Project Finance
Credit Analysis

Ratings
$168,869,843 Senior Current Interest Bonds, Series 1998A.......BBB–
$166,106,059 Senior Capital Appreciation Bonds,
Series 1998B...................................BBB–
Rating Watch.................................None
Rating Outlook..............................Stable

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Outlook
Fitch’s medium-term outlook on Pocahontas Parkway Association, VA (the Association) senior current interest bonds and senior capital appreciation toll revenue bonds is stable with a ‘BBB–’ rating. While construction risk has been manifested, and ramp-up and operating risks continue, Fitch believes that this project is able to sustain additional construction delays and protracted traffic ramp-up, while continuing to make timely scheduled debt service payments. A stress scenario where initial revenue operation is delayed until Jan. 1, 2003 and/or a first-year traffic ramp-up is approximately 50% of the road’s projected market share would still allow for timely debt service payment. Fitch views this scenario as a minimum threshold for investment grade and assigns it a low probability.

Rating Considerations
Fitch recently affirmed the ‘BBB–’ rating on the Association’s outstanding Route 895 connector toll road revenue bonds. This action factored in the Association’s recent announcement that the design-build contractor, FD/MK (a joint venture between Fluor Daniel, Inc. and Morrison Knudsen [Ohio], now Washington Group International) does not expect to meet the April 2002 guaranteed completion date for the project due to staff turnover and vacancies experienced by a subcontractor (Recchi America) performing critical bridgework. The Association and FD/MK now expect project completion in the third quarter of 2002, as early as July, but no later than early September (Labor Day).

Labor shortages, supervisory vacancies and inexperience on the CSX railroad crossing job site have placed the project two to three months behind schedule. In addition, the James River Bridge crossing, which is a more immediate problem, apparently has had some quality of work issues that have caused work to be redone, slowing down construction progress. In spite of these issues, Recchi has indicated that it can meet the guaranteed completion date and has generated recovery plans to do so. However, FD/MK views the Recchi recovery plan as aggressive and expects completion to occur in July/August 2002. If Recchi defaults, it will be the responsibility of FD/MK to ensure that the job is completed.

While Fitch views the delay with concern given the standalone, non-recourse nature of the net revenue pledge from operations of this project, it is Fitch’s opinion that construction risk was a material rating consideration when the bonds were originally rated in 1998. Important mitigants include capitalized interest through August 2002, the fixed-price design-build contract, the completion guaranty from the parent
corporations, and the subordinated contractor loan agreement. It is Fitch’s assessment now that construction risk has been brought to bear under the revised construction timetable, and that this credit is able to withstand this delay, and make timely debt service payments. However, if further construction delays result in initial revenue operation beyond Jan. 1, 2003, it would trigger a formal Fitch review of the toll road senior revenue bonds.

The long-term issue with the delayed opening relates to ramp-up risk and ultimate confidence in the financial forecast of the project. While ramp-up is a concern even with projects that open on time, a delay heightens that risk as the cushion that the project works with to ramp-up revenue to meet escalating debt service requirements is smaller. Fitch’s analysis indicates that this project has the ability to tolerate an initial revenue operation delay of one year (relative to the Jan. 1, 2002 revenue operation date assumed in the original finance plan), and a protracted ramp-up.

The Pocahontas Parkway Association is a private, non-stock, not-for-profit corporation without members, organized under provisions of Chapter 10 of the 1950 Virginia Code. The Association was incorporated in 1997 for the limited purpose of financing, constructing and operating the project, a nine-mile, four-lane, limited-access tollway in the southern metropolitan Richmond area.

**Strengths**
- Financial cash flows continue to survive a Fitch stress test at a low investment grade level.
- Project serves largely existing development and provides a logical river crossing.
- Multiple layers of legal and operating ties by the Commonwealth demonstrate its commitment to the project.
- Metropolitan area has experience with other toll road operations.
- Projected toll increases reasonably pace inflation.
- Contracts provide the proper incentives and protections during the design-build stage.
- Subordinated bonds provide some project equity.
- No cross-default provisions on senior debt.

**Risks**
- Less cushion now for construction delays.
- Project heavily leveraged with senior lien debt.
- Financial cashflows depend on frequent toll rate increases.
- Project depends on some new development.
- Relatively low area incomes minimize time-value savings.
- Possibility of future debt.

**Security Provisions**

**Security Pledge:** The bonds are payable and secured by the trust estate, which includes all revenues, the revenue fund, debt service and debt service reserve funds, renewal and replacement account, the surplus fund, and a portion of the construction fund. It is important to note that the retainage account, which is within the construction fund, is not included in the trust estate, but is managed by the trustee.

**Toll Covenant:** The schedule of tolls must be sufficient to produce toll revenues, by the second anniversary of the opening date of the project, equal to 125% of annual debt service on the senior and first-tier subordinate bonds, and 100% of annual debt service on all bonds, plus the projected current expenses.

**Debt Service Reserve Fund:** As additional security, a senior debt service reserve fund is required with an amount on deposit equal to the lesser of: 10% of the issue price of the senior bonds; maximum annual debt service on the senior bonds; and 125% of average annual debt service on the senior bonds. This reserve is currently funded at $31.7 million, which translates into the first three years debt service.

**Additional Bonds:** Additional senior bonds may be issued for project purposes if future toll revenues are projected to be not less than 150% of senior and first-tier subordinate bond debt service and 100% of annual debt service on all bonds plus the projected current expenses, unless waived by the Virginia Department of Transportation (VDOT). Completion bonds may be issued without satisfying the above requirements. However, current projections do not indicate a need for completion bonds.

The Commonwealth Transportation Board (CTB) has authorized the construction of the ramps to I-295 northbound (the southbound ramps were in the original scope) and the preliminary design work for the airport connector interchange, but not construction of the interchange. This additional work is to be funded with $16 million in CTB allocated state resources. There will be additional funding required beyond the
appropriated amounts to build the airport connector and interchange. However, a plan of finance has yet to be finalized. While the airport connector is expected to generate additional traffic on the road, additional bonds issued by the Association are not currently contemplated. Issuance of additional bonds would trigger a formal Fitch review.

**Flow of Funds**

Revenues are to be delivered to the trustee immediately upon receipt for credit to the following funds and accounts in the following order:

- Revenue Fund
- Rebate Fund
- Construction Fund
- Senior Bonds Debt Service Account
- Senior Bonds Debt Service Reserve Account
- First Tier Subordinate Debt Service Account
- First Tier Subordinate Debt Service Reserve Account
- Current Expenses Reimbursement to VDOT
- Extraordinary Maintenance and Repair Reimbursement to VDOT
- Renewal and Replacement Fund
- Second Tier Subordinate Debt Service Account
- Preliminary Design Work and Discretionary Directed Changes Reimbursement to VDOT
- Surplus Fund

**Project Legal Structure**

This project has a complex, multi-layered legal structure, which includes the enacting legislation under the Public-Private Transportation Act of 1995, the comprehensive agreement between VDOT, FD/MK and the Association, the design-build contract, the completion guaranty, the project financing agreement, the master trust indenture, the State Infrastructure Bank loan agreement and the contractor loan agreement.


**Mitigants to Delayed Construction**

The project finance plan called for capitalized interest payments using bond proceeds for debt service through Aug. 15, 2002. Currently, available capitalized interest funds are expected to be sufficient to satisfy debt service obligations through August 2002. The contract with FD/MK calls for liquidated damages in the amount of $25,000 a day up to a maximum of $25 million as compensation to the Association for damages incurred due to a delay in completion beyond the April 2002 guaranteed completion date. In the event of a five-month delay, with an early September completion, the accumulated liquidated damages as of that date should be adequate to cover approximately 80% of the scheduled debt service payment on Feb. 15, 2003. Allowing for the permitted initial two-month toll-free operation of the facility, with revenue operation in early November 2002, toll revenue generated between November and mid-February should be more than adequate to cover the difference.

It is important to note that while the cordial working relationship between the VDOT and FD/MK is currently expected to result in timely and satisfactory settlement of all claims, the risk of legal challenges is always present, and Fitch shall monitor developments closely as they evolve over the next two years. If it is determined that liquidated damages are owed, VDOT will give written notice to the contractor, the Association and the trustee. Thereafter, any draw request must include a calculation for liquidated damages and that amount will automatically be due. The control of approximately $8 million in retainage on the contract currently held by the trustee and the projected retainage balance of $11 million–$12 million on substantial completion should facilitate access to the necessary liquidated damages funds for debt service payment. However, since the retainage account does not fall within the trust estate, it only provides leverage for negotiations.

In addition to the above factors, there are other protections, which include a completion guarantee from the parent companies Fluor Corporation and Morrison Knudsen Corporation. Also, under a contractor loan agreement, FD/MK has agreed to provide a revolving credit loan, upon request by the Association, of up to $5 million at any one time outstanding to pay debt service on the senior and first tier subordinate bonds, in exchange for the Series 1998E Bond. The contractor loan may be tapped only after debt service reserve funds are depleted. Lastly, the projected balance of $3 million–$4 million in the construction fund may also provide some additional available funds for debt service payment, if there are no change orders beyond the scope of the guaranteed price of the design-build contract.
Continuing Case For Investment Grade

Fitch’s analysis indicates that this project has the ability to tolerate an initial revenue operation delay of one year (relative to the Jan. 1, 2002 revenue operation date assumed in the original finance plan), and a protracted ramp-up. For instance, a Fitch stress test assumes a ramp-up factor of 52% (versus 80% in the finance plan) for the first twelve months of revenue operation, 70% (versus 100% in the finance plan) in the second year, and then growing by 5% each year thereafter, reaching 90% by the sixth year, and staying at that level through the life of the bonds.

This analysis provides a substantially more conservative, but plausible, scenario than projected in the project’s original finance plan in 1998, and provides a minimum threshold for continuation of an investment grade rating. Under this scenario, timely debt service payment is expected to be met on both the senior bonds and the first tier subordinate capital appreciation bonds, series 1998C; the subordinate bonds are not rated by Fitch. A low probability exists that the senior and first tier subordinate debt service reserve funds will be tapped in order to pay debt service, except to act as a liquidity facility if there are delays in obtaining liquidated damages. The senior debt service reserve is currently sized to cover the first three years’ debt service. The repayment schedule for the deeply subordinated series 1998D bonds held by the Commonwealth Transportation Board for the initial $18 million loan and future VDOT advances, if any, for operating expenses, and for any Series 1998E bonds will clearly slip under this scenario. However, the flexible nature of these obligations requires repayment only if funds are available.

The traffic and revenue forecast developed by Wilbur Smith Associates (WSA) at the time of the project financing, in 1998, incorporated socio-economic forecasts, a VDOT transportation model and stated preference surveys with a detailed traffic modeling analysis. Based on an initial toll rate of $1.50, the study estimated opening year traffic at 23,200 vehicles per day, which represents a 14.5% screenline share of traffic. While the WSA projection for corridor share does not appear unreasonable, there are clear uncertainties. The comfort provided by limited river crossings, time-distance savings and larger traffic volumes to the west and north is tempered by the lower volumes east and south. To the extent that the Interstate-64 diversion is lower, the exposure is significant given the lower volumes along other routes. Lastly, the one-year ramp-up period that has been applied appears too aggressive given experience at other start-up toll road projects.