FitchRatings

RATING ACTION COMMENTARY

# Fitch Upgrades NC Turnpike Auth's Sr Rev Bonds and TIFIA Loan

Wed 29 Nov, 2023 - 4:11 PM ET

Fitch Ratings - Chicago - 29 Nov 2023: Fitch Ratings has upgraded the rating on North Carolina Turnpike Authority's (NCTA) outstanding senior lien turnpike revenue bonds, senior lien turnpike revenue bond anticipation notes (BANs), and subordinated Transportation Infrastructure Finance and Innovation Act (TIFIA) loan to 'BBB+' from 'BBB'. Fitch has also assigned 'BBB+' ratings to series 2024A&B senior lien turnpike revenue bonds totaling approximately $372 million and an approximately $424 million subordinated series 2024 TIFIA loan. The Rating Outlook for both the bonds and TIFIA loans is Stable.

## RATING ACTIONS

| ENTITY / DEBT | RATING | | PRIOR |
|---|---|---|---|
| North Carolina Turnpike Authority (NC) | | | |
| North Carolina Turnpike Authority (NC) /Toll Revenues - First Lien/1 LT | LT | BBB+ Rating Outlook Stable Upgrade | BBB Rating Outlook Stable |
| North Carolina Turnpike Authority | LT | BBB+ Rating Outlook Stable | BBB Rating Outlook |

## RATING RATIONALE

The upgrade reflects the strong financial metrics associated with the expected financing for Phase 2 of the Complete 540 expansion project. Coverage metrics are pressured in the near term with mandatory debt service coverage ratios (DSCRs) averaging 1.5x through 2027 under the rating case, but are expected to improve following the opening and ramp-up of Phase 1. The metrics associated with the financing of the Complete 540 project when including Phase 2 are strong under the rating case, with scheduled DSCR averaging 2.0x from 2024 through 2062.

The rating reflects the Triangle Expressway's history of robust traffic and revenue growth and the Complete 540 expansion project's commuter-based traffic profile, supported by an expanding service area with strong population and economic growth. The rating is further supported by a commitment from the North Carolina Department of Transportation (NCDOT) to fund operating, maintenance and rehabilitation costs if toll revenues are insufficient, strengthening the bonds' gross pledge. Complete 540 is also supported by a construction completion guarantee from NCDOT during the construction phase.

## KEY RATING DRIVERS

**Revenue Risk - Volume - Midrange**

**Strong Market, Continued Growth -** Triangle Expressway and the planned Complete 540 extensions will serve as major alternatives to congested toll-free roadways and also as a key route to the main employment center in the region, Research Triangle Park (RTP). Economic activity in the service area is expected to contribute to future traffic growth, with the recent addition of two parkway interchanges leading to continued ramp-up on the existing expressway through 2023. However, with the limited number of toll roads in the area, there still exists the potential for sensitivity to annually increasing toll rates, given uncertainty as to overall demand and perceived value of time savings.

**Revenue Risk - Price - Stronger**

**Rate-Making Flexibility Available -** NCTA has flexibility to increase toll rates without any additional legal or regulatory approvals. The expressway has a set annual rate increase schedule through 2035, with rates increasing somewhat above inflation. NCTA maintains

**Infrastructure Dev. & Renewal - Midrange**

**Gross Pledge Supports Asset -** The existing expressway is in new condition with limited maintenance needs expected over the intermediate term. The planned Complete 540 extensions are expected to have minimal initial capital needs as brand-new facilities when completed. Capex will be required over time to keep the road viable, but NCDOT pledges to cover the expressway's operating, maintenance and rehabilitation expenses if toll revenues are insufficient. An independent engineer is required to perform annual inspections, supporting asset preservation.

**Debt Structure - 1 - Midrange**

**1 - Senior and Subordinate Debt**

**Back-loaded, Fixed-Rate Debt -** NCTA's overall capital structure consists of fixed-rate amortizing debt with no refinance risk, though annual debt obligations escalate from 2022 to maximum annual debt service in 2058 when including Complete 540 Phase 2 debt, pressuring NCTA's financial flexibility. Rate covenants are adequate, requiring toll increases to meet forward-looking minimum DSCRs of 1.3x and 1.1x on senior and total debt, respectively.

Structural reserves are sufficient with a reserve fund surety on the existing senior lien bonds. The TIFIA loan can spring to senior parity debt upon occurrence of a bankruptcy-related event, supporting a lack of differentiation in attribute scoring between liens. TIFIA benefits from a deferability provision that provides additional payment flexibility.

## Financial Profile

Coverage levels steadily increased through ramp-up prior to the pandemic, but have stabilized at approximately 1.7x in fiscal 2023 as a result of increasing annual debt service. Fitch's rating case, which incorporates the expected debt for Complete 540 Phase 1 and 2, produces a scheduled DSCR averaging 2.0x from 2024 through 2062. It is Fitch's view that, while dependent on growth, there is sufficient coverage cushion and liquidity support from the NCDOT-backed O&M and R&R guarantees to offset slower-than-expected growth.

all congestion reliever roadways in strong corridors that face competition from non-tolled alternate routes. The existing expressway's tolls, at a moderate $0.20/mile for passenger cars, are lower than those of its peers, ranging from $0.30-$0.45/mile. However, the peers have greater franchise strength as they have substantially longer operating history.

## RATING SENSITIVITIES

### Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--A prolonged negative shift in operating performance resulting in rating case mandatory DSCR sustained below 1.5x;

--Reluctance by the authority to increase toll rates above the approved rate schedule if needed;

--Reduced support for the expressway by the state of North Carolina.

### Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

-- Maintenance of solid financial metrics with rating case mandatory DSCR of at least 1.8x for a sustained period after completion of Phase 2.

## TRANSACTION SUMMARY

NCTA expects to issue approximately $372 million in series 2024A&B senior lien turnpike revenue bonds to finance, in part, the costs of land acquisition, design, construction and equipping of Complete 540 - Phase 2, consisting of the extension of the Triangle Expressway for approximately 10.2 miles from I-40 to I-540/I-87/U.S. 64/U.S. 264 in Knightdale. The senior lien turnpike revenue bonds are fully amortizing with final maturity in 2058.

The authority also expects to enter into the 2024 TIFIA Loan Agreement with USDOT to borrow a principal amount of up to $424 million. Proceeds of the series 2024 TIFIA Loan, when drawn upon, will be used to finance a portion of the costs of Complete 540 - Phase 2.

## CREDIT UPDATE

Construction of Complete 540 Phase 1 is divided into three projects with two construction groupings. Each project has a separate fixed-price, date certain DB contract with experienced, joint-venture construction firms and enhanced by performance security packages that include performance and payment bonds as well as liquidated damage payments. The authority has currently expended approximately 86% of funds anticipated in the total plan of finance.

All segments of Complete 540 Phase 1 are anticipated to be open to traffic by July 1, 2024. The updated opening date represents a 171-day (5 months and 19 days) delay from the previous date of Jan. 12, 2024. Causes of delay include delays in the issuances of the Unlimited Notice to Proceed, weather delays, as well as other third-party delays. Complete Phase 2 is expected to open to tolling in 2029.

The Complete 540 project has a construction completion guarantee from NCDOT. The construction completion assurance agreement mitigates cost overruns in the event construction costs exceed those specified in the design-build contract. The obligation of NCDOT in regards to renewal payments and construction cost overruns is to be funded from amounts available in the State Highway Fund or the State Highway Trust Fund. Each such payment is subject to appropriation by the State and the availability of amounts in such fund.

In Fitch's view, the relatively straightforward nature of the construction, coupled with the construction completion guarantee from NCDOT for Phase 1 and 2, mitigates completion risk.

## FINANCIAL ANALYSIS

The Fitch base and rating case were developed by applying the assumptions outlined below for both the existing Triangle Expressway and the Complete 540 Phase 1 and 2 segments. For both cases, toll revenues through the opening of Phase 2 provide sufficient coverage for mandatory debt service providing additional mitigations for completion risk.

Fitch's base case applies sponsor traffic and revenue assumptions for Complete 540, as prepared by the traffic and revenue consultant, but assumes revised opening dates of July 1, 2024 for Phase 1 and Jan. 1, 2029 for Phase 2, higher near-term inflation rates (2.7% in

Gross toll revenues increase at a CAGR of 3.3% from 2033 (post ramp-up of Phase 2) through 2062. The scheduled DSCR averages 2.2x from 2024 through 2062.

Fitch made a number of adjustments from the sponsor's traffic and revenue assumptions in developing the rating case. The rating case assumes the same revised opening dates as the base case and an extended ramp-up period of four years (three-year ramp-up in base case). Increased revenue leakage rates are applied to bill-by-mail revenue associated with Complete 540 in all years. Fitch also assumes a 10% decrease in value of time and a 25% reduction of induced demand on Triangle Expressway. Similar to the base case, the rating case assumes higher near-term inflation rates and lower long-term inflation rates, an annualization of 305, a 15% reduction factor in work-business-related trips, and a two-year economic growth lag.

Gross toll revenues increase at a CAGR of 3.4% from 2033 (post ramp-up of Phase 2) through 2062. Fitch notes mandatory coverage ratios over the next few years through 2027 are low, averaging 1.5x, but are driven by a number of the aforementioned conservative assumptions. Scheduled DSCRs under the rating case average 2.0x from 2024 through 2062.

## SECURITY

The senior bonds are secured by a gross lien on revenue of the expressway. The TIFIA loan is secured by a lien on revenues after the payment of the senior lien bonds. TIFIA can spring to senior parity debt upon occurrence of a bankruptcy related event. Significant support is provided to both the debt and the overall system by North Carolina Department of Transportation's covenant to fund operating, maintenance and capital costs in the event expressway revenues are insufficient.

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3' unless otherwise disclosed in this

information on Fitch's ESG Relevance Scores, visit
https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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## PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the

## APPLICABLE CRITERIA

Transportation Infrastructure Rating Criteria - Effective from 16 May 2023 to 18 December 2023 (pub. 16 May 2022) (including rating assumption sensitivity)

Infrastructure & Project Finance Rating Criteria (pub. 17 May 2023) (including rating assumption sensitivity)

## APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Third-party Model (1)

## ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

## ENDORSEMENT STATUS

| | |
|---|---|
| North Carolina Turnpike Authority (NC) | EU Endorsed, UK Endorsed |

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