[Bond Case Briefs](#)

Municipal Finance Law Since 1971

[Fitch Ratings: Reviewing Infrastructure Issuers for Coronavirus Vulnerability.](#)

Fitch Ratings-New York-18 March 2020: The coronavirus pandemic represents a significant challenge to the global economy, and therefore, to the performance of transactions in the infrastructure and project finance space, according to Fitch Ratings. The wide range of transactions, from enterprise to project structures, single-assets to multi-asset, demand-based to contracted, and single jurisdiction to multi-jurisdiction provide for a wide variety of potential impacts. Given the fast-moving nature of events, this release outlines our approach to reviewing the infrastructure and project finance ratings monitored by Fitch in the context of this crisis. This may evolve over time as the situation changes. However, providing insight into Fitch's approach to this crisis at this stage will provide visibility into our process and thinking in a volatile environment. It is Fitch's view that demand-based transactions will be most affected at the outset with contracted transactions feeling the knock-on effects as the crisis evolves.

Fitch has categorized our ratings into higher and lower risk sub-sectors and is currently grouping credits within those sub-sectors based on their flexibility to absorb this stress at their current rating level. This review will take 10 days to two weeks but Fitch will prioritize sectors with a higher magnitude of potential rating impact for action during that period. Where rating actions are not warranted Fitch will provide commentary with credit-specific views. Lower risk sub-sectors will be reviewed according to our normal annual surveillance procedures.

The impacts of the coronavirus pandemic, while still evolving, create risks that are far beyond what has been experienced in the infrastructure and project finance sectors in many decades. While the Global Financial Crisis (GFC) provides a benchmark and demonstrated the stability of core infrastructure assets (enterprises and projects), the rapid shutdown of major global economies that is being experienced now creates the potential for the near-term economic impact to be materially worse, and creates uncertainty on the future collateral effects on contractual arrangements and the nature of the recovery.

The following are considerations tied to Fitch's Key Rating Drivers for infrastructure and project finance ratings:

DEMAND-BASED ASSETS MOST VULNERABLE: Demand-based assets, particularly those in the transportation space, have been and are expected to continue being most significantly impacted, with airports exposed to declines that appear worse than those experienced after the 9/11 terrorist attacks, and ports seeing declines comparable to or exceeding drops seen through the GFC. The knock-on underlying economic impacts, potential reticence for travelers to return to the skies or to cruise vessels as quickly as in the past, changes in the supply chain for goods, and counterparty exposure related to airlines and shipping companies all put into question the pace of the recovery. Toll roads are affected with commuter volumes significantly declining. Though these assets are exposed to broader economic weakness and the nature of the recovery, they are also more likely to have volumes return faster as life returns to some normalcy. Managed lanes, which are more prevalent in the U.S., are especially vulnerable to acute traffic declines as they are congestion relievers. However, most benefit from debt deferability provisions under the U.S. government's TIFIA loan program that mitigate short-term demand volatility.

CONTRACTED ASSETS HAVE COUNTERPARTY RISKS: Contracted assets, particularly those in the energy space, are primarily exposed to the credit quality of their counterparties. The relative historical stability of utility counterparties (power and water) provides some comfort, though modest rating downgrades in those sectors would relate to transactions that are currently directly capped by a major counterparty. The increased prevalence of commercial and industrial (non-utility like) counterparties in energy transactions creates some risk of added volatility in counterparty credit quality.

MERCHANT RISK ELEVATED: Fitch rates one purely merchant power asset and a number of contracted transactions with merchant tails. Volatility in commodity prices and uncertain demand in the energy and power markets are expected to put pressure on current power prices and longer-term price growth. These transactions are structured with higher financial margins in the merchant period as a mitigant to contract rollover risk, so revised rating case margins could now be tighter. These impacts will vary by market.

SPORTS EXPOSURE MIXED: The sports sector has a combination of contracted revenues and demand-based revenues. The league financings are secured by media contracts so are exposed to any material weakening in credit quality in the major media players. The team, stadium and arena financings have some of the benefit of media revenues but are more exposed to variable revenues tied to demand, such as tickets, sponsorships and advertising. The presence of annual and multi-year contracts in the case of stadium and arena financings, the historical practice of not providing refunds but instead providing credits against future contracts and ticket purchases to smooth cash-flow, and a fully-funded debt service reserve fund of at least six months provide protection.

CONSTRUCTION DELAYS LIKELY: Projects in construction may have logistical impacts from labor and materials shortages and unpredictable interface issues that cause delays and cost increases.

OPERATING UNDERPERFORMANCE LIKELY: While operations would typically not be a systemic concern for our infrastructure and project finance ratings, coronavirus may cause the performance of assets to be affected if operations are impacted by labor and material shortages, although this should only be a short-term concern. Delays in scheduled maintenance activities should also not be a material concern in most situations, provided the delays are not protracted.

FORCE MAJEURE DECLARATIONS LIKELY: The coronavirus pandemic and governmental actions taken to contain it will trigger force majeure provisions in certain contracts. Where force majeure contractual defenses are unavailable, legal doctrines such as impossibility, impracticability and frustration will also come into play. Disputes around excuses for nonperformance inevitably will be hotly contested and rife. Fitch will consider specific language in material agreements that may cause performance impacts or delays to be uncompensated from revenue, operating or construction counterparties as well as the elevated potential for disputes creating a higher level of credit risk.

BUSINESS INTERRUPTION CLAIMS UNCERTAIN: Many infrastructure enterprises and projects have business interruption insurance. However, policy language and exclusions vary. A case-by-case analysis is required to determine whether revenue loss resulting from the coronavirus pandemic will be covered. This heightens the importance of management's discretionary internal liquidity policies and structured liquidity in infrastructure transactions.

REFINANCE RISK ELEVATED: Transactions with bullet debt that have maturities in the next three to six months, particularly those with large bullets and weaker credit profiles, will be more exposed to sharp spikes in credit spreads. In the infrastructure space, these tend to be large enterprises with diversified operations but if they are already facing operational challenges this crisis could exacerbate the impact. Project financings with bullet debt are typically limited to those with long-tenured concessions or very long useful lives, so they retain some ability to roll over debt with short-term instruments pending a more favorable long-term financing environment.

Infrastructure assets also have key risk mitigants that warrant consideration:

GOVERNMENT INTERVENTION LIKELY – The powers and actions of government (national, state and local, coordinated multi-sovereign), particularly as they relate to transportation infrastructure enterprises and projects, have the potential to have both adverse and positive impacts. These include the administrative actions and regulations that have already restricted economic and social activity. However, transportation infrastructure is the backbone of every economy, so governments are heavily incentivized to provide financial and other support to stabilize the economy and vulnerable industries (such as the airlines) to facilitate an orderly recovery. Where government policies are known or highly likely Fitch will consider the impact in its analysis.

ENTERPRISES MORE PROTECTED: Most infrastructure enterprises have a diverse number of assets and, in some cases, are located in various jurisdictions, have assets with quasi-monopolistic characteristics and long useful lives, both restricted and unrestricted liquidity, balance sheet flexibility as growth capex plans can be modified, and management discretion on the distribution or application of surpluses that provide material resilience to navigate the events of the next three to six months.

PROJECTS HAVE STRUCTURAL PROTECTIONS: Most project structures, while being single asset in most cases, have strong capital structures that restrict how revenues are applied, including requiring equity distribution tests that protect lenders by tying up cash due to underperformance before dividends can be transferred to sponsors. Most projects also have fully cash-funded debt service reserve funds. Those with six month reserves are more vulnerable to a prolonged event and a slow recovery.

Fitch's rating committees will focus for each transaction on the potential magnitude and impact of the downturn and the ability to recover, while maintaining critical levels of liquidity for the current rating level. Fitch will continue to target a 'through-the-cycle' view with a focus on the extent that operating cash flow can service debt at the existing rating level, the ability to maintain existing levels of liquidity, the ability to recover to a financial profile consistent with the current rating level by 2022, and, to the extent liquidity is tapped, the time it takes to replenish critical reserves. Fitch recognizes that near-term metrics could breach indicative rating thresholds in 2020 and 2021. The focus will be less on any one metric and more on the ability to withstand this crisis and revert within two to three years to a more stable credit profile that is consistent with the current rating.

It bears repeating that while a number of the precepts listed above vis-a-vis infrastructure assets are conventional thinking, the scenario that might play out here could be much worse than anything previously contemplated – in particular, the rapid pace of decline. As a result, tenets of the past that infrastructure is stable and will only be mildly impacted – which was true even in the GFC – may be tested. Only time will tell, so the scenarios that Fitch considers, including its Rating Case, may well imply a higher percentage of rating actions than have been seen before.

Certain transactions where the risks are very apparent will warrant quick action by Fitch, with limited discussion with issuers. In other instances, there will be more flexibility for discussions with issuers and their expert advisors who are also critical to Fitch's analytical process. Fitch is mindful that, besides the credit impacts of this crisis, issuers have other pressing challenges to confront, including dealing with employee, customer and public life and safety. Our analysts will work with issuers whenever possible to ensure they have timely notification, so they are available to review and discuss our decisions and commentary. However, it is also important to note that Fitch has obligations to investors that warrant timely communication of our decisions, i.e. by the next day, so we ask for issuer's understanding and accommodation of our process.

Fitch will maintain an ongoing dialogue with issuers, as we monitor the evolution of this crisis and provide periodic credit commentary to investors.

Contact:

Cherian George
Global Head
Infrastructure and Project Finance
+1-212-908-0519 (office)
+1-917-593-0644 (mobile)
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Media Relations: Sandro Scenga, New York, Tel: +1 212 908 0278, Email: sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com