

FITCH AFFIRMS ALAMEDA CORRIDOR TRANSPORTATION AUTH, CA'S SR, SUB & SECOND SUB REVS; OUTLOOK STABLE

Fitch Ratings-New York-31 March 2017: Fitch Ratings has affirmed the Alameda Corridor Transportation Authority's (ACTA, the authority) \$986.2 million in senior bonds at 'A', \$425.8 million in subordinate revenue bonds at 'BBB+', and \$556.9 million in second subordinate revenue bonds at 'BBB'.

The Rating Outlook on all bonds is Stable.

ACTA also has \$83.7 million in unrated series 2012 bonds, which are on parity with the rated senior revenue bonds.

The ratings reflect a vital rail corridor that handles nearly a third of the throughput for the San Pedro Bay ports (SPB ports; Port of Los Angeles and Port of Long Beach, both rated 'AA' senior/ Outlook Stable). Backstop commitments from the ports provide some revenue stability and mitigate against the authority's exposure to throughput volatility and rate adjustment limitations. Credit concerns include ACTA's heavily back-loaded debt structure, which Fitch expects to trigger several years of shortfall advances after 2026 if the debt is not restructured and/or volume and inflation growth remains modest.

Specifically, the 'A' rating on the senior lien reflects superior coverage levels, stronger structural protections, and an expected lack of dependence on shortfall advances, while acknowledging the open nature of the lien for future restructuring transactions. The first subordinate and second subordinate bond ratings of 'BBB+' and 'BBB', respectively, reflect the liens' subordinated positions within the ACTA's debt structure, lower coverage levels, weaker structural protections, and expected reliance upon shortfall advances post 2026.

KEY RATING DRIVERS

Revenue Risk - Volume: Midrange

ESSENTIAL CORRIDOR, ELEVATED VOLATILITY: The corridor provides an essential intermodal transportation link between the SPB ports and two of the nation's largest railroads, Union Pacific and BNSF. However, ACTA's loaded throughput has exhibited slightly more volatility than that of the SPB ports as a result of its exposure to trans-loading and shipment of intermodal cargo to some lower growth regions beyond the Southern California basin. ACTA's import cargo is also somewhat susceptible to diversion, though limited diversion is expected given timing efficiencies provided by the SPB ports and the railroads. Positively, elasticity to rate increases has been low and is expected to remain low going forward given ACTA's current rate framework.

Revenue Risk - Price: Midrange

MODERATE RATE-MAKING ABILITY: ACTA has a moderate ability to modify rates, evidenced by its rate framework which tracks rate increases to changes in the consumer price index (CPI). Annual rate increases are subject to a minimum threshold of 1.5% and a maximum threshold of 4.5%, which protects against very low or negative inflation but limits the authority's ability to offset sharp declines in volume with commensurate rate increases. Periods of lower inflation growth are somewhat mitigated by the allowance of shortfall advances by the SPB ports, which have an obligation to cover up to 40% of any debt service shortfall. ACTA is also able to

pass through maintenance and operational (M&O) costs to the BNSF and Union Pacific railroads, though ACTA remains responsible for its own administrative costs.

Infrastructure Development/Renewal: Stronger

MINIMAL CAPITAL NEEDS: ACTA's capital improvement planning mechanisms are considered strong and reflect the anticipated needs of both the ports and the railroads. The corridor is in good condition and is currently operating well above medium-term throughput forecasts; making future expected capital needs modest. The asset benefits from a \$15 million reserve account to cash-fund capital-related needs, well above expected annual capital spending of roughly \$1 million to \$2 million. No additional borrowing for capital-related projects is expected over the near term.

Debt Structure: Stronger (Senior); Midrange (Subordinate and Second Subordinate)

BACK-LOADED DEBT STRUCTURE: ACTA's debt structure is fixed-rate and largely back-loaded, with about 37% of total outstanding debt in the form of capital appreciation bonds. The lower score of ACTA's two subordinate liens reflects the liens' subordinated position within the overall debt structure, weaker structural features, and reliance on shortfall advances to meet obligations post fiscal 2026 unless additional restructuring occurs.

Financial Metrics:

ADEQUATE COVERAGE, HIGH LEVERAGE: ACTA benefits from solid senior full-term rating case average debt service coverage ratios (DSCR) of 2.5x, and adequate first subordinate and second subordinate DSCRs of 1.6x and 1.3x, respectively (including the port's contingent obligations and ACTA's administrative costs). Notably, minimum rating case project life coverage ratios (PLCR) are higher at 3.3x senior, 2.4x first subordinate, 1.7x second subordinate, demonstrating potential financial relief provided by ACTA's 10 year tail. Overall, ACTA's coverage ratios are slightly higher than Fitch's indicative guidance for ports, representing Fitch's view that additional financial cushion is necessary to offset ACTA's increased volume and price risk. Rating case year five leverage (including contingent obligations and administrative costs) is adequate for the senior and first subordinate lien at 6.8x and 10x, but elevated on an all in basis at 13.9x. High leverage is mitigated by ACTA's lack of capital needs, which should allow for progressive deleveraging through final maturity.

Peers: In comparison to 'A' category rated ports within Fitch's portfolio, ACTA has a lower percentage of minimum annual guaranteed revenues but higher senior coverage levels, representing the additional cushion necessary to offset ACTA's lower degree of revenue stability.

RATING SENSITIVITIES

Negative: Sustained underperformance of throughput which is not adequately offset by rate increases, resulting in sustained total coverage well below 1.3x and ongoing dependency on shortfall advances could pressure the ratings.

Negative - Material changes in the credit quality of the two port counterparties, or an inability of the railroads serving ACTA to cover M&O, may pressure the ratings.

Negative - Material changes in trade with Asia, and correspondingly, ACTA's TEU throughput, could result in a downgrade.

Positive - ACTA's increasing debt service profile and dependence on revenue growth to avoid shortfall advances makes upward rating migration unlikely.

CREDIT UPDATE

Performance Update

ACTA's TEUs declined 3.7% in fiscal 2016 (ended June 30), reflecting continued tonnage declines at the Port of Long Beach during the aftermath of the West Coast labor disputes. TEUs have continued on a downward trajectory during fiscal year-to-date 2017, declining nearly 15% for the six months through December. Declines primarily reflect the bankruptcy of one of the Port of Long Beach's largest shippers, Hanjin Shipping, which has depressed cargo shipments. Given the recent approval of Terminal Investment Limited to operate at Hanjin's former terminal, Fitch expects backfilling of cargo losses to occur over the next few years. Assuming a slow recovery of losses, ACTA's financial metrics are expected to remain in line with its current ratings.

Use fee and container charges declined by 1.9% in fiscal 2016 and 6.2% fiscal 2017 year to date, explained by declines in TEUs which have been somewhat offset by inflationary rate increases. Administrative costs have continued on an upward trajectory, growing by 8.5% in fiscal 2016 and 16.5% fiscal year-to-date 2017, reflecting increases in professional service costs and other administrative expenses.

Senior DSCR decreased to 2.3x in fiscal 2016 from 3.3x in fiscal 2015, reflecting declines in net revenues and a step up in annual debt service. Total DSCR remained roughly the same at 1.3x, as a result of declines in net revenues which were offset by declines in annual debt service. Senior and total leverage increased to 7.1x and 13.3x from 6.9x and 13.1x, respectively, as a result of net revenue declines. Fitch expects metrics to marginally weaken in fiscal 2017 as a result of year-to-date performance, but improve over time as TEU losses are recouped and expense growth normalizes.

Fitch Cases

Fitch's base and rating cases include the following assumptions: outstanding debt includes accreted interest, DSCR and leverage calculations include ACTA's administrative costs, and unrestricted cash includes the revenue fund and grows at inflation. Fitch has also assumed that shortfall advances trigger a \$1.00/TEU increase in loaded waterborne rates per TEU, consistent with the terms of the operating agreement. Fitch has also incorporated more conservative overall TEU growth rates of 1.5% to 2% in comparison to past assumptions of 2.7% to 3.9% in its forecasts, reflecting Fitch's view that higher growth rates may be optimistic given historical performance coupled with the current political environment.

Fitch's base case assumes 2% TEU growth, inflationary rate increases of 2%, and inflationary administrative cost growth of 2%. Fitch's rating case assumes 1.5% TEU growth, rate increases at the minimum threshold of 1.5%, and 2.5% administrative expense growth. Fitch's base case analysis yields full-term DSCRs and year five leverage of 2.6x and 6.6x senior, 1.7x and 9.7x first subordinate, and 1.4x and 13.4x second subordinate, respectively. Fitch's rating case analysis yields full-term DSCRs and year five leverage of 2.5x and 6.8x senior, 1.6x and 10x first subordinate, and 1.3x and 13.9x second subordinate, respectively. PLCRs are at least 40 basis points (bps) higher than full-term DSCRs on all liens.

Fitch's breakeven analysis indicates that in order to breakeven to 1x DSCR while exhausting all available cash reserves, annual revenue growth would have to decline by 11.2% on the senior lien, decline by 0.3% on the first subordinate lien, and grow at a modest 1.7% on the second subordinate lien. In Fitch's view, the aforementioned percentages demonstrate that all liens have a very low dependence on growth when considering available contingent obligations of the ports. However, breakeven percentages decline substantially when excluding the port's contingent obligations. Under this scenario, no growth would be required for senior lien, 4.3% growth would be required on the first subordinate lien, and 5.3% required on the second subordinate lien.

While current metrics are considered adequate for their respective ratings, both Fitch's base and rating case require over \$300 million in shortfall advances in order to meet obligations through

debt maturity as a result of ACTA's back-loaded debt service obligations. Furthermore, avoiding shortfall advances on all liens would require revenue growth of at least 5.3% to breakeven, which may not be feasible. Credit quality could be compromised to the extent the authority becomes dependent on shortfall advances to meet obligations. However, Fitch views positively the long tail currently provided by the use permit and the presence of call options within ACTA's debt structure, which should provide for sufficient financial relief via a refunding or restructuring transaction if necessary.

Security:

Bondholder security includes the pledged revenue stream and all other monies held by the trustee except for the M&O fund and the reserve account, both of which are for purposes of operating and capital maintenance of the corridor. Pledged revenues consist primarily of the volume assessment charges payable by the railroads and debt service shortfall advances payable by the ports. Shortfall advances from the ports are subordinate to their own costs and debt obligations. A use and operating agreement among ACTA, the ports and the railroads governs the volume assessment of charges.

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Applicable Criteria

Rating Criteria for Infrastructure and Project Finance (pub. 08 Jul 2016)

<https://www.fitchratings.com/site/re/882594>

Rating Criteria for Ports (pub. 17 Oct 2016)

<https://www.fitchratings.com/site/re/889015>

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