FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Alameda Corridor Transportation Auth, CA's Sr, Sub & Second Sub Revs; Outlook Negative

Thu 03 Dec, 2020 - 3:00 PM ET

Fitch Ratings - New York - 03 Dec 2020: Fitch Ratings has affirmed the Alameda Corridor Transportation Authority's (ACTA) $986 million in senior bonds at 'A', $488 million in subordinate revenue bonds at 'BBB+', and $557 million in second subordinate revenue bonds at 'BBB'. The Rating Outlook on all bonds remains Negative.

ACTA also has $84 million in unrated series 2012 bonds, which are on parity with the rated senior revenue bonds.

RATING RATIONALE

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/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.

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 debt structure, lower coverage levels, weaker structural protections, and expected reliance upon shortfall advances post 2026.

The Negative Outlook reflects ongoing downside risk from coronavirus-related volume disruptions, exacerbated by ACTA's reliance on continued growth in excess of inflation to cover its backloaded debt service coupled with its relatively modest levels of unrestricted cash. Because of its liquidity position and accelerating debt service profile, ACTA remains more exposed than the ports it services to volume declines stemming from ongoing negative economic effects of the coronavirus. Management is considering a refunding of $350 million to reduce debt service in 2022-2025, which would help alleviate near-term pressure.

KEY RATING DRIVERS

Essential Corridor, Elevated Volatility - Revenue Risk (Volume): Midrange

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. ACTA's share of SPB port imports has declined modestly in recent years to approximately 30% of total TEUs. Positively, elasticity to rate increases has been low and is expected to remain low going forward given ACTA's current rate framework.

Moderate Rate-Making Ability - Revenue Risk (Price): Midrange

ACTA has a moderate ability to modify rates as evidenced by its rate framework that tracks rate increases to changes in the consumer price index (CPI) for Los Angeles, Anaheim and Riverside. 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. Rate increases for calendar 2019 and 2020 were 4.1% and 3.2%, respectively. 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 payment. ACTA is also able to pass through many M&O costs directly to the BNSF and Union Pacific railroads, though ACTA remains responsible for its own administrative costs and capital refurbishment through the Reserve Account.

Minimal Capital Needs - Infrastructure Renewal/Development: Stronger

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, resulting in modest future expected capital needs. The asset benefits from $55.8 million in available cash balances as of October 2020, well above expected annual capital spending of approximately $6 million. No additional borrowing for capital-related projects is expected over the near term.

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

ACTA's debt structure is fixed-rate and largely back-loaded, with approximately 40% of total outstanding debt in the form of capital appreciation bonds. The lower debt structure 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. The authority is exploring a possible refunding of senior lien bonds to reduce debt service between 2022-2025, in addition to reducing any near-term shortfall advances that might occur as a result of the coronavirus pandemic. The principal amount of the refunding would be approximately $350 million.

Financial Profile

ACTA benefits from solid senior full-term rating case average debt service coverage ratios (DSCRs) of 2.7x, and adequate first subordinate and second subordinate full term average DSCRs of 2.0x and 1.3x, respectively (including the port's contingent obligations and ACTA's administrative costs). Overall, ACTA's coverage ratios are at the upper end of 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 4.4x and 7.4x but elevated on an all-in basis at 10.3x. Higher leverage is mitigated by ACTA's relatively modest capital needs, which should allow for progressive deleveraging through final maturity.

PEER GROUP

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

RATING SENSITIVITIES

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

---A return to a Stable Outlook could be possible, and the ratings affirmed, if Fitch sees sustained recovery in volume and revenues due to the easing of pandemic-imposed restrictions resulting in normal throughput and/or passenger patterns or the adaption of strategies that convincingly stabilizes the finances.

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

--A prolonged period of material throughput declines that presents further challenges to stabilize the finances of the affected ports;

--Further credit erosion of the major shippers, terminal operators, or cruise counterparties that result in payment delinquencies to the ports;

--Sustained deterioration in port liquidity levels.

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].

CREDIT UPDATE

Performance Update

On a yoy basis, ACTA's TEUs decreased 11.8% in the 12 months ending Sept. 30, 2020. This decline reflects the strain on TEU volumes imposed by the outbreak of coronavirus beginning in February 2020. Similarly, TEUs at the SPB ports decreased 6.6% for the same period, with Port of Los Angeles declining 10.9% and Port of Long beach declining 1.1%.

Although ACTA increased rates 3.2% (loaded TEUs) and 3.3% (empty TEUs), total operating revenues decreased 8.0% in fiscal 2020 due to the stresses imposed on TEU activity by the outbreak of coronavirus. Fiscal 2020 administrative expenses, excluding depreciation and maintenance-of-way expenses, increased 9.7% from fiscal 2019. This increase is reflective of the 25.8% increase in professional services expense from fiscal 2019 levels. On a yoy basis (July-September 2020), fiscal 2021 YTD revenues have increased 1.4% from the same period of the prior year, reflecting the rebound in TEU and cargo volumes from troughs experienced in February 2020.

In fiscal 2020, Fitch calculated that the authority would have needed a $4.9 million shortfall advance in order to meet its obligations. The authority indicated that it had sufficient available cash balances from prior debt restructurings and interest earnings to remedy the shortfall. Similarly, the authority specified that this approach will also be used in 2021 to fulfill its obligations.

In fiscal 2020, Fitch-calculated senior DSCR (including contingent obligations, net of administrative costs) decreased to 1.9x, from 2.3x in fiscal 2019. Total Fitch-calculated DSCR for fiscal 2020 remained stable at 1.3x. Fitch-calculated senior net-debt to cash flow available for debt service increased to 7.2x and total leverage increased to 14.2x. These weakened financial metrics are driven by lower cash flow available for debt service in fiscal 2020.

The Authority's Governing Board approved the selection of both a new ACTA chief executive officer and chief financial officer in 2020. Fitch will monitor management's policies going forward.

ACTA is exploring options to refund some of its senior lien debt. The purpose would be to reduce the authority's debt service between 2022-2025, in addition to reduce any near-term shortfall advances that might occur as a result of operational and financial issues arising from the coronavirus pandemic. The principal amount of the refunding would be approximately $350 million.

FINANCIAL ANALYSIS

Fitch Cases

Fitch's rating case assumes that TEU volumes do not return to pre-coronavirus outbreak levels until fiscal 2023. From there, Fitch assumes 1.5% TEU growth for inbound and empty containers, coupled with inflationary rate increases of 1.5%, and inflationary administrative cost growth of 2%. Under these assumptions, full-term DSCRs average 2.7x (senior), 2x (first subordinate) and 1.3x (second subordinate). Additionally, year five leverage under these assumptions yield 4.4x (senior), 7.4x (first subordinate) and 10.3x (second subordinate).

Fitch's severe downside case includes similar assumptions to the rating case, with a slower, more gradual return to pre-coronavirus TEU volumes by fiscal 2024. This analysis yields full-term average DSCRs of 2.6x (senior), 2.0x (first subordinate) and 1.3x (second subordinate). In addition, year five leverage under these assumptions yield 4.5x (senior), 7.5x (first subordinate) and 10.4x (second subordinate).

While current metrics are considered adequate for their respective ratings, both Fitch's base and rating case require shortfall advances in order to meet obligations through debt maturity as a result of ACTA's back-loaded debt service obligations. 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

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.

Asset Description

Alameda Corridor Transportation Authority is a public body that administers the Alameda Corridor, a 20-mile multi-track freight rail system linking the ports of Los Angeles and Long Beach, the two largest container ports in North America, with the transcontinental rail network east of downtown Los Angeles.

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

Alameda Corridor Transportation Authority has an ESG relevance score of '4' for Labor Relations and Practices due to follow-on impacts of labor relations between port tenants and longshoremen at the ports of Los Angeles and Long Beach during periods of contract negotiations, which may potentially have a negative impact to the credit profile, and is relevant to the rating in conjunction with other factors.

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
Alameda Corridor Transportation Authority (CA)				
• Alameda Corridor Transportation Authority (CA) /General Revenues - Second Subordinated Obligations/1 LT	LT	BBB Rating Outlook Negative	Affirmed	BBB Rating Outlook Negative
• Alameda	LT	BBB+ Rating Outlook Negative	Affirmed	BBB+ Rating

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Infrastructure and Project Finance Rating Criteria (pub. 24 Mar 2020) (including rating assumption sensitivity)

Ports Rating Criteria (pub. 15 Oct 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

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

GIG AST Model, v1.1.2 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Alameda Corridor Transportation Authority (CA)	EU Endorsed

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Industrials and Transportation US Public Finance Infrastructure and Project Finance

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