



Department of the Auditor General

The Pennsylvania Turnpike's financial obligation under Act 44 is unsustainable, causing the deterioration of the financial condition of the Turnpike, while placing an unfair burden on PA motorists and businesses.

INTRODUCTION: The Turnpike's financial condition is deteriorating as a result of Act 44.

Act 44 of 2007 was an attempt by the Pennsylvania General Assembly and the former governor to find revenues for public transit agencies and road and bridge repairs. The original plan included tolling Interstate 80, transferring control of I-80 from PennDOT to the Turnpike, and requiring the Turnpike to pay PennDOT \$900 million per year from the I-80 toll revenues for 50 years.

The Federal Highway Administration ultimately denied the state permission to toll I-80; however, the Turnpike was still required to make the annual payments to PennDOT. Without the dedicated revenue stream of I-80 tolls, Act 44 provided for the \$900 million annual payment to be reduced to \$450 million.

The Turnpike must make annual payments to PennDOT through 2057. By that time, the Turnpike will have paid \$24 billion for statewide transportation needs. This report shows how the annual required payments are causing the deterioration of the Turnpike's financial condition.

Highlights

- The Turnpike's financial condition is deteriorating as a result of the required annual Act 44 payments made to PennDOT for roads, bridges, and public transit.
- Turnpike was forced to issue debt to make the required Act 44 payments because the I-80 tolls never materialized.
- Negative effects of Act 44 on the Turnpike's financial condition include:
 - tolls increasing dramatically
 - deteriorating balance sheet
 - debt obligation doubled
 - debt coverage ratio declining
 - bond ratings downgraded
- Act 44 is detrimental to the Turnpike's financial condition, and payments should be phased out now. At the same time, the state must develop a transportation package that is self-sustaining, stable, predictable, and growing.

FUNDING: Turnpike issues bonds to make annual payments. Faced with the required payments ranging from \$750 million to \$900 million the first three years, but without the promised I-80 tolls, the Turnpike did not have adequate toll revenues—or other available revenue sources—to make the Act 44 payments to PennDOT; its only option was to issue bonds to fund the annual payments.

The bonds the Turnpike issues for the Act 44 payments are revenue bonds that are payable from Turnpike tolls. These bonds are considered “subordinate” because their debt service is paid after tolls are used for the operating budget and for debt service payments on “senior” revenue bonds issued to fund the Turnpike’s capital projects.

The Turnpike has also issued subordinate “special” revenue bonds to fund its Act 44 obligation. These “special” revenue bonds are not only toll-supported, but are also credit-enhanced by the commonwealth’s Motor License Fund. The Motor License Fund acts as an additional source of debt repayment if the Turnpike were to default.

As of May 31, 2013, the Turnpike transferred \$3.85 billion to PennDOT, financed by \$4.3 billion of debt. The Turnpike projects that it must issue at least an additional \$11.4 billion in debt for future Act 44 payments.

EFFECTS: Turnpike financial condition is deteriorating. Taking on more than \$4.0 billion in debt to provide funds for statewide spending is having a serious impact on the Turnpike’s financial condition, especially since the costs to carry the debt remains solely the responsibility of the Turnpike and its customers. The negative effects of Act 44 are described in the following sections.

➤ **Tolls increasing dramatically while traffic volume remains flat and could decline**

From its creation in 1940 through 2004, the Turnpike raised tolls only five (5) times. With the passage of Act 44 and the Turnpike’s increasing debt load, the Turnpike was forced to increase tolls each year since January 1, 2009 in order to meet the Act 44 obligation and make annual debt service payments. All of the toll increases put in place since 2009 are attributable to the Turnpike’s need to make the Act 44 payments.

The Turnpike expects to increase tolls between 3.0 and 5.5 percent each year through 2057. Going forward, at least three (3) percent of the annual toll increases will be needed for the Act 44 obligation. Additional increases will be required for the Turnpike’s capital program and maintenance on existing roads.

The table below shows the average passenger vehicle cash toll rate paid in 2007 and in 2013 as well as the projected toll rates for 2021 and 2057. Future rates assume only a three (3) percent annual increase in tolls; amounts for the cross-state trip are from Gateway (exit #2) to the Delaware River Bridge (exit #359).

Year	Average toll rate (¢/mile)	Cross-state total toll	% change from 2007
2007	5.9¢	\$21.25	--
2013	10.9¢	\$39.15	84%
2021	13.8¢	\$49.59	133%
2057	40.0¢	\$143.74	576%

As the table shows, as long as Act 44 stays in place, by 2021 the cash-paying Turnpike

customer can expect to pay at least \$50 to drive across the state using the Turnpike.

If traffic volume does not increase—which could easily occur as motorists choose not to pay \$50 to drive across the state—it will be nearly impossible for the Turnpike to have adequate revenues to meet its annual debt service payments without some other revenue source.

According to the Turnpike’s contracted consultant, traffic volume is projected to increase on average 1.6 percent each year, even with annual toll increases.

However, such a projection may be optimistic and unreasonable. According to the Turnpike’s own data, in the past 10 years, traffic volume has remained relatively flat.

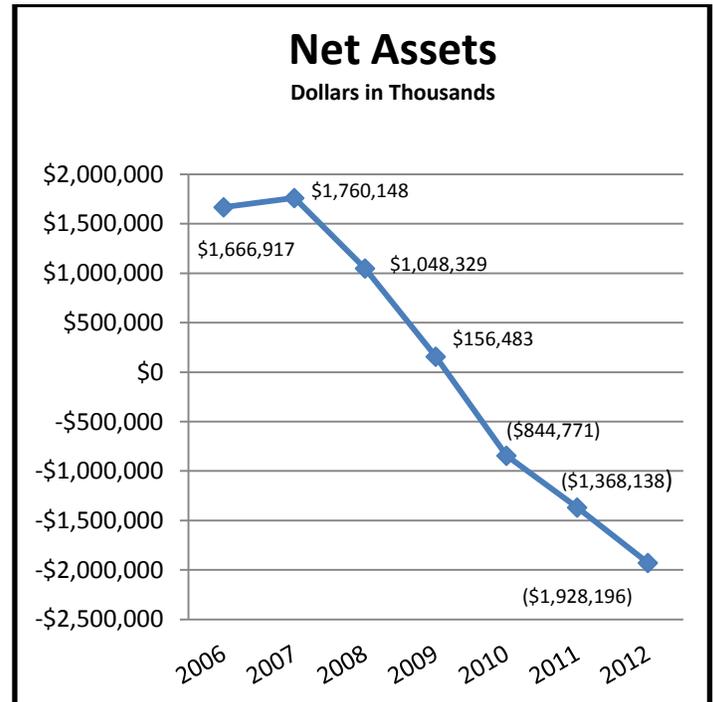
We are not alone in thinking the consultant’s traffic projections are unattainable. Moody’s, a credit-rating agency, has called the traffic volume estimates “optimistic.”

The Turnpike will be forced to raise tolls even higher than the projected 3.0 to 5.5 percent annual increases to generate additional cash flow to make its debt service payments. Such increases could drive more motorists away from Turnpike use and onto the regular highway system, causing even greater stress on the transportation system.

➤ **Deteriorating financial condition**

Net assets (total assets less total liabilities) is a measurement of an agency’s financial condition. The higher the net assets, the better the financial condition. Assets include cash, equipment, buildings, and investments, while liabilities include accounts payable, bonds payable, and interest payable.

In 2007, just as Act 44 was passed, the Turnpike reached its highest net asset value at \$1.76 billion. Just five years later, by 2012, net assets had declined by 210 percent to a deficit of \$1.93 billion. The following chart shows the dramatic drop in the Turnpike’s net assets.



➤ **Outstanding debt obligation doubled with Act 44**

The Turnpike’s total debt obligation (not including interest) has increased from \$2.5 billion in 2007 to nearly \$8.0 billion in 2012. Of the \$8.0 billion, half, or \$3.96 billion (including financing costs), was incurred due to Act 44 payments.

The Turnpike must make annual debt service payments (principal and interest) on all of its issued debt. Prior to Act 44, the debt service payment was \$150 million to \$180 million per year. Since 2007, that amount has more than doubled from \$179 million to \$395 million in 2012, an increase of 120.6 percent.

Of that \$395 million debt service payment, 36 percent, or \$141 million, was specifically for Act 44 bonds.

The Turnpike has projected its Act 44 debt service payment to grow to \$200 million by 2014, to \$400 million by 2020, and then to grow about \$100 million every four years, until it reaches nearly \$1 billion by 2054.

This annual increase in debt load is unsustainable. The Turnpike assumes it can continually raise tolls for debt service; however, at some point those projected toll increases could become cost prohibitive and cause motorists to seek alternate routes. If that were to happen, then the Turnpike risks not being able to raise sufficient revenue to cover its debt service payments, and defaulting on those payments could become a reality.

If the Turnpike were to default on the Act 44 debt that is backed by the Motor License Fund, that default could have dire consequences for the Motor License Fund, PennDOT, and taxpayers.

Every dollar of the Motor License Fund that would pay for Turnpike debt would not be available for public safety or for roads and bridges, which are already in need of critical repairs. Act 44, which was created to provide transportation funding, could exacerbate the funding need by using Motor License Fund monies for Act 44 debt instead of for transportation projects.

Alternatively, to avoid a default situation, the Turnpike could put any remaining revenues after paying general operating expenses toward debt service payments. However, doing so would be to the detriment of capital improvements or roadway expansion and improvement projects on the Turnpike system. With this

option, motorists would be driving on another roadway in need of repairs.

➤ **Debt coverage ratio declining with increased debt payments**

Debt coverage ratio is the amount of cash flow available to meet annual interest and principal payments on debt. The Turnpike has two debt coverage ratios: one for all debt regardless of the pledged revenues, and one for its mainline debt, which is backed by toll revenues. Mainline debt includes the Act 44 bond debt.

In 2007, prior to Act 44, the Turnpike's debt coverage ratios were:

Total debt:	2.27x
Mainline debt:	2.81x

By 2012, both debt coverage ratios had declined due to the Act 44 debt load and were:

Total debt:	1.45x
Mainline debt:	1.78x

The rate covenant from the Turnpike's debt policy requires the mainline debt coverage ratio to be at least 1.20x.

The Turnpike has projected that its mainline debt coverage ratio will decline to 1.28x by 2014, and that it will hover between 1.20x and 1.30x for the next 30 years based on its consultant's projections that assume both increased toll rates and increased traffic volume.

However, with the uncertainties surrounding the premise that traffic volume will increase at the same time toll rates increase and with the decrease in the debt coverage ratio, a high probability exists that the Turnpike will violate the required mainline debt coverage ratio of 1.20x, which could impact future bond ratings.

➤ **Bond ratings downgraded; debt financing costs increase**

With the heavy debt load that the Turnpike is carrying, debt financing through the bond market is becoming increasingly expensive for the Turnpike because investors are seeking higher interest rates for taking on the risk of whether the Turnpike will obtain the revenues needed to avoid a default.

The bond market has also become more expensive for the Turnpike because its bond ratings have been downgraded since Act 44 passed. Lower ratings result in higher interest rates as bondholders demand a greater return for their assumed greater risk.

The Turnpike's bonds are rated by Moody's, Standard & Poor's (S&P), and Fitch, the three major credit-rating agencies, based on the Turnpike's ability to make debt service payments and avoid defaults.

Prior to Act 44, the bond rating agencies had never downgraded Turnpike bonds. In fact, Moody's and S&P upgraded the Turnpike's bond rating. However, after enactment of Act 44, each of the three bond rating agencies downgraded the bond rating for Turnpike's debt (including Act 44 debt).

Before Act 44, the Turnpike's bonds were rated "very strong" and of "high quality" by the three rating agencies. After the downgrades, Turnpike's bonds were rated "upper-medium grade." While this rating classifies the bonds as strong, it also means that the bonds are more suspect to changes in circumstances and economic conditions.

In fact, when Moody's downgraded the Turnpike's senior bonds in April 2013, it based the downgrade on the potential risk that the Turnpike could need to raise tolls more than the projected amounts of 3.0 to

5.5 percent in order to maintain the targeted debt coverage ratio.

RECOMMENDATION:

Immediate action is needed to phase out Act 44 obligations of the Turnpike. The Turnpike's financial condition is being significantly impaired by Act 44 requirement. Without a legislative fix, Act 44 payments will inevitably cause serious erosion of the Turnpike's financial condition.

The Turnpike cannot continue to issue debt to meet the required Act 44 obligation to PennDOT. Toll rates cannot be allowed to become cost prohibitive for taxpayers using the Turnpike and create a decline in use, causing the Turnpike to default on its debt payments and/or forcing the Turnpike to cease its capital programs.

The governor and the General Assembly must pass a transportation bill that addresses all the transportation needs of the commonwealth, including public transit. This transportation package must be self-sustaining, stable, predictable, and growing. At the same time, it must fix Act 44 and phase out the Turnpike's obligation to make annual payments to PennDOT, while providing transition funding for public transit during the years that the Turnpike's payments phase out.

Every year that Act 44 is not amended is another year that compounds the deteriorating financial condition of the Turnpike.

Addendum 1: Annual Act 44 Payments

Annual Act 44 payments Turnpike Commission makes to PennDOT	
Actual payments made to date	
Fiscal year ended May 31:	
2008	\$750,000,000
2009	\$850,000,000
2010	\$900,000,000
2011	\$450,000,000
2012	\$450,000,000
2013	\$450,000,000
Total Actual Payments	\$3.85 billion
Future payments due annually	
Each fiscal year:	\$450,000,000
2014 - 2057	(for 44 years)
Total Future Payments	\$19.8 billion
Total Actual and Future Payments	\$23.65 billion
<small>Note: The \$900 million annual payment was phased-in over three years. When the FHWA denied the request to toll I-80, the annual payment amount decreased to \$450 million.</small>	

Addendum 2: Outstanding Debt Obligation

Dollars in Thousands			
Fiscal Year Ended May 31	Total Turnpike Debt Payable (a)	Amount of Total Debt for Act 44 (b)	Amount of Total Debt without Act 44 (a-b)
2006	\$2,176,475	\$0	\$2,176,475
2007	\$2,481,640	\$0	\$2,481,640
2008	\$3,836,840	\$776,710	\$3,060,130
2009	\$4,772,335	\$1,729,760	\$3,042,575
2010	\$6,429,971	\$2,892,573	\$3,537,398
2011	\$7,719,598	\$3,478,787	\$4,240,811
2012	\$7,952,371	\$3,955,985	\$3,996,386