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Light is Finally Dawning on Turnpike Debt Growth

In January of this year, the Pennsylvania's Auditor General proclaimed that the Pennsylvania Turnpike was "drowning in debt" to which the Turnpike CEO responded that it was "simply not true". He elaborated by saying that the Turnpike "has developed a sound, fiscally responsible approach to meet all of its financial obligations…". Seven months later, in another news article, the CEO's attitude seems to have changed a bit as he admits that the Turnpike cannot continue its policy of raising fares and issuing more and more debt for the long term. But given the circumstances he claims this is the best the Commission can do and the strategy does not pose an immediate threat. In other words, we are okay in the very short run, but this is going to get very messy in a couple of years.

As we noted in a *Policy Brief* (*Volume 12, Number 5*) from January, the situation is getting worse every year with no end in sight. And of course the culprit is Act 44 of 2007 which mandated that the Commission use funds from expected toll revenues to supply $900 million a year to PennDOT to fund mass transit and road and bridge repairs through 2057. The linchpin of Act 44 was the imposition of tolls on Interstate 80. When the Federal government denied permission to impose the tolls, the Legislature lowered the annual payment to PennDOT to $450 million, but the burden fell on existing Turnpike toll revenues.

So the Commission began to borrow in order to comply with the Act 44 requirement and began a policy of increasing toll rates to cover the debt service. According to the Commission's fiscal 2011 Comprehensive Annual Financial Report (CAFR) they had $2.5 billion in bonds outstanding in 2007, the year Act 44 was passed. By fiscal 2011 the total debt had more than tripled to $7.7 billion fueled in large part by the $2.95 billion in payments already made to PennDOT. By 2011debt service payments had climbed to $352 million, almost double the level of just four years earlier.

According to the CAFR, revenues from mainline fares in 2011 reached $739.7 million. Adding revenues from other sources puts the Commission's total at $901.4 million. Meanwhile their operating expenses were $641.5 million along with and the interest and bond expenses of $333.3 million and a $450 million payment to PennDOT. Thus, the Turnpike incurred a net asset loss of $523.4 million in 2011 and had an operating loss over $75 million. And as the debt level continues to rise, so will debt services costs driving added pressure to find more revenue.

How long will the Turnpike be able to borrow on the extraordinarily favorable terms it has enjoyed in recent years? In just three years debt will swell by almost $1.5 billion, not counting what the Turnpike will need to borrow for its capital developments. Its debt now stands at 8.5 times earnings and will soon be ten times earnings. This is what credit rating agencies will have to consider as they determine credit worthiness of the Turnpike. Lower credit ratings will raise borrowing costs for future bond issues creating ever increasing financial difficulties for the Turnpike that will impair its ability to deliver quality services.

Funding ongoing operations as well as meeting the rapidly rising debt service expenses will require continually rising Turnpike fees. Economically, permanent large annual hikes in toll rates will eventually cause traffic to fall sufficiently to flatten or decrease revenue from the fare hikes. Credit rating agencies will have no choice but to look at the situation that will exist in a few years and start lowering the Turnpike's bond rating. Tolls have already risen 104 percent since 2004 while traffic has been relatively flat over the period. With the price of fuel sharply higher since 2004, the continued raising of fees will likely cut significantly into Turnpike usage. That will put more traffic on other roads less able to handle the volume and could cut into the state's overall productivity by causing travel times to increase while boosting the expenditures on maintenance of roads unexpectedly forced to carry more load.

In short, this pattern of issuing more debt and increasing tolls to pay for it is very perilous and perhaps the Commission CEO finally sees the writing on the wall. This is a dangerous pattern that will likely result in serious harm to the Turnpike's long term fiscal health.

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