Fitch Affirms Maryland Transportation Authority's Transportation Facilities Project Revs at 'AA-'

Fitch Ratings-New York-26 August 2016: Fitch Ratings has affirmed Maryland Transportation Authority's (MDTA or authority) approximately $2.3 billion of outstanding transportation facilities project revenue bonds at 'AA-'. The Rating Outlook is revised to Positive from Stable.

KEY RATING DRIVERS
The Positive Outlook reflects MDTA's continued positive traffic trends and financial flexibility including robust coverage performance relative to peers while near-term leverage is expected to migrate downward. Positive rating movement will hinge on continued strong financial performance combined with near-term certainty on tolling policies and additional clarity on potential debt funding for the capital improvement program.

The rating reflects a net revenue pledge derived from a diverse system that provides critical transportation links in the mid-Atlantic region, demonstrated traffic levels that have been largely resilient to economic conditions, a high level of economic rate-making ability and demonstrated commitment to strong financial performance with debt service coverage above 2.0 times (x) and a robust liquidity position. In addition, the rating also incorporates uncertainty regarding future financial flexibility given recent policy decisions to reduce toll rates and MDTA's future capital needs.

Revenue - Volume: Stronger
Critical Transportation Network: MDTA revenues are derived from a diverse system of seven mature assets and the Inter County Connector (ICC) that provide critical transportation links in a high volume market with limited competing facilities. The systems legacy facility transactions have historically experienced low elasticity while numerous significant toll increases have been introduced.

Revenue - Price: Stronger
Demonstrated Toll Increases: The authority has a demonstrated ability to raise rates to maintain financial flexibility and meet internal policies. This ratemaking ability is supported by the facilities' affluent service areas comprising Baltimore and Washington D.C. metropolitan statistical areas. The recent toll cut in 2015 may signify a fundamental policy shift that causes some uncertainty regarding future independent rate setting ability.

Infrastructure & Renewal: Stronger
Prudent Capital Planning: The authority's facilities are in overall satisfactory condition while the Nice Bridge is considered in fair condition and there remains some continuing interest and discussion of a replacement effort. The 2016-2022 capital program mostly addresses system preservation and congestion relief, now that significant investment projects are largely completed. The program will mostly be cash-funded while some additional debt is likely.

Debt Structure: Stronger
Conservative Debt Structure: The authority operates according to a policy of maintaining debt service coverage ratio (DSCR) above 2.0x, unencumbered cash above $350 million, and a statutory bond cap of $2.325 billion while rising to $3.0 billion after 2020.

Strong Financial Performance: MDTA has a demonstrated track record of producing solid DSCR and maintaining moderate leverage, currently at 4.11x and 3.54x respectively, while retaining a high level of financial flexibility. The Fitch base case DSCR averages 2.69x and remains significantly above the authority's target of 2.0x in all periods; in its rating case DSCR is indicated to average 2.44x, falling no lower than 1.80x, and leverage to peak no higher than the 7x range, consistent with its current rating.

Peer Group
Florida's Turnpike and MDTA are characterized as essential facilities with strong catchments and limited direct competition. Both have considerable ongoing capital needs. Additionally, maximum annual debt service coverage for both facilities is comparable at close to or above 2.0x while Florida Turnpike has lower leverage below 2.5x.

RATING SENSITIVITIES
Negative - Under-performance of traffic and revenue with unwillingness to adjust tolls accordingly resulting in the inability to maintain financial metrics with coverage dropping below 2x.

Positive - A clear direction of capital needs while maintaining robust debt service coverage above 2.25x with moderate leverage expectations could warrant upward movement of the rating.

SUMMARY OF CREDIT

Fiscal year (FY) 2015 traffic is up 2.8% on legacy facilities while increasing 8.1% with inclusion of the ICC and JFK Express Toll Lanes; revenue increased 3.6% and 5.6% respectively. Fiscal YTD 2016 (six months) traffic has also increased on legacy facilities and while including the ICC and JFK Express Toll Lanes, rising 1.9% and 8.8% respectively. In this same time period, revenue is down 1.4% on legacy facilities while increasing 0.7% when including the ICC and JFK Express Toll Lanes. This revenue decline is a result of recent toll reductions effective July 1, 2015, which primarily targeted the ICC, Chesapeake Bay Bridge, JFK Express Toll Lanes, and E-ZPass rates.

The recent toll cuts, which were heavily influenced by the elected governor of Maryland, followed several prior significant rate increases which were put into place during a period of increased financing and spending on expansion oriented capital projects. As toll hikes were implemented, legacy facility revenue increased at a 10-year compound annual growth rate (CAGR) of 7.9% while traffic has remained essentially flat with a CAGR of -0.2% through fiscal 2015, demonstrating the systems robust traffic profile with respect to the inelasticity relationship. The authority expects toll levels to remain at current levels in the medium term.

FY 2015 expenses increased 6.3%, down from recent years as expansionary projects come to a close. Recent elevated cost increases have stemmed from escalating salary and benefits as well as E-ZPass and service center-related costs. Looking forward, MDTA expects costs to increase approximately 4% year over year past fiscal 2018. As net revenue reached an historic high in FY 2015, DSCR reached 4.11x while leverage declined to 3.54x.

The 2016-2022 capital plan is substantial at approximately $2.26 billion in aggregate while largely focusing on maintenance and renewal. Debt raising activity to fund capital works is expected to be manageable in forthcoming years, while some uncertainty exists with regards to potential financing needs if the Nice Bridge is determined to need replacement; this remains a continuing development that Fitch will continue to monitor going forward.

Fitch's base case uses sponsor revenue and expense assumptions where revenues grow at a compound annual growth rate of 0.6% growth through FY 2024 while operating expenses grow at a CAGR of 4.2% in that same period. Debt issuances are assumed to total $450 million through fiscal 2024 to take into consideration potential additional capital outlays and financing for a Nice Bridge replacement effort. In this scenario, coverage reaches a minimum of 2.27x and averages 2.69x while net debt/CFADS remains below approximately 6x. Fitch's rating case assumes similar expenses while revenues experience a shock in fiscal 2018 with a 4% decline. Thereafter, a year of flat growth is followed by a recovery period and normalized growth through fiscal 2024. Further, increased additional debt totalling $910 million is assumed to recognize a potential scenario where the authority increases their capital program outlays to cover the replacement of the Nice Bridge while using less available cash. This scenario represents a stressful phase in the business cycle and a capital demanding environment that results in coverage reaching a minimum of 1.80x and averaging 2.44x through fiscal 2024 while leverage migrates up to the 7x range in that same time period.

SECURITY
The bonds are primarily secured by the net revenues of the transportation facilities projects. Pledged revenues are derived from a diverse system of eight toll facilities including I-95 between Baltimore and the Maryland-Delaware state line, three bridges crossing Chesapeake Bay, Potomac River and Baltimore harbor, two tunnels on I-95 and I-895 and ICC since operations began in February 2011.

Contact:

Primary Analyst
Samuel Marsico
Analyst
+1-212-612-7810
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Secondary Analyst
Chad Lewis
Senior Director
+1-212-908-0886

Committee Chairperson
Scott Zuchorski
Senior Director
+1-212-908-0659

Additional information is available at 'www.fitchratings.com'.