

RATING ACTION COMMENTARY

Fitch Rates NC Turnpike Authority \$98MM State Appropriation Bonds 'AA+'; Outlook Stable

Fri 06 Nov, 2020 - 4:33 PM ET

Fitch Ratings - New York - 06 Nov 2020: Fitch Ratings has assigned an 'AA+' rating to the following bonds of the North Carolina Turnpike Authority (NCTA):

--\$98.4 million Monroe Expressway System State Appropriation Revenue Refunding Bonds, Series 2020 (Federally Taxable).

The bonds are expected to sell via a negotiated sale on Nov. 19, 2020 and will refund outstanding series 2011 bonds for debt service savings. The bonds may be structured as an advance refunding or a refunding with a forward delivery. The par amount and structure will be determined at pricing.

Fitch has affirmed the following ratings of the NCTA at 'AA+':

--\$115 million triangle expressway system appropriation revenue bonds, series 2019;

--\$10.3 million state annual appropriation revenue bonds, series 2009B (federally taxable - issuer subsidy - Build America Bonds).

The Rating Outlook is Stable.

SECURITY

The bonds are special obligations of the authority, secured by, and payable from, a \$24 million annual state appropriation from the highway trust fund. No additional security is provided by tolls or other revenues of the Monroe Expressway System or any other funds held under the General Revenue Bond Trust Agreement. The series 2009B and 2019 bonds issued for the Triangle Expressway are similarly secured by a \$25 million annual state appropriation from the highway trust fund.

ANALYTICAL CONCLUSION

The 'AA+' rating on the authority's state annual appropriation revenue bonds reflects the strength of the pledged primary revenue stream - a fixed annual appropriation from the state of North Carolina's highway trust fund (HTF). The rating reflects the strong growth prospects and ample resilience of the HTF and is capped one notch below the state's 'AAA' Issuer Default Rating (IDR), as the operations of the HTF are not considered to be distinct from other operations of the state and there is a requirement to appropriate. Growth of revenues deposited in the HTF has been strong for the past 10 years, following a steep decline during the Great Recession. Fitch expects long-term growth to resume at a pace that exceeds inflation as the economy recovers from the pandemic-induced downturn. Given expected leveraging and current high debt service coverage of debt and standing appropriations paid from the HTF, the bond structure can easily absorb a decline in revenues expected to result from a moderate recession scenario or a drop in revenue equivalent to the largest prior decrease.

Fitch's analysis of bonds backed by transportation and motor vehicle revenues is informed by Fitch's global infrastructure group (GIG) coronavirus scenarios for passenger and truck traffic on U.S. toll roads based on expectations for significant traffic losses through 1H20 and moderate recovery through year end. Fitch anticipates the bonds' structure will withstand sharp coronavirus-driven revenue declines at a level consistent with Fitch's baseline macroeconomic scenario without deterioration in long-term credit quality.

Sound Growth in Revenue Stream: Fitch expects revenues, which include motor vehicle usage fees based on the retail value of vehicles registered or titled in N.C., motor fuel taxes and a variety of other transportation-related fees, to track relatively strong long-term growth in the North Carolina economy, above the rate of inflation.

Ample Resilience: Given permitted maximum issuance under the state issued Build NC limited obligation program and ample coverage of debt service and standing appropriations that support debt service for bonds issued by the NCTA and the state port authority, the HTF can easily absorb a decline in revenues expected to result from a moderate recession scenario, steeper declines associated with Fitch's current baseline and downside macroeconomic assumptions, which both indicate a decline slightly in excess of that experienced during the Great Recession, and a stress scenario of a 34% decline annualized.

Rating Capped One Notch Below IDR: The rating is limited to one notch below N.C.'s 'AAA' IDR, reflecting the commitment of the state to annually appropriate debt service from the HTF. The Monroe Expressway, partially funded by the bonds, serves as an alternative to congested free roads in a rapidly developing part of the state and is considered an important project to the state.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to a positive rating action/upgrade:

--Not applicable given the state's 'AAA' IDR and the cap at the state appropriation rating.

Factors that could, individually or collectively, lead to a negative rating action/downgrade:

--Pledged revenue declines that exceed the severity of Fitch's base case assumptions and lead to materially thinner coverage of annual debt service and a weakened level of resilience in the structure;

--Changes in the pledged revenue allocation and/or additional leveraging that weakens debt service coverage and the resilience cushion;

--A downgrade of the state IDR.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [<https://www.fitchratings.com/site/re/10111579>].

CURRENT DEVELOPMENTS

Sector-Wide Coronavirus Implications

The outbreak of coronavirus and related government containment measures worldwide has created an uncertain global environment for U.S. state and local governments and related entities. Fitch's ratings are forward-looking in nature, and Fitch will monitor the severity and duration of the budgetary impact on state and local governments and incorporate revised expectations for future performance and assessment of key risks.

While the initial phase of economic recovery has been faster than expected, GDP in the U.S. is projected to remain below its 4Q19 level until at least 4Q21. In its baseline scenario, Fitch assumes continued strong GDP growth in 3Q20 followed by a slower recovery trajectory from 4Q20 onward amid persisting social distancing behavior and restrictions, high unemployment and a further pullback in private-sector investment. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the reports titled, "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update" (<https://www.fitchratings.com/research/sovereigns/fitch-ratings-coronavirus-scenarios-baseline-downside-cases-update-08-09-2020>), published Sept. 8, 2020 and "Fitch Ratings Updates Coronavirus Scenarios for U.S. State and Local Tax-Supported Issuers" (<https://www.fitchratings.com/research/us-public-finance/fitch-ratings-updates-coronavirus-scenarios-for-us-state-local-tax-supported-issuers-01-10-2020>), published on Oct. 1, 2020 on www.fitchratings.com.

HTF Update

The N.C. department of transportation reported a fall-off in revenue collections to the HTF in the latter part of fiscal 2020, as the stay-at-home order to mitigate the pandemic affected both motor fuel sales and the auto sales that drive highway usage taxes. Total revenues deposited in the HTF fell \$45 million (2.8%) yoy, driven by a 6.8% decline in motor fuel tax revenues, while highway usage taxes declined marginally.

The state legislature took several actions in July 2020 that affect operations of the DOT. These include changing the way the DOT manages its cash, authorizing a \$700 million Build N.C. debt issuance (higher than the \$300 million annual limit in the original Build N.C. legislation), and reducing the percentage of the motor fuel tax that is allocated to the HTF to 19% from 29% in fiscal 2021 and subsequently to 20% in fiscal 2022 and 25% in fiscal 2023 and thereafter. Given a state forecast of a 4.5% decline in transportation related revenues for fiscal 2021, transfers to the HTF are expected to decline 21% as compared with fiscal 2020 due to the lower motor fuel tax allocation. Collections at this level would still provide an ample 6.5x coverage of maximum annual debt service (MADS) on the combined obligations related to the NCTA annual bonds, fixed transfers to the Port Authority, and the Build NC bonds.

DEDICATED TAX CREDIT PROFILE

The NCTA, a N.C. public agency, is empowered to design, build and operate projects specifically authorized by the state assembly. The Monroe Expressway, previously referred to as the Monroe Connector System, is a 19.8 mile toll road in a rapidly growing part of the state. Construction is complete and the expressway has been in operation since November 2018.

Transportation operations and capital improvements are funded through two state funds, the Highway Fund (HF) and the HTF. The HTF is the dedicated mechanism for funding capital improvements, although in many respects the two funds are managed together, with each receiving revenues on a formulaic basis and transfers between the funds as necessary. Revenues deposited into the HTF include a 3% highway use tax on the retail value of motor vehicles purchased or titled in N.C., a portion of all motor fuel tax revenues (was 29% but has been reduced by statute to 19% in fiscal 2021, and will increase to 25% by fiscal 2023), and a portion of certain fees shared for the issuance of certificates of title.

Strong Growth Prospects for Tax Revenues

Revenues totaled approximately \$1.56 billion in fiscal 2020 and have grown at a pace that exceeds inflation over the past 15 years, increasing at a 2.9% CAGR between fiscal years 2005 and 2020. This incorporates a steep 19% decline during the Great Recession. Recent growth has been strong, increasing at a 5.5% CAGR in the 10 years since the Great Recession. Revenue growth reflects the two larger components of the deposits into the HTF, highway user fees (54% of fiscal 2020 revenues) and a portion of motor fuel taxes (36%). Highway user fees have experienced stronger growth reflective of economic growth in the state. Motor fuel taxes are expected to be a slower growth revenue stream but have also increased. The mix of revenues transferred into the HTF results in a more rapidly growing revenue stream than is typically true of programs that rely on consumption-based motor fuel taxes alone.

Resilience of Security

Fitch applies both a short-term stress driven by the coronavirus and long-term perspective to arrive at an assessment of the bonds' structural resilience. Based on fiscal 2020 revenues of \$1.56 billion, the HTF could withstand an 88% decline in revenues and maintain sufficient coverage of MADS (\$190.2 million), which includes the standing appropriations for transfers to the N.C. Turnpike Authority and the State Port Authority for debt service and level debt service on bonds issued by the state under its Build N.C. program. This cushion is well in excess of Fitch's 34% coronavirus stress applied to most transportation credits, a stress that reflects a recession of unprecedented depth in the post-war period and travel reductions associated with social distancing measures. MADS coverage by unaudited fiscal 2020 revenue falls to 5.4x from 8.2x under Fitch's 34% revenue decline assumption, which Fitch considers to be consistent with the 'aaa' resilience assessment.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR
North Carolina, State of (NC) [General Government]		
● North Carolina Turnpike Authority (NC) /State Annual Appropriation/1 LT	LT	AA+ Rating Outlook Stable Affirmed AA+ Rating Outlook Stable

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[U.S. Public Finance Tax-Supported Rating Criteria \(pub. 27 Mar 2020\) \(including rating assumption sensitivity\)](#)

APPLICABLE MODELS

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

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

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North Carolina Turnpike Authority (NC)

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