
- Geographic footprint and type of roadway
- Regional economic fundamentals and demographic trends
- Familiarity and acceptance of tolling in the region
- Competition from other modes of transportation or alternative routes
- Historical traffic volatility related to economic swings
- Demand elasticity with past toll increases
- Approach to tolling
- Expectations for future regional economic and demographic growth and land use
- Technological advancements that can influence demand

Greenfield projects: Newly built alignments, or greenfield projects, can introduce additional rating risks. It's challenging to predict construction costs and timely completion, forecast traffic and revenue performance, and anticipate management practices. New toll facilities often rely on revenue growth to repay debt issued to finance their capital costs. If their performance falls short in the early years, it's hard to catch up, as most have back-loaded debt structures. As a result, greenfield project ratings tend to be lower than ratings of established toll roads until after construction is completed and they demonstrate operating performance and ability to increase toll rates as needed to support all obligations.

Similarly, when operators add new tolls to an existing facility — with priced-managed or high-occupancy toll lanes, for example — ratings are affected by uncertainty about how the introduction of tolls will affect traffic, as toll-free lanes are directly adjacent to the tolled facility.

Management and operating practices
Rating agencies also consider the experience and past actions of the management team, including its record for cost management, facility maintenance, tolling approach and debt policies. If the tolling agency has been threatened by outside influences such as political interference or market forces, evidence of mitigating action plans and protective financial cushions can strengthen its ratings.

Public vs. Private Ownership Structures
The ownership structure can play into the overall rating analysis. Toll facilities are managed under various quasi-governmental constructs with public

control and can also be managed through a public-private partnership contract. Factors affecting performance are, among other things, political environment, ownership structure and experience, performance requirements, debt structure features and asset maintenance. While individual approach and policies governing operations vary by agency and project, it is possible to compare certain credit factors more broadly.

Toll Rate Setting: Rating agencies generally take a positive view of a proactive toll policy that allows for frequent incremental toll increases.

- **Public Toll Agencies:** Financing agreements typically include bondholder protections in the form of rate covenants requiring public agencies to raise tolls to ensure compliance with minimum debt coverage thresholds. While many agencies have been able to build political consensus to support toll increases that generate additional revenues for major capital funding and help reverse losses from economic downturns, some agencies face ongoing political pressures to keep toll rates from rising. The lack of political will to increase toll rates can limit the agency's ability to proactively manage its operations and adequately maintain its toll facilities. As a result, ratings can become adversely affected as financial margins erode and asset quality deteriorates, requiring significant deferred maintenance. Outside political intervention in toll-rate setting or toll-rate caps are also viewed negatively by the rating agencies.
- **Toll Concession P3s:** Toll-rate increases are set contractually for most private concessions. Being profit-driven, private owners want to maximize revenues and minimize costs. Yet their contracts also stipulate asset renewal and replacement requirements. Equity dividend payments are typically required to be made from surplus revenues only after making annual lifecycle and debt service payments, ensuring facility preservation. Credit ratings can be affected if flexibility to raise rates is restricted in a way that impairs the concessionaire's ability to maintain and renew the assets and maintain adequate debt coverage.

Liquidity Levels: Another important credit consideration relates to liquidity levels and cash retention.

- **Public Toll Agencies:** Public agencies that are able to build up cash balances to support their capital needs are generally viewed more positively by the rating agencies compared with public agencies that drain liquidity to make transfers to other governments and rely on high revenue growth to support their own capital needs.
- **Toll Concession P3s:** The requirement for equity returns typically results in higher levels of debt and minimal liquidity remaining in the project, which tends to limit ratings, making it less likely that a toll concession will be rated in the high investment-grade category.

Having a better understanding of what goes into debt ratings can help tolling project leaders improve their credit quality and reduce their debt repayment costs, which ultimately affect the feasibility, timing and flexibility of new facility construction and expansion.

Resources

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Additional resources

https://ncppp.org/

https://www.fhwa.dot.gov/

http://pwfinance.net/

https://www.moodys.com/

https://www.fitchratings.com/site/home

https://www.standardandpoors.com/en_US/web/guest/home

https://www.krollbondratings.com/

https://www.dbrs.com/

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