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OUTLOOK
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Contacts

Cintia Nazima +1.212.553.1631
AVP - Analyst
cintia.nazima@moodys.com

John Medina +1.212.553.3604
Senior Vice President
john.medina@moodys.com

Julia Ponte +55.11.3043.7339
Lead Ratings Associate
julia.ponte@moodys.com

Ian Rice +1.212.553.4810
Ratings Associate
ian.rice@moodys.com

Kurt Krummenacker +1.212.553.7207
Associate Managing Director
kurt.krummenacker@moodys.com

Jim Hempstead +1.212.553.4318
MD - Global Infrastructure & Cyber Risk
james.hempstead@moodys.com

Toll Roads – US

2024 Outlook - Stable with slowing but still-growing traffic and revenue

Summary

» **Traffic and revenue growth will slow further as GDP growth decelerates and unemployment rises.** The stable sector outlook reflects our expectation that median traffic and revenue growth for rated US toll roads will be slower in 2024 than in 2023 but in line with pre-pandemic levels. Revenue growth will remain above traffic growth because of toll rate increases.

» **With remote work patterns stabilizing, macroeconomic measures are resuming their influence on traffic growth.** The stabilization follows fluctuations during the peak pandemic years, which had an outsized effect on traffic. Now, macroeconomic measures such as GDP, population and employment growth will again become the main drivers of traffic growth, as they were before the pandemic.

» **Commercial traffic growth is slowing to historical norms.** This traffic is slowing from exceptionally high levels during the pandemic, when consumer spending on goods surged and supply chains were snarled. The slowdown in demand for goods, along with slower GDP growth, is weighing on commercial traffic growth**.** Commercial vehicles pay much higher tolls than passenger vehicles and therefore have a significant effect on toll revenue.

» **Toll increases are also slowing, further limiting revenue growth.** Toll rate increases – many of which are pegged to inflation or a related index – can drive toll revenue growth at higher levels than traffic growth alone. But slowing inflation is limiting toll increases for publicly managed toll roads, especially compared with some above-average toll rate increases during the past couple of years to match high inflation. Privately managed toll roads continue to implement toll rate adjustments per formula-based tolling regimes within their individual concession agreements.

» **Most toll roads will maintain their credit quality.** Toll roads have strong financial metrics, which will help them maintain their credit quality even as traffic and revenue growth slow. They can use their large cash piles to fund capital projects, but some incremental debt might be required because project costs have risen with inflation.

» **What could change the outlook.** We would consider changing the outlook to positive if we were to expect median annual traffic growth of 2% or higher and median annual revenue growth above 4% for the coming 12 months. We would consider changing the outlook to negative if we expected median traffic declines and median revenue growth below 2%.

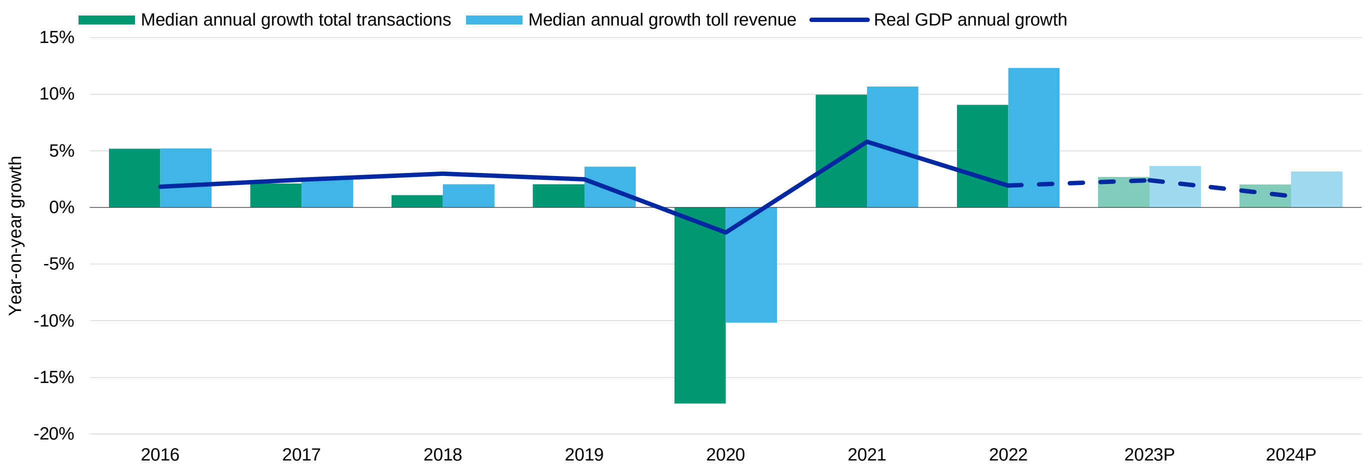
Outlook definition

The stable outlook reflects our view of credit fundamentals in the US toll road sector over the next 12 months. Sector outlooks are distinct from rating outlooks, which, in addition to sector dynamics, also reflect issuers' specific characteristics and actions. A sector outlook does not represent a sum of upgrades, downgrades or ratings under review, or an average of rating outlooks.

Traffic and revenue growth will slow further as GDP growth decelerates and unemployment rises

The stable sector outlook reflects our expectation that traffic and revenue growth for US toll roads will continue to slow in 2024 as subdued economic growth and rising unemployment weigh on consumer and business spending. We expect median tolled traffic and revenue growth of 2% and 3%, respectively, for rated US publicly managed toll roads (Exhibit 1). That is down from our expectations for 2023 but still within our range for a stable outlook – and in line with historical averages following the pandemic-driven swings of the last few years.

Exhibit 1
Traffic and toll revenue growth are slowing to pre-pandemic levels



Historical data include all rated publicly managed toll roads with available information. 2023 and 2024 reflect data available for toll roads' respective fiscal years and Moody's Investors Service's projections.
Source: Moody's Investors Service, US Bureau of Economic Analysis and toll roads' websites

Revenue growth will remain higher than traffic growth because of toll rate increases. But revenue growth is slowing as inflation slows and limits toll rate increases and as commercial traffic growth eases from pandemic peaks. Commercial vehicles pay much higher tolls than passenger vehicles and account for a larger share of many toll roads' total revenue now than before the pandemic, given their strong performance during the pandemic. So a decline in commercial traffic could cause a decline in total revenue, even if passenger toll revenue growth continues.

Our expectations are underpinned by our view that US real GDP growth will average 1.0% in 2024, down from 2.4% in 2023, and US unemployment will rise to 4.3% from 3.7% in 2023.

We would consider changing the sector outlook to positive if we were to expect median annual traffic growth of 2% or higher and median annual revenue growth above 4% for the coming 12 months. We would consider changing the outlook to negative if we expected median traffic declines and median revenue growth to fall below 2%. The outlook has been stable since December 2022, when we changed it from positive.

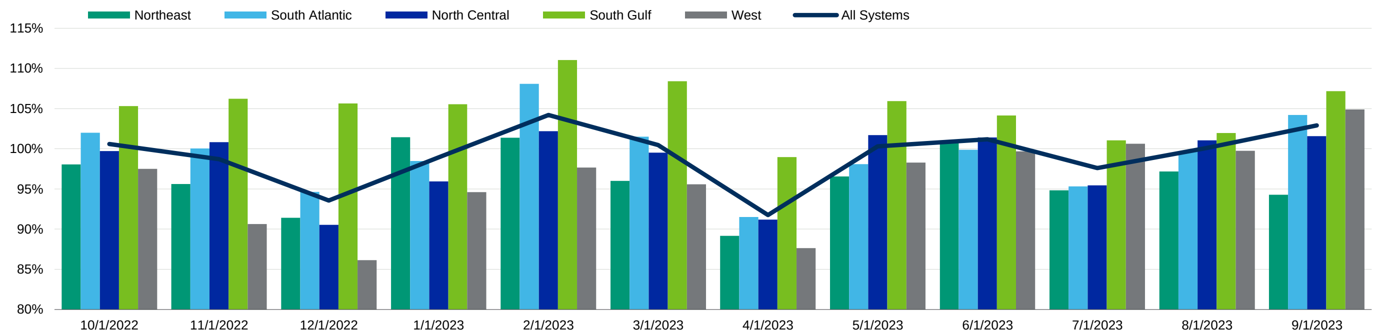
With remote work patterns stabilizing, macroeconomic measures resume influence on traffic growth

Monthly national seasonally adjusted vehicle miles traveled (VMT) – which reflect traffic on all public US roads – are near or above pre-pandemic levels in most parts of the country, as is traffic on many rated toll roads. The traffic recovery for a given month compared with the same month in 2019 still varies by region, but the difference between regions is narrowing. The traffic recovery remains slowest in the Northeast and West in most months (Exhibit 2), where a comparatively high proportion of employees continue to work from home, according to data from Kastle Systems International, which tracks office occupancy through security badge swipe data.

Exhibit 2

Traffic recovery continues to lag in Northeast and West, but the gap between regions has narrowed

Monthly national seasonally adjusted vehicle miles traveled (VMT) as a % of 2019 level



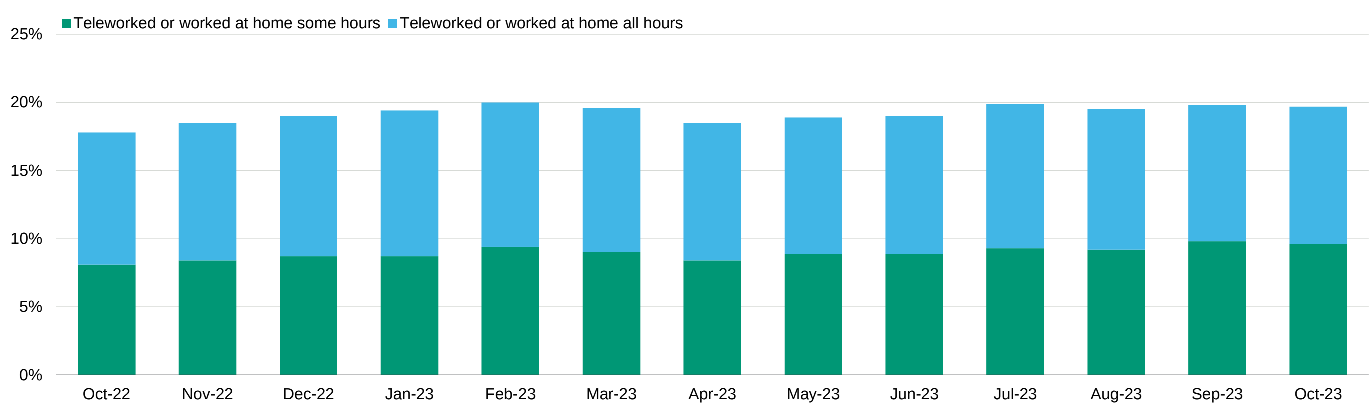
Source: Federal Highway Administration

In aggregate, return-to-office working patterns have stabilized in the US (Exhibit 3). The large number of employees working remotely during the pandemic peak and then returning to the office had an outsized effect on traffic from 2020 through 2022. But now, macroeconomic measures such as GDP, employment, population growth and local decisions related to land use will again become the main drivers of traffic, as they were before the pandemic. These measures vary by region, underpinning the regional differences in traffic (Exhibit 4).

Exhibit 3

Remote work patterns have stabilized

Employees who teleworked or worked at home for pay as a % of total US persons at work



US Bureau of Labor Statistics started collecting this information on its monthly Current Population Survey (CPS) in October 2022.
Source: US Bureau of Labor Statistics

Exhibit 4

Macroeconomic measures that have traditionally driven traffic – and regional differences – are returning to fore as primary drivers of traffic

Average pre-pandemic VMT, population and GDP growth by region

	2008-2011	2012-2015	2016-2019
VMT growth by region			
South Atlantic	0.10%	0.82%	1.89%
South Gulf	-0.60%	2.55%	1.27%
West	-0.26%	2.34%	0.71%
North Central	0.32%	1.31%	0.24%
Northeast	-0.75%	0.62%	0.07%
Population growth by region			
South Atlantic	1.13%	1.15%	0.89%
South Gulf	1.31%	1.09%	0.83%
West	1.15%	1.03%	0.77%
North Central	0.36%	0.44%	0.21%
Northeast	0.46%	0.51%	0.28%
GDP growth by region			
South Atlantic	-0.17%	2.10%	2.56%
South Gulf	0.99%	3.07%	2.16%
West	0.39%	3.18%	3.89%
North Central	0.24%	1.93%	1.30%
Northeast	0.84%	1.87%	1.82%

Sources: Federal Highway Administration, US Bureau of Labor Statistics and US Bureau of Economic Analysis

Commercial traffic growth is slowing to historical norms

Commercial traffic growth is slowing from exceptionally high levels during the peak pandemic years, when consumer spending on goods surged and supply chains were snarled. As consumer spending continues its shift to a more normal mix of goods and services and consumers become more cautious spenders in the cooling macroeconomic environment, demand for goods will be constrained.

Moreover, as supply and demand come more into balance, and supply chains normalize as a result, commercial traffic is returning to pre-pandemic levels in many regions. However, some areas in which trade routes and cargo flows have changed may continue to benefit from higher levels of commercial traffic compared with pre-pandemic levels.

The slowdown in commercial traffic constrains toll road revenue growth in the aggregate because, as noted above, commercial vehicles pay much higher tolls than passenger vehicles.

Commercial traffic will continue to differ by region, affecting both traffic and revenue growth. As a consequence of supply chain and labor-related issues over the past few years, some shifts of trade flows took place, such as a shift of activity from West Coast to East Coast ports. As trade patterns normalize, commercial traffic patterns will vary among toll roads near the East, West and Gulf Coasts. Commercial traffic is already declining in some regions and may decline in others as the economy slows in 2024.

We also expect nearshoring to increase commercial traffic on roads that connect to the US-Mexico border and related manufacturing facilities in the US. A growing number of multinational companies are announcing plans to reallocate manufacturing operations to Mexico or the US to be closer to consumer markets, to diversify from supply chain disruption and geopolitical risks, and to take advantage of US federal incentives under the Inflation Reduction Act of 2022 and the CHIPS and Science Act of 2022.

Toll increases are also slowing, further limiting revenue growth

Toll rate increases can drive toll revenue growth at higher levels than traffic growth alone. Most toll roads raise toll rates based on increases in the consumer price index (CPI) or a similar index, or by at least a fixed 2% to 3% annually. Other toll roads increase toll rates when needed to fund capital spending and related debt obligations. But slowing inflation and affordability concerns are limiting toll increases. Following a couple of years of high inflation, we expect inflation will slow to 2.5% in the US in 2024, down from 4.0% in 2023 (Exhibit 5). This slowdown is somewhat positive for toll roads because it constrains operating and capital cost increases. But it also limits toll rate increases, which then weighs on toll revenue growth.

Exhibit 5
Inflation is declining from pandemic peaks
CPI (% annual average)

Sources: US Bureau of Labor Statistics and Moody's Investors Service

State-owned toll roads in Florida and Texas Transportation Commission-managed toll roads did not raise tolls or did not raise them as much as they could have in 2023 because of affordability concerns from drivers and politicians given high inflation over the previous couple of years. However, these roads have announced they will increase toll rates in 2024 per their toll rate polices. Discount programs are another way toll roads address affordability concerns. Florida's toll relief program, which went into effect in 2023, does not reduce toll revenue because credits issued under the program are reimbursed from funds appropriated by the state legislature. Affordability for drivers will remain a consideration in toll-rate setting. But we expect most rated toll roads will maintain their credit quality because of their strong financial metrics, even if they do not raise tolls, raise them less than inflation or even discount tolls.

All of the rated privately managed toll roads, which account for just 12% of the 58 US toll roads we rate, have continued to implement their formula-based tolling regime within their individual concession agreements. Their regimes allow for inflation-indexed or a fixed minimum percentage annual toll rate adjustment, except for one toll road. Most of the rated privately managed toll roads are managed lanes – a set of lanes built adjacent to non-tolled lanes to alleviate congestion in urban and suburban areas. They typically use congestion or dynamic pricing, in which tolls are changed to maintain speeds and traffic at or above a minimum level. Given managed lanes' pricing power, revenue is above pre-pandemic levels for most rated managed lanes and we expect them to maintain solid revenue growth in 2024.

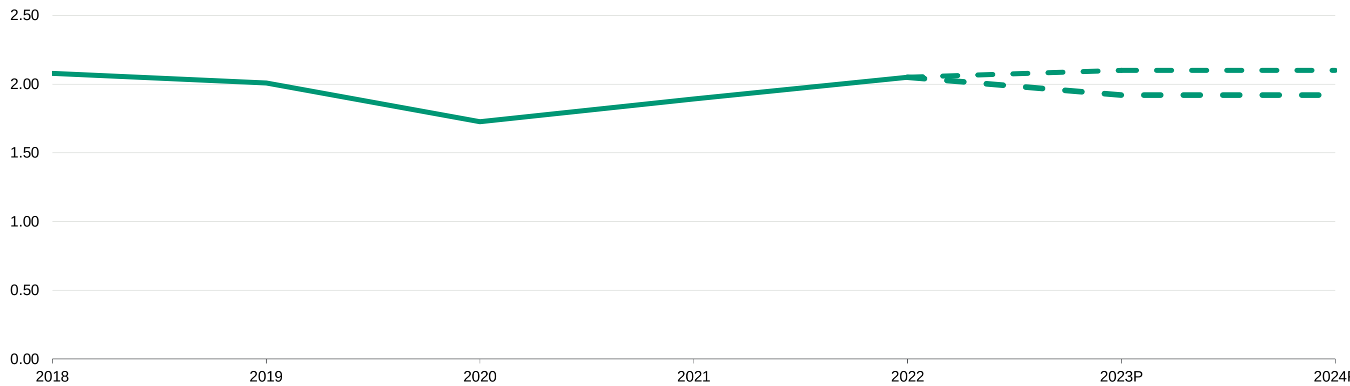
Most toll roads will maintain their credit quality

Most toll roads maintain strong financial metrics, which will help them maintain their credit quality even as traffic and revenue growth slow. Rated publicly managed toll roads' median debt service coverage ratio by net revenues rose above pre-pandemic levels in 2022 (the latest available full-year data). We expect the ratio will remain near this strong level in 2023 and 2024 (Exhibit 6) as revenue continues to increase slightly and operating costs do not increase as much as during the recent period of high inflation.

Exhibit 6

DSCR has returned to pre-pandemic levels and we expect this metric to remain strong

Historical median DSCR through 2022 and projected range for 2023 and 2024



Median DSCR for rated publicly managed toll roads.

Source: Moody's Investors Service

Given strong revenue growth in 2021 and 2022 following the pandemic-driven decline in 2020, and cost cutting measures in 2020 and 2021, the rated publicly managed toll roads' median ratio of days cash on hand has remained above 1,000 days since 2021. We expect it will be slightly lower in 2023 and 2024 but still strong.

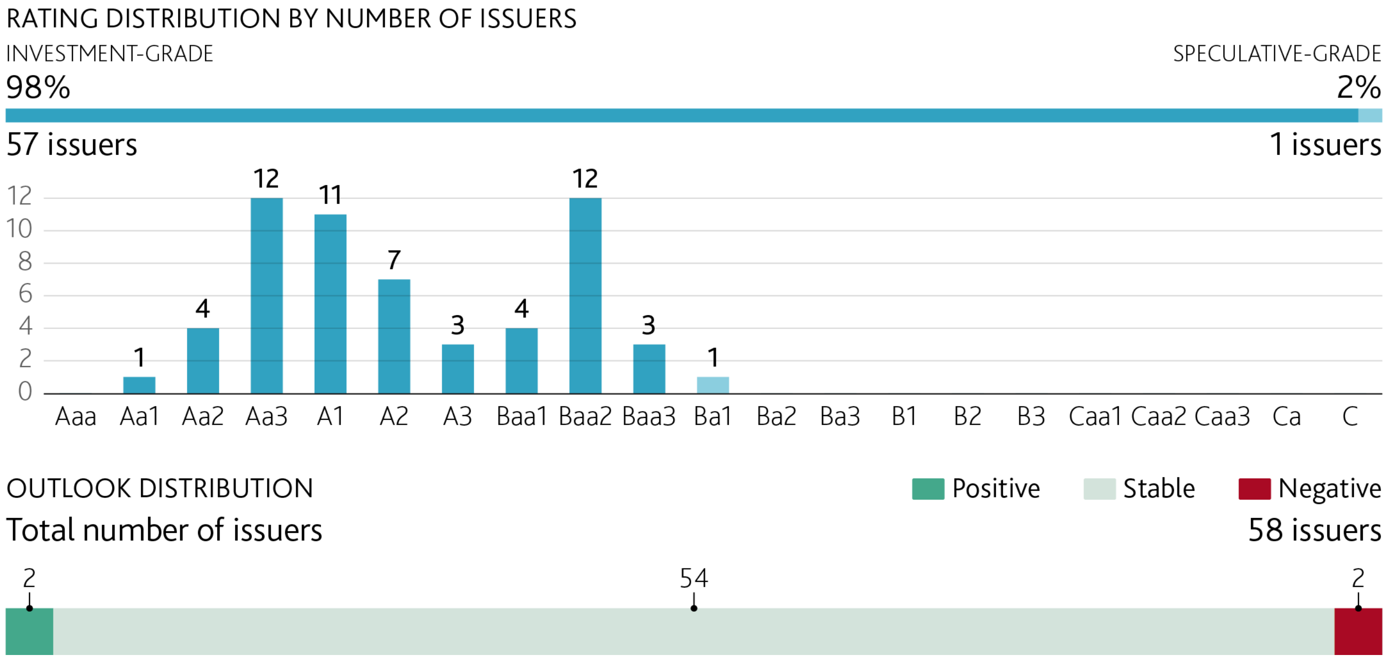
Given high debt costs and increased construction costs, we expect toll roads will continue to use their large cash holdings to fund capital projects. This follows a typical pattern whereby publicly managed toll roads accumulate cash and subsequently use it to fund new capital investments. However, additional debt might be required because project costs have increased over the past few years with materials inflation and rising labor costs.

Funding from the Infrastructure Investment and Jobs Act (IIJA) for non-tolled roads and transit projects reduces reliance on toll revenues for non-toll system needs. However, because departments of transportation and transit agencies are running out of pandemic grants, there is the potential for some to seek funding from toll roads for projects that are not related to the toll roads.

Appendix: US toll road public ratings and outlooks

Exhibit 7

Distribution of senior lien, long-term public ratings and outlooks for US toll roads



As of 6 December 2023

Source: Moody's Investors Service

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