Rating Update: Moody's affirms ratings on North Texas Tollway Authority

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NORTH TEXAS TOLLWAY AUTHORITY, TX
Toll Facilities
TX

Opinion

NEW YORK, February 06, 2013 --Moody's Investors Service has affirmed the A2 rating on $ 6.1 billion of outstanding First Tier debt, the A3 on the $1 billion Second Tier Debt outstanding, and the Baa3 on the $400 million of deeply subordinated Capital Improvement Fund (CIF) debt outstanding of the North Texas Tollway Authority (NTTA).

RATINGS RATIONALE

The ratings reflect a balance between the high level of leverage - which is among the highest in the rated peer group of government-owned toll roads - with the strong recent history of toll transaction and revenue growth. The double-digit growth in both traffic and revenue was expected following new segment openings, and toll increases. Going forward, toll transactions are expected to increase in line with GDP, though somewhat higher given the continued expansion of the Dallas area. The revenue growth is expected to be somewhat tempered by challenges in collections of video tolling transactions, which are expected to continue to increase as a proportion of the whole, given that an all electronic tolling (AETC) system is able to attract more, if infrequent, users.

The growth in transactions and the system's ability to support its operations and debt service at current levels is anchored by a service area that fundamentally remains strong and is trending in a positive direction, even as the recovery in the region has decelerated with such challenges as the American Airlines bankruptcy and cuts in jobs in other industries, but remains stronger than that of the nation as a whole.

Construction risk on the system roads is minimal, now that all segments on all of the system's roads are fully operational. The 2013 to 2017 Capital Improvement Plan (CIP) anticipates lane addition and some extension works and additional debt of approximately $200 million, which is expected to be less given the NTTA's expected ability to cash fund some or all of the projects.

STRENGTHS

- Strong service area continues to generate traffic growth for NTTA system, though the economic growth has started to slow compared to that of the state

- Traffic for the fiscal year ending in December 2012 grew 13% compared to the previous year, while toll revenue increased 25%.

- Construction risk for system projects is minimal as the system's main roads are fully operational. CIP for existing roads consists mainly of lane additions or extensions.

- Strong tolling policy requires increases which grow based on set annual rates and depend on willingness and ability to increase toll rates

- Historically adequate DSCRs; projections show continued DSCRs on First Tier Bonds above 1.5 times

- Strong levels of liquidity

CHALLENGES

- Payment of increasing debt service profile through 2037 is dependent on meeting projected increases in traffic and escalating toll rates

- Anticipated toll tag penetration and collections for the video tolling or ZipCash transactions continue to be lower than originally expected, posing a challenge in revenue recovery of these transactions

- Expanding service area will sustain pressure for additional capital improvements, though NTTA has opted out of several TxDOT projects and would likely fund additional projects through the Special Projects System (SPS), which is outside the NTTA System revenue pledge. NTTA has some exposure to construction or operating cost that run over those covered under an agreement with TxDOT.

DETAILED CREDIT DISCUSSION

LEGAL SECURITY: NTTA's bonds are secured by net system revenues. The rate covenant in the amended and restated trust agreement dated April 1, 2008 under which these bonds are issued requires net revenues to provide at least 1.35 times coverage of first tier debt service requirements, 1.2 times coverage of outstanding first tier and second tier debt service, and 1.0 times coverage on all outstanding obligations secured by net revenues, including third tier bonds. The rate covenant is not limited by the tolling formula set forth in the project agreement NTTA signed with the Texas Department of Transportation (TxDOT) for Sam Rayburn Tollway (SRT or SH 121) or by the authority's toll policy adopted through a board resolution. The first tier bonds are additionally secured by a debt service reserve fund equal to average annual debt service, second tier reserves equal one half of average annual debt service, and third tier reserve fund as pursuant to supplemental agreements authorizing the bond.

Additional First Tier bonds may be issued if net revenues during designated year were at least 1.35 times the average annual debt service requirements for outstanding first tier and second tier bonds or estimated net revenues for the current and each subsequent fiscal year is 1.35 times debt service requirements on first tier bonds; 1.2 times debt service requirement on all first and second tier bonds; 1.0 times debt service requirements on all obligations. An amount equal to 10% of the principal amount of first tier bonds may be issued for completion of a project, without having to meet the additional bonds test.

Additional second tier bonds can be issued if actual net revenues during designated year were at least 1.2 times the average annual debt service requirements for outstanding first tier and second tier bonds or estimated net revenues for the current and each subsequent fiscal year is 1.2 times debt service requirement on all first and second tier bonds, 1.0 times debt service requirements on all obligations.

Third Tier Bonds require that actual net revenues during designated year are at least 1.0 times the average annual debt service requirements for outstanding first tier and second tier bonds or estimated net revenues for the current and each subsequent fiscal year is 1.0 times debt service requirements on all obligations

INTEREST RATE DERIVATIVES:

At the close of the 2012 fiscal year, NTTA had outstanding variable rate bonds in the amount of $278.4 million, or 3.6% of total debt. The authority also had soft put bonds outstanding in

the amount of $316.7 million consisting of $215 million with a put date of January 1, 2016 and $101.7 million with a put date of January 1, 2019. A failed conversion and remarketing does not constitute an event of default, and instead results in a step-coupon rate of 12% per annum on the 2016 put bonds and 10% on the 2019 put bonds. There is no liquidity facility provided to cover such an event.

The NTTA also has two interest rate swaps outstanding with Citibank and JP Morgan Chase. Pursuant to the swap agreement with JP Morgan Chase the NTTA could be obligated to post collateral if the rating on FGIC and the Authority's First Tier Bonds are rated below A3 by either of the two agencies rating the bonds. Though FGIC is now below the rating trigger, the NTTA's First Tier Bonds are rated above the threshold. Based on the mark-to-market as of December 31, 2012, the negative fair value on the 2004 bonds was $19.0million and $23.3 million for the 2005 swap transaction.

RECENT DEVELOPMENTS

Total traffic on NTTA facilities grew notably in 2012 by 13% compared to the previous year due to increasing usage of the final segments of the Sam Rayburn Tollway (SRT) and the President George Bush Turnpike Eastern Extension, the supportive local economic conditions, and the use of all electronic tolling which encourages more users on the road. Toll Tag penetration for the year remained at the expected 78%, compared to an 83% toll tag penetration in 2011. Given that all NTTA facilities are solely electronically tolled, additional users are charged through video tolling, or ZipCash. ZipCash transactions are billed via an invoice and are charged a 50% premium over Toll Tag users as well as an administrative fee for non-payment in a 30 day period.

The increase in ZipCash transactions continues to pose a collections challenge for NTTA. Revenue leakage, calculated as the value of ZipCash transactions not collected and those not invoiced at the end of the year over the total value of all transactions did improve to around 13% for 2012 compared to 16.8% for 2011. Improvement in these processes is key for the authority given the increase in video tolling and the Toll Services Agreements (TSA with NTE Mobility Partners and the LBJ Infrastructure Group managed lanes project, for which it will collect tolls. The projects are expected to begin operations in 2014 and 2015. These TSAs could prove burdensome to the NTTA if the value of the tolls that it pays the corresponding party is more than what it is able to collect. However, payments to the corresponding parties are not secured by or payable from system toll revenues.

REVENUE INCREASES IN PART DUE TO TOLL INCREASES, DEBT SERVICE COVERAGE REMAINS ABOVE TARGET

Toll revenue grew notably in FY 2012 to $522 million, which represents an increase of 26% over FY 2011. The revenue growth is due to the increase number of users and a full year of the increased toll rate which went into effect in July of 2011. Expenses are also below the budgeted amounts, providing a more robust operating margin.

Audited financial information for FY 2011 indicate a bond ordinance DSCR on First Tier and Second Tier debt of 1.8 times. Moody's calculated DSCR on First and Second Tier debt for the

same year is 1.52 times. Unaudited financial information for 2012 indicates debt service coverage ratios in the range of 1.5 times for the first tier debt and 1.3 times for first and second tier debt, levels that are aligned with our expectations.

Debt service coverage on all of the debt, including first and second lien, Capital Improvement Fund subordinated bonds and the unrated ISTEA loan was 1.3 times in FY2011 and expected to be around 1.2 times in FY 2012. Going forward the all in coverage should be closer to 1.15 times.

The calculation for the Debt Service Coverage Ratio in the Government Owned Toll Roads methodology divides annual operating revenues, less operating expenses (excluding depreciation), by annual total debt service costs for all liens of debt. Under this definition, the NTTA score falls into the Ba category given the all-in coverage that is expected to remain in the range of 1.15 times.

LEVERAGE REMAINS AMONG THE HIGHEST OF PEER GROUP

After the January 1, 2013 debt service payment, the authority has approximately $7.6 billion of long-term debt outstanding, with close to 80% at the First Tier level. Though the ratio of debt to operating revenues has been decreasing in the past couple of years, to 17.04 times in 2011 from 24.6 times in 2008, it still remains among the highest of the rated toll road peer group The median for debt to operating revenue in 2011 for all Moody's rated tolled facilities was 4.83 times and that of A2 rated credits is 7.90 times.

The system's annual debt service commitments increase through 2036, at which point they begin to decrease. The increasing and back-loaded structure achieves the goal of matching expected increasing traffic and revenue trends to debt service, but also pressures the system to need continuous growth in transactions and revenue to meet its rising obligations. The debt service structure accounts for the - 0.5 notching on the scorecard factor for Other Financial, Debt, and Operational Factors.

TRAFFIC AND REVENUE PROJECTIONS INCORPORATE SOME CUSHION TO YIELD TARGETTED DEBT SERVICE COVERAGE

Traffic and revenue projections are based on the most recent update (February 2012) to the traffic consultant's study, which incorporates several modifications from the previous October and December 2011 updates. The update incorporates an annual average growth in traffic of 3.2% through 2020 and 1.8% through 2030. Average annual revenue growth in these corresponding periods is projected at 7% and 4.6%, which could vary with actual collections, but has some cushion on the net revenue side given the recent trend of expenditures coming in under budget.

The revenue projections are expected to yield first lien debt service coverage in the range of 1.5 to 1.6 times and 1.25 to 1.3 times on the First and Second Tier debt. Additionally, the payment of the ISTEA and CIF debt, alongside the estimated deposit to the Reserve Maintenance Fund (RMF), will yield sufficient coverage. We note that given the high debt service coming due in 2013, NTTA has prefunded a portion of its 2013 first tier debt service payment and the deposit into the RMF.

FUTURE DEBT ISSUANCE IS LIMITED GIVEN THE BUILD OUT OF SYSTEM FACILITIES

The 2013-2017 Capital Improvement Plan includes around $520 million of system maintenance, improvement, and construction projects. However, NTTA expects to issue limited new debt in the next couple of years and expects to fund these projects from its capital improvement fund.

NTTA is required to provide a $26 million contribution to TXDOT for the NTE Mobility Partners TSA, and expects to fund this with cash as well. Committed projects will require additional capital commitments in the future, but these are not expected to come on line in the next three to five years.

SPECIAL PROJECTS SYSTEM EXPECTED TO BE SELF SUFFICIENT

The NTTA has developed the SPS to fund projects that are outside of the NTTA system. These include the President George Bush Turnpike Western Extension (PGBT-WE), which is an 11.5 mile extension of the existing PGBT from SH 183, providing access to the new Dallas Cowboy Stadium. NTTA contributed $72 million of equity towards the project and last year funded the remaining costs of approximately $1.2 billion through a combination of $674 million in SPS revenue bonds and a Transportation Infrastructure Finance and Innovation Act Loan (TIFIA) in the amount of $418 million. The Chisholm Trail Parkway is located south of Forth Worth in Tarrant County. The road is being funded with $640.5 million in SPS revenue bonds and approximately $327 million in NTTA equity.

The projects qualified for a TELA from TxDOT, which covers a predetermined level of debt service, operating and maintenance and capital expenditures. Any construction or future operating and maintenance cost overruns that cannot be covered with toll rate increases or the TELA will be the responsibility of the NTTA system. The NTTA is working with TxDOT on a possible third project which would be funded under the SPS and not the system.

Though we believe that the possibility of NTTA being tapped for such support is remote, legally this contingency exposes the NTTA bondholders to risks unrelated to the revenue generating assets that back the bonds. Therefore, Moody's will closely monitor their performance and what unintended effects their operation could have on the NTTA system.

Outlook

The outlook for the ratings on NTTA system debt is stable, incorporating the resilience of the system during the economic recession and the recent trends in traffic and revenue despite some of the challenges in collections. The outlook is based on the expectation that net revenues will be sufficient to meet DSCR of at least 1.5 times for senior debt and in the range of 1.15 times on all debt including the deeply subordinated Intermodal Surface Transportation Efficiency Act (ISTEA) loan and Capital Improvement Fund (CIF) bonds.

What could change the rating - Up

The rating is well placed in its rating category given its strong market position and growth, which is countered by elevated levels of leverage, a growing debt service schedule, and high leakage on AETC and would be unlikely to change upwards in the near to medium term.

What could change the rating - Down

Lower than currently forecasted traffic and revenues would put negative pressure to this rating, given the dependence on such growth to meet its rising debt service costs. We continue to believe that improvements in revenue collections is key and hence cumulative increases in receivables could also strain the creditworthiness of the issuer.

Key Data/Indicators

Type of Toll Road Single asset, multi-segment

FY 2012 Transaction Traffic Volume (reported): 587,236,062

Percent change from 2011: 13.2%

FY 2012 Annual Toll Revenue: $522,566,634

Percent % change from 2010: 25.9%

Toll Transactions, 5-year CAGR: 10.4%

First Tier Debt Service Coverage, FY 2011 (bond ordinance): 1.78x

First and Second Tier Debt Service Coverage (bond ordinance), FY 2010: 1.60x

Net Revenue First Tier Debt Service Coverage, FY 2011: 1.71x

Net Revenue First and Second Tier Debt Service Coverage, FY 2011: 1.52x

Base Case: average 10-year projected debt service coverage, first tier only: 1.59x

Base Case: average 10-year projected debt service coverage, first and second tier: 1.36x

Average 10 year projected debt service coverage, all current and planned debt (including projected deposits into Reserve Maintenance Fund): 1.11x

Lowest projected 10 year total debt service coverage, current and planned debt (including projected deposits into Reserve Maintenance Fund): 1.08x in 2018

METHODOLOGY SCORECARD FACTORS:

Factor 1a) Asset Type: A

Factor 1b) Operating History: Aa

Factor 1c) Competition: A

Factor 1d) Service Area Characteristics: Aa

Factor 2a) Annual Traffic: Aaa

Factor 2b) Traffic Profile: Aaa

Factor 2c) Five-Year Traffic CAGR: Aaa

Factor 2d) - Ability and Willingness to Increase Toll Rates: Aa

Factor 3a) Debt Service Coverage Ratio: Ba

Factor 3b) Debt to Operating Revenue: Caa

Factor 4a) Capital Needs: Aa

Factor 4b) Limitations to Growth: A

Notching Factors

1.Debt Service Reserve Fund Levels: 0

2.Open/Closed Flow of Funds: -0.5

3.Days Cash on Hand: +1.0

4.Other Financial, Debt and Operational Factors: -0.5

Scorecard Outcome: A2

The principal methodology used in this rating was Government Owned Toll Roads published in October 2012. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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