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Maryland Transportation Authority; Toll Roads Bridges

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Maryland Transportation Authority

Long Term Rating

AA-/Stable

Affirmed

Rationale

S&P Global Ratings affirmed its 'AA-' long-term rating and underlying rating (SPUR) on the Maryland Transportation Authority's transportation facilities projects (TFP) revenue bonds. The outlook is stable.

The ratings on MDTA reflect our opinion of the toll system's very strong enterprise and financial risk profiles. The very strong enterprise risk profile reflects our view of the mature system comprised of seven pledged facilities that we believe provide essential service for key routes within a very strong competitive position through its assets providing essential service for central Maryland's highway, bridge, and tunnel network, including Interstate 95 (I-95). It further reflects our view of the favorable service area economy, which we believe provides MDTA with a strong and resilient base of demand.

The very strong financial risk profile reflects the authority's very strong financial performance across a host of indicators, both historic and forecasted. Although we expect to observe modest near-term improvement across debt service coverage (DSC) and debt metrics, we believe metrics will approximate recent historic levels over the longer term, as the authority proceeds with funding its capital plan, including the addition of new debt beginning in fiscal 2020.

The very strong enterprise risk profile reflects our view of the toll system's:

- Very strong market position. In our view, MDTA's seven pledged facilities provide essential service to Central Maryland's highway, bridge, and tunnel network. . Given its control over key assets and history of resilient demand levels, we believe the authority maintains a strong competitive position, supporting what we believe are minimal restrictions on pricing power.
- Extremely strong service area economic fundamentals, which include favorable gross domestic product (GDP) per capita and unemployment metrics for the Baltimore-Towson-Columbia, MD metropolitan statistical area (MSA).
- Low industry risk relative to that of other industries and sectors.
- Extremely strong management and governance, supported by moderately sophisticated, conservative, and prudent financial planning and risk management practices.

The very strong financial risk profile reflects our view of the toll system's:

- Very strong financial performance, evidenced by the authority's DSC metrics of 3.4x in fiscal 2017 and 3.5x in fiscal 2016, and our expectation that DSC will be no lower than 3.2x through at least fiscal 2023.

- Extremely strong debt and liabilities capacity, with debt to net revenue at 4.8x in fiscal 2017, and projected to fall to 3.3x for fiscal 2018. Driving near-term improvement in debt metrics, including fiscal 2018, is steady financial performance combined with the \$503 million cash defeasance of debt in fiscal 2018. We anticipate that debt metrics will likely continue to support the extremely strong assessment as the authority begins adding debt in fiscal 2020 to support its capital plan.
- Very strong liquidity and financial flexibility. After deploying approximately \$600 million in cash to reduce its debt balances in fiscal 2018, we expect MDTA will maintain very strong liquidity metrics throughout the forecast period. Supporting this view is MDTA's track record of steadily building its liquidity position, supported by conservative budgeting practices, timely rate adjustments, and strong underlying demand for the authority's key assets.

Net revenue from the facilities designated TFPs under the trust agreement secure the bonds. Though Bondholders are also entitled to a pledge against general account projects, these are subject to authority termination. Therefore, the authority excludes the revenue and expenses associated with general account projects in its calculation of DSC as per the trust agreement, and we also exclude these in our analysis. At fiscal year-end 2017, MDTA had approximately \$2.3 billion TFP-secured debt outstanding. Due in part to a \$503 million cash defeasance of the series 2008 bonds effective June 29, 2018, as well as a partial, \$100 million, cash defeasance of the series 2007 bonds in fiscal 2017, MDTA's total TFP-secured debt fell to approximately \$1.6 billion at fiscal year-end 2018.

Outlook

The stable outlook reflects our expectation that MDTA's strong underlying demand base, quasi-monopolistic control over key assets in central Maryland's road network, and prudent financial planning practices will likely enable it to sustain its very strong market position and financial metrics.

Upside scenario

As it proceeds with funding its capital plan, if the MDTA sustains DSC metrics stronger than the levels it has forecasted, or if liquidity levels return to the stronger levels demonstrated in recent years, we could raise the rating by one notch.

Downside scenario

We do not expect to lower the rating, given our expectation that MDTA would raise rates to maintain its financial metrics if demand materially softened, or if capital needs were materially higher than forecasted. However, if DSC and debt metrics weaken from the levels suggested by MDTA's base case forecast, we could lower the rating.

Enterprise Risk

Our assessment of MDTA's enterprise risk profile as very strong reflects its extremely strong economic fundamentals, low industry risk, very strong market position, and extremely strong management and governance.

Economic fundamentals

We consider the Baltimore-Towson-Columbia MSA to be the authority's primary service area, though we note the system's reach includes portions of the greater Washington, D.C. metropolitan area. The system's reach extends more

broadly, given the authority's control over key assets used by tourists, truckers, commuters, and other travelers passing through central Maryland.

Favorable indicators for the MSA include GDP per capita of approximately \$70,000, and unemployment levels that, at 4.2% in 2017 were marginally below the U.S. rate of 4.4%. The MSA's population of greater than 2.8 million residents provides MDTA a relatively large demand base that continues to support the system's strong activity levels. Though the three-year projected population growth rate of 1.1% is below the national projected rate of 2.4%, we believe credit risk related the lower projected growth rate is mitigated by the size and maturity of the service area economy, which we believe will continue to support generally strong demand levels for MDTA's pledged facilities in the future.

Market position

We consider MDTA's overall market position very strong. Its seven pledged facilities consist of:

- Three Baltimore water-crossings: the Fort McHenry Tunnel, the Baltimore Harbor Tunnel, and the Francis Scott Key (Baltimore Harbor Outer) Bridge;
- JFK Memorial Highway (I-95), including the Express Toll Lanes;
- The Chesapeake Bay Bridge;
- The Nice (Potomac River) Bridge; and
- The Intercounty Connector (ICC).

The authority also operates the Thomas J. Hatem Bridge, which comprised about 3% of the authority's total traffic in 2017. The Hatem Bridge is considered a general account project and thus we exclude its revenue and expenses associated with it in our analysis.

Rising to 163.6 million in fiscal 2017, MDTA's system wide traffic levels hit record levels for a seventh consecutive year. The completion of the ICC in 2011, the commencement of operations of the Express Toll Lanes on I-95 in 2014, and general economic growth have supported the recent years' growth in traffic levels. Based on longer-term historical data, we believe MDTA's demand characteristics demonstrate a notable degree of resiliency. Traffic levels fell only modestly during the Great Recession, from 2008-2010, quickly rebounding to surpass pre-recession peak levels in 2011, exclusive of any impact from the ICC.

Data through the first nine months of fiscal 2018 indicate total traffic levels increased 1.6% compared to the same period from the prior year, and management projected finishing fiscal 2018 with 1.7% growth in total traffic. Management's base case forecast, which we consider reasonable in its assumptions, forecasts annual total traffic growth of 0.7% on average for fiscal years 2019-2025. Overall, although we expect to observe modest fluctuations over time, such as due to changing economic conditions, we expect MDTA's traffic levels will remain generally stable, supported by its relatively large and economically prosperous demand base in the state of Maryland.

Management and governance

The toll system's management and governance, in our view, is extremely strong. This assessment reflects our view of the system's strategic positioning; risk management and financial management; and organizational effectiveness.

Multiple specific financial goals drive MDTA's financial planning. These board-instituted policies include maintenance of DSC at or above 2.5x through fiscal 2020, and 2.0x thereafter, including existing and forecasted debt; and maintenance of unencumbered cash no lower than \$350 million. MDTA's historic financial performance has consistently exceeded the levels outlined by its coverage and liquidity goals. Based on management's forecasts, we expect actual performance will continue to surpass its policy-determined thresholds.

MDTA's risk management framework supports our management and governance assessment. Based on historic performance, we believe that MDTA proactively adjusts rates, capital spending, and cash management to maintain actual and forecasted metrics that are in line with, or exceed, the strong levels prescribed by its internal policies. The authority commissions an external consultant to formulate 10-year financial forecasts each year, and presents six-year financial forecasts to the state legislature twice per year, per statute, though MDTA's forecasts and budgets are not subject to legislative approval. The authority's financial forecasts include generally conservative assumptions, including conservative capital spending and interest rate assumptions.

MDTA commissions a private-sector consultant to perform state-of-repair inspections of each of its facilities each year, using the results to inform its capital plans. MDTA maintains a variety of insurance policies, and it maintains a simple debt structure that includes no variable rate debt and no contingent liabilities. In our view, MDTA's senior management demonstrates considerable expertise and experience in operating the toll system and maintaining its assets. We understand that MDTA manages succession planning concerns through its approach to hiring and training of mid- and junior-level staff.

Financial Risk

Our assessment of MDTA's financial risk profile as very strong reflects the toll system's very strong financial performance, strong debt and liabilities capacity, and very strong liquidity and financial flexibility.

Our financial profile risk assessment considered historical as well as pro forma figures. The pro forma figures reflect the authority's baseline forecast, which we believe is reasonable in its assumptions of steady revenue and expense growth, with low positive traffic growth. Our analysis also considers the authority's sensitivity scenario forecasts, which we believe conservatively forecast financial performance under a variety of scenarios.

Overall, we base our financial risk profile assessment on our forward-looking view of MDTA's financial performance, informed by historical results in addition to the issuer's various forecasts. Our financial profile assessment also considered MDTA's financial policies, which we consider credit neutral.

Financial performance

The very strong financial performance assessment reflects MDTA's DSC metrics of 3.4x in fiscal 2017, 3.5x in fiscal 2016, and 4.1x in fiscal 2015. The stronger coverage for fiscal 2015 was primarily a result of lower annual debt service requirements that year. Though annual debt service requirements will fall further, by 49% from fiscal 2017-2019, the authority's capital plan calls for the issuance of multiple series of additional debt. As the related debt service comes on line, we expect that DSC will likely remain very strong, supported by generally stable activity levels.

We believe MDTA's base case financial forecast is reasonable and somewhat conservative in its assumptions. Although we note the forecast indicates DSC may fall below 3x by fiscal 2024, as annual debt service requirements rise, the relatively long time horizon and conservative assumptions mitigate our concern over the prospect of lower forecasted DSC. Conservative assumptions employed in the forecast include full funding of the authority's capital plan (the authority typically funds a portion of its capital plan, and not the entire plan each year), a lack of rate increases, and conservative expense growth assumptions. Our analysis assumes that MDTA will maintain, on average, very strong DSC levels.

MDTA's rate-setting practices support our financial performance assessment for the authority, and contribute to our expectation that, despite rising debt service requirements over the longer term (7-10 year time horizon), the authority will continue to demonstrate very strong financial performance. Since 2001, the authority has instituted rate adjustments on seven occasions.

The most recent rate adjustment was a rate reduction implemented July 1, 2015, which was a reaction by the authority to significantly greater-than-anticipated revenue generation following prior rate increases. We note that management's forecasts assume no additional rate increases will be implemented. Based on its historical practices, however, we believe the authority would likely adjust rates as needed to maintain financial metrics no lower than those called for by its internal policies.

Debt and liabilities

We assess MDTA's debt and liabilities capacity as extremely strong. MDTA's very strong financial performance helped support very strong debt to net revenue of 4.8x in fiscal 2017. The metric improved from 5.3x in fiscal 2016 due to net revenue growth and amortization of debt. With modest net revenue growth, supported by projected 1.7% traffic growth, and the \$603 million cash defeasance of debt, management's estimates for fiscal 2018 indicate debt to net revenue will improve to 3.3x. As the authority adds debt in funding its CIP, we expect that its debt to net revenue metrics will likely remain within the range we consider to be extremely strong.

MDTA's CIP for the 8-year period 2018-2025 outlines \$3.9 billion in expenditures. The funding plan calls for \$1.3 billion in new debt, to be issued in multiple series, each year beginning in fiscal 2020. We note that MDTA's approach to capital planning involves the inclusion of additional projects each year, above and beyond what MDTA will likely pursue. Over the past six years, MDTA funded on average 77% of its annual capital program. However, MDTA's forecast assumes full funding of the current capital plan. As such, we believe the forecasted debt metrics are likely somewhat conservative.

MDTA's statutory debt ceiling for toll-revenue backed debt is currently \$2.325 billion, and will increase to \$3.0 billion thereafter. We expect that MDTA will continue to remain in compliance with its statutory debt limits.

Liquidity and financial flexibility

We assess MDTA's liquidity and financial flexibility as very strong. Over the past several years, MDTA accumulated extremely strong cash balances, as net revenue performance consistently exceeded budgeted levels. Due to the \$603 cash defeasance of debt that occurred in fiscal 2018, management estimates available liquidity of approximately \$440 million, equivalent to about 560 days' cash on hand. The projected fiscal 2018 figures compare to \$982 million in available liquidity at fiscal year-end 2017, equivalent to 1,383 days' cash on hand. The forecast indicates liquidity to

debt of 28% for fiscal 2018, compared to 42% for fiscal 2017.

Through the forecast period, MDTA projects maintaining available liquidity in excess of the level required per internal policy (\$350 million). Based on the forecast, we expect MDTA will maintain available liquidity sufficient to equate, on average, to between 400-600 days' operating expenses. We expect liquidity to debt will fall to roughly between 15-25% as the authority adds debt beginning in fiscal 2020. Based on its historic and projected financial performance, we consider MDTA's liquidity and financial flexibility to be very strong.

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