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INDUSTRY OUTLOOK

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2014 Outlook – US Toll Roads

Slow Recovery in Traffic Growth Shows Staying Power

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We changed our outlook for the US Toll Road Industry to stable from negative on December 3, 2013. This outlook expresses our expectations for the fundamental business conditions in the industry over the next 12 to 18 months.

» **We are changing our outlook for the US Toll Road Industry to stable from negative, based on our view that the slow and steady recovery in traffic growth is sustainable into 2014.** We expect 2014 traffic growth of about 1.5% on a median basis for rated toll roads, as the US economy strengthens. This traffic growth rate marks what we believe is a sustainable comeback from a nearly 3% decline in 2009, when our outlook turned negative on the industry.

» **We expect toll revenue will see a mid-single-digit percentage gain in both 2013 and 2014, driven mainly by continued widespread toll-rate increases and modest traffic growth.** This revenue growth rate marks a slowdown from 2012, when toll revenue climbed 11.2% on the back of large rate increases.

» **Increasing leverage remains an important risk.** State and local governments continue to exert demands on the excess cash flows of toll roads to subsidize their own capital and operating needs, or have shifted some of their transportation financing responsibilities to existing toll roads.

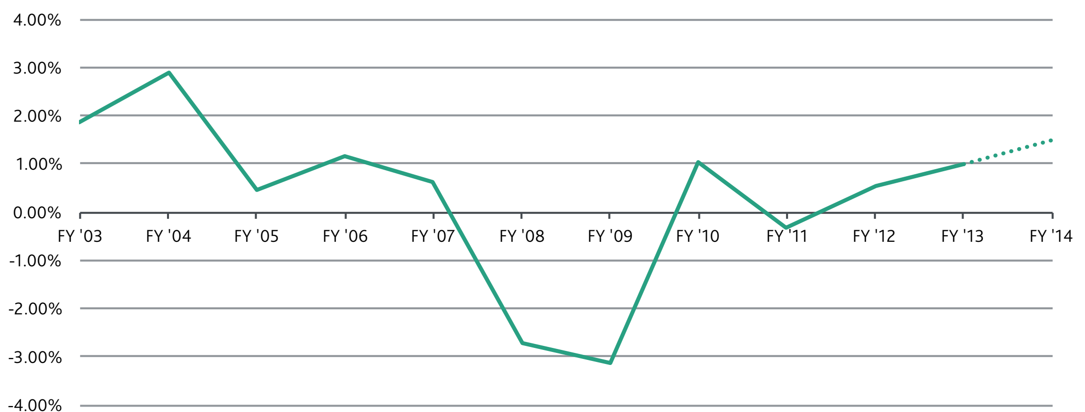
» **We could shift back to a negative outlook if the US economy falls back into recession or gasoline prices rise.** We note that toll rate increases could face some push back from toll road users and thereby depress revenue growth, particularly if the economy falls back into recession. Reduced revenue would hurt financial margins and liquidity, and negative pressures would become even more acute if gas prices rise.

Stabilizing traffic and growing revenues tilt our outlook to stable

We are changing our outlook to stable from negative, based on our view that the slow and steady recovery in traffic growth is sustainable into 2014. We expect traffic growth to rise about 1.5% in 2014 on a median basis (see chart 1), based on year-to-date trends for the 10 largest toll roads we rate,[1] as the US economy strengthens. This rate marks what we believe is a sustainable comeback from a nearly 3% decline in 2009, when our outlook turned negative on the industry.

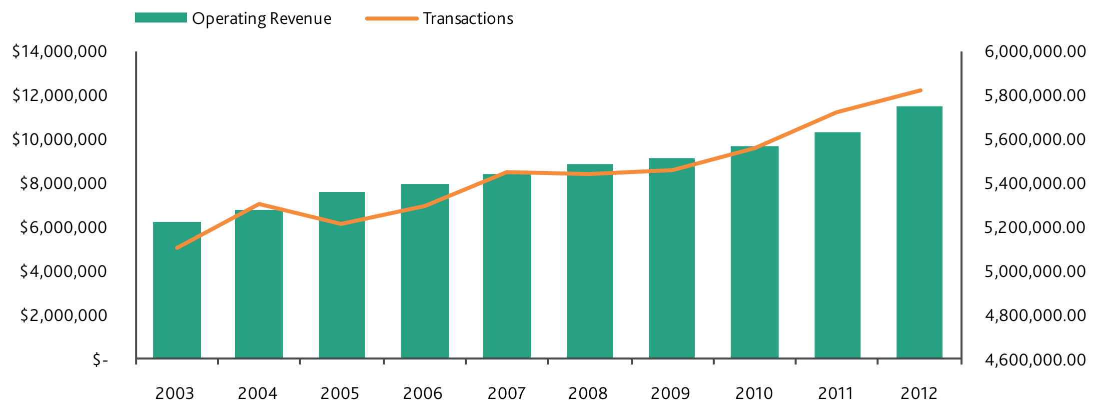
We expect toll road traffic to trail US GDP growth of 2% to 3% in 2014 (Moody's forecast). Slower-than-GDP national traffic growth reflects demographic shifts and changing driving patterns for younger drivers, meaning that the rate of traffic growth is slowing down overall and so the slower, albeit more stable, growth rates reflect a "new normal." What gives us confidence that expected growth rates are sustainable is that even slow-growing established toll roads in developed areas, such as Bay Area Toll Authority (Aa3 stable), Illinois State Toll Highway Authority (Aa3 stable) and New York State Thruway Authority (A2 stable), are reporting modest traffic gains this year through September of about 1%, compared with a historical rate of just under 2% before the recession.

EXHIBIT 1
US Toll Roads: Median Total Traffic Growth
Annual Growth Total Transactions (%)



Note: 2013 and 2014 are our estimates.
Source: Moody's Public Finance Monitoring System/Municipal Financial Ratio Analysis database of publicly rated government-owned toll roads

EXHIBIT 2
US Toll Roads: Operating Revenue and Traffic



Note: Operating revenue is shown on the left scale and transactions are shown on the right scale.
Source: Moody's Public Finance Monitoring System/Municipal Financial Ratio Analysis database for publicly rated government-owned toll road.

[1] Largest by revenue

Toll road traffic rose in 2012 and is growing at about 1% in 2013, although the pace is uneven across the US, with growth strongest in states that weathered the recession better than others, such as Texas, and weakest growth in economically challenged or undiversified areas, or where large toll increases took effect, such as the New York metropolitan area. For instance, the New Jersey Turnpike Authority (A3 stable) saw a 50% toll increase in 2012 that reduced traffic by 3.5%. The Triborough Bridge and Tunnel Authority (Aa3 stable) implemented a toll increase in March 2013 to yield a 7.5% revenue increase and this has lowered traffic by 1.1% through August.

Median year-over-year traffic growth remained almost flat at 0.5% following a slight 0.3% decline in 2011. The median five-year compound annual decline of 0.7% in 2012 was virtually the same as the 0.8% compound annual decline in 2011 medians, which is indicative of the continued slow traffic recovery following the recession.

Of the 42 government-owned US toll roads we track, roads located in high-growth states such as Florida and Texas stand out in terms of traffic growth rates:

» The North Texas Tollway Authority (A2 stable) in Dallas significantly outperformed the Moody's 2012 median of 0.5% with 13.9% traffic growth from 2011-12, in part because of the opening of new roadway segments and sustained population growth in the service area.

» The Central Texas Regional Mobility Authority (Baa2 stable) in Austin also outperformed the median in 2012 with 11.8% traffic growth, supported by ongoing traffic ramp-up as new segments opened, and population growth.

» Traffic growth for Florida's Turnpike (Florida Department of Transportation; Aa3 stable) resumed at 1.8% in 2012 and into fiscal 2014, despite a large rate increase in July 2012.

» Some toll roads lag behind in terms of median traffic growth rates, including the **Triborough Bridge and Tunnel Authority**, which saw a 0.3% decline in 2012 and a 1.1% decline through August because of toll increases, and the Nassau County Bridge Authority (A3 stable), which saw traffic drop 5.7% because of Hurricane Sandy-related closures.

We are also seeing signs of traffic recovery for some single-asset roads, such as the Foothill-Eastern Transportation Corridor Agency (Ba1 stable) and San Joaquin Hills Transportation Corridor Agency (B1 stable) roads in Orange County, California, which have seen 2.8% and 5% traffic growth, respectively, through October 2013, compared to the same period in 2012.

Most government-rated toll roads define traffic as one passenger or commercial vehicle passing through a booth or gantry (or tolling point).

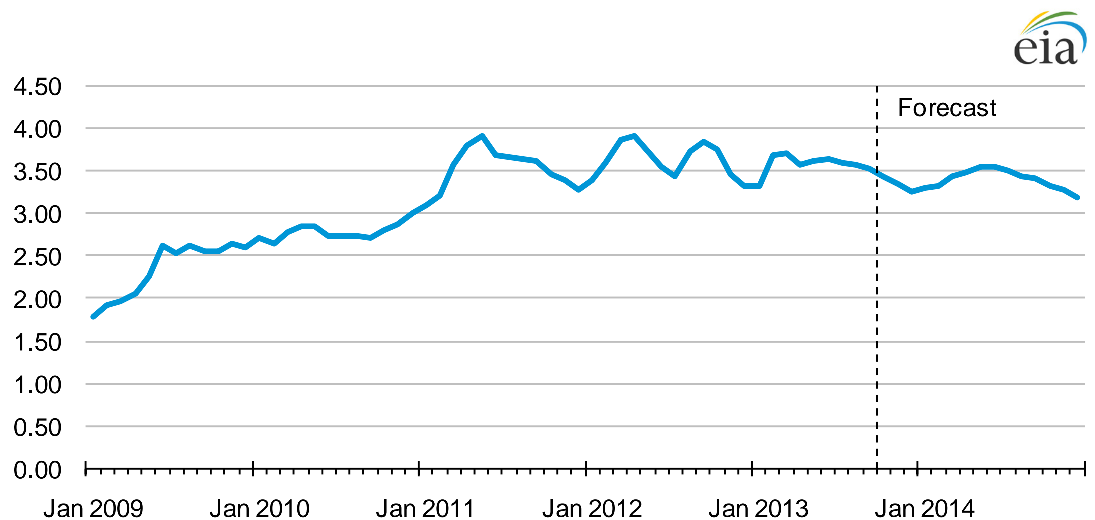
We could shift back to a negative outlook if the US economy falls back into recession or gasoline prices rise. We note that rate increases could face some push back from toll road users and thus depress revenue growth, particularly if the economy falls back into recession. Reduced revenues would hurt financial margins and liquidity, and negative pressures would become even more acute if gas prices rise. However, based on the US Energy Information Administration's gasoline-price forecast in October (see chart), we do not expect a significant increase in the cost of fuel at the pump.

It is unlikely we would take a positive view of the industry in 2014. We would have to see sustained traffic and revenue growth over a two-year period in order to move to a positive outlook.

EXHIBIT 3

US Retail Gasoline Prices

Dollars per gallon



Note: Retail prices include state and federal taxes

Source: EIA, Short-Term Energy Outlook, October 2013

Modest Traffic Growth Along With Higher, but Uneven Tolls, Will Push Up Revenue in 2014

We expect toll revenues will see a mid-single-digit percentage gain in both 2013 and 2014, driven mainly by continued widespread expected toll-rate increases and modest traffic growth. This revenue growth rate marks a slowdown from 2012, when toll revenue climbed 11.2% on the back of large rate increases. We expect increases to be unevenly distributed across the sector as some toll roads are planning no rate increases, some are implementing inflation-indexed increases and others larger, one-off increases.

A number of toll roads have recently implemented inflation-indexed or multi-year toll increases, such as the Florida Turnpike, the Central Texas Regional Mobility Authority (Baa2 stable), the Tampa-Hillsborough County Expressway Authority (A3 positive) and the Ohio Turnpike and Infrastructure Commission (Aa3 stable). We see indexed tolls as helping to make revenue growth more predictable and also insulating traffic levels from rate spikes that contribute to volatility. Revenue predictability in turn enables toll roads to more accurately plan and budget for both operating and capital expenses, which we view as a credit-positive.

Toll roads that haven't raised toll rates are either not leveraging up or may be under-investing in capital asset maintenance, at the risk of incurring higher costs down the road. Some toll roads are delaying the inevitable and will face steeper increases to support substantial amounts of debt for new projects, such as the **New York State Thruway Authority**, which is currently financing a replacement for the Tappan Zee Bridge at a cost of $4 billion, but has yet to increase tolls to support the added debt service. We estimate tolls on the new bridge will be nearly double the current $5 rate. Others are issuing substantial amounts of debt to support non-toll projects, such as the Pennsylvania State Turnpike Commission (Aa3 stable) and the Ohio Turnpike, and this will contribute to steady increases in toll rates, at least at the rate of inflation, which is currently running at about 1.0%.

Increasing leverage remains an important risk

State and local governments continue to exert demands on the excess cash flows of toll roads to subsidize their own capital and operating needs, or have shifted some of their transportation financing responsibilities to existing toll roads.

This trend accelerated in the recent recession as governments faced political pressures against raising taxes and instead turned to toll roads to help finance various infrastructure projects. The Ohio Turnpike, the New Jersey Turnpike Authority (A3 stable) and the Harris County Toll Authority (Aa3 stable) in Texas illustrate this trend. And the Pennsylvania Turnpike and Triborough Bridge and Tunnel Authority in New York have well-established transfers of excess cash flow to subsidize state-wide transportation and transit systems. The Pennsylvania Turnpike is a particularly telling example of an increase in leverage owing to transfers that resulted in a downgrade of the senior lien bonds to A1 from Aa3 earlier this year.

The use of toll roads as "cash cows" to finance non-tolled projects has increased leverage without a corresponding investment in toll road capacity, as seen in a near doubling of median debt per roadway mile from 2008 to 2012. However, we note that this added leverage did not depress median debt service coverage ratios (DSCRs) in fiscal 2012, which remained at 1.69 times on a net revenue basis given widespread toll rate increases.

States and local governments are proposing and implementing other ways of financing projects that could help moderate future debt leverage for established toll roads. These include the creation of new tolling authorities in states like Delaware, Kentucky, Georgia, North Carolina and Virginia; the implementation of comprehensive development agreements (or CDAs) with existing agencies as well as the use of public-private partnerships (P3s) and private-equity investments. The creation of new tolling authorities with independent toll-raising and debt-issuing ability may help alleviate the future leverage burden for existing toll roads.

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» European Toll Road Operators: Weak Traffic Trends to Continue, December 2012 (147994)

» Milking the Cash Cow: US Toll Roads Are Reliable Source of Cash for Struggling State and Local Governments but Rate Affordability Exerts Credit Pressure, February 2012 (138832)

» Chilean Toll Roads: Strong credit fundamentals drive concession activity, October 2012 (142211)

» Credit Risks and Rewards of Electronic Toll Collection, February 2011 (131073)

Credit Focus:

» ASF, APRR and Sanef: Peer comparison of three French toll roads, December 2012 (147990)

Global Financial Risk Perspective:

» Global Macro Outlook 2013-15: Navigating towards calmer waters, November, 2013 (159743)

Rating Methodologies:

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» Moody's Rating Methodology-Operating Toll Roads, December 2006 (101003)

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