

New Issue: Moody's Assigns A2 to Philadelphia PA Airport Revenue Refunding Bonds Series 2015A; Outlook is Stable

Global Credit Research - 06 Aug 2015

Outstanding ratings on \$1.19 billion of rated debt affirmed

PHILADELPHIA (CITY OF) PA AIRPORT ENTERPRISE
Airports
PA

Moody's Rating

ISSUE	RATING
Airport Revenue Refunding Bonds, Series 2015A (AMT)	A2
Sale Amount \$96,835,000	
Expected Sale Date 08/12/15	
Rating Description Revenue: Government Enterprise	

Moody's Outlook STA

NEW YORK, August 06, 2015 --Moody's Investors Service has assigned an A2 rating to the Philadelphia (City of) PA Airport Enterprise's approximately \$97 million Airport Revenue Refunding Bonds Series 2015A. Moody's has also affirmed the rating on all outstanding parity bonds. The city owns and operates Philadelphia International Airport (PHL) and Northeast Airport (NEP).

SUMMARY RATING RATIONALE

The A2 rating considers that the very low liquidity and heightened competitive environment is mostly offset by a large, robust service area that provides sufficient demand to support an international hub. The rating additionally considers that leverage will increase over time as the airport finalizes its capital improvement program, which will also increase airlines costs above the current levels, but that both leverage and costs will remain moderate for A2 rated international gateway airports. The combination of low liquidity, comparatively low coverage metrics and the construction risk of the capital program positions the rating weakly within the A2 category and any further deterioration in liquidity, failure to achieve the 1% growth forecast by the airline consultant, or increases in the project cost during construction would place negative pressure on the rating.

OUTLOOK

Our stable outlook reflects our expectation that the airport will see moderate growth in enplanements, that liquidity will recover from the current low levels through the airline agreed rate recovery, and that debt will be issued on the schedule indicated in the offering documents.

WHAT COULD MAKE THE RATING GO UP

- Liquidity measured in days cash on hand above 600 days on a sustainable basis
- Above average enplanement growth on a sustained basis

WHAT COULD MAKE THE RATING GO DOWN

- Unexpected, unrecovered expenses that further decrease liquidity
- Capital plan results in substantial increases in debt above currently projected levels in the mid-term
- Leverage exceeding \$300 debt per O&D passenger

-Enplanement growth trends below the 1% consultant forecast

STRENGTHS

-Stable service area of approximately 6.0 million with above average wealth measures

-Large amount of service offerings to domestic as well as international destinations in North America and Europe bolstered by the airport's position as a hub for American Airlines Group, Inc. (Ba3 stable)

CHALLENGES

-Current liquidity is below historical norms due to a deferred recovery of expenses and is weak compared to other international hubs

-Large capital plan that could result in increase in leverage and airline costs

-Competition for connecting traffic from American's hub in Charlotte, which operates at a lower cost but has limited ability to accommodate additional traffic in its current configuration

-Competition from nearby airports in the New York and Baltimore metropolitan area, along with significant competition from Amtrak-Northeast Corridor service results in low passenger utilization rates

RECENT DEVELOPMENTS

The city reached agreement with airlines serving PHL on a five-year use and lease agreement that has two mutual one-year option periods. The agreement keeps substantially all business terms of the previous agreements with respect to rate making through a residual cost center structure and maintains revenue sharing for non-terminal and airfield cost centers. Provisions for capital spending are also contained in the agreement and additionally grants the airlines to choose a minimum of one but potentially all three major enabling projects for the capacity enhancement program. The airlines must notify the airport of which projects to pursue by December 31, 2016.

Enplanements at the airport remained flat in FY2015, year over year. However, enplanements are down 1.3% calendar year-to-date through June, which is well below the average of 4.6% total growth for all large US hubs as calculated by Moody's. A continuation of enplanement losses leading into the first large bond issuance planned for 2017 could place negative pressure on the rating.

DETAILED RATING RATIONALE

REVENUE GENERATING BASE

Key to our rating is our assumption that American Airlines will remain committed to the market. American Airlines (through legacy US Airways operations) utilizes the airport as a Northeast hub and key connection point for US travelers to connect onto European or Caribbean destinations. With a population over 6 million, the Philadelphia MSA is estimated by the Census Bureau to be the sixth largest MSA in the nation. While the city does not rank among the top 15 points of entry for foreign visitors to the US, the city was the 10th largest point of embarkation for foreign travelers from the US in 2013 according to the National Travel and Tourism Office. The city's international connections are demonstrated by the large international service offering from American Airlines and the recent additions of international service by Qatar Airways to Doha and Delta Air Lines to London-Heathrow.

As we assess the likelihood that American Airline's operations could be significantly curtailed at PHL, we note that key alternative airports do not have capacity to accept the diverted traffic. Federal operational constraints at New York's John F. Kennedy International Airport and Washington D.C.'s Reagan National Airport limit the ability to add significant service at either airport. The main competition for European connections would be Charlotte International Airport (Charlotte (City of) NC Airport Enterprise, Aa3 stable). Charlotte offers lower airline costs, but the airport as currently configured is nearing full capacity and cannot accommodate the additional traffic. PHL's position in the highly populated Northeast also makes it a strong location as a connecting hub. Over the long-term, as Charlotte grows in both population and physical airport size, it may emerge as a greater competitive threat.

The airport also faces strong competition for O&D travel from Amtrak rail service and other international hubs in Newark (NJ) - Liberty International Airport and Baltimore/Washington Thurgood Marshall International Airport. The strong competition is seen through the airport's 1.40 times utilization, which is well below the median 2.6 times utilization for large hub airports in FY2013.

FINANCIAL OPERATIONS AND POSITION

In FY2014, the airport rolled over a significant amount of revenue credit from FY2013 that reduced airline collections. However, during the year there was an abnormally high amount of snow removal events while also encountering a one-time cash expense when labor contracts settled for a total of approximately \$10 million. As a result, net revenue debt service coverage fell to 0.91 times in FY2014 from 1.07 times in FY2013. The residual rate making allows for the collection of the shortfall in the next year, but the airport has reached an agreement with the airlines that stabilized rates and by drawing on the balances in the O&M reserve account. The enterprise will recover the draw over FY2016-FY2018. The deferral takes advantage of the enterprise's existing descending debt service profile and helps to smooth airline costs. The airlines' pledge to repay the drawn reserves applies outside of the recently agreed to use and lease agreement.

Debt service coverage is estimated to again fall below 1.0 times based on actuals through March and projections for the last three months of FY2015. The shortfall was again caused by higher than budgeted snow removal costs and enplanement levels that are on track to come in below the 1.8% forecast for FY2015.

Given the expense increases and relatively flat enplanement trajectory, airline cost per enplaned passenger (CPE) has been increasing. CPE increased to \$11.74 in FY2014 from \$10.48 in FY2013, and is estimated to be \$12.81 for FY2015. CPE will again see a significant increase in FY2016 as the budgeted value jumps to \$14.72, largely as the cost recovering of the expenses for the past two years takes effect. Financial forecasts made available with this sale estimate that CPE will increase to just above \$16 based on annual enplanement growth of 1% through 2020. While the increase is high, airlines have visibility to these increases and projected amount compares favorably with reported values for international airports in New York and Washington, D.C.

Liquidity

Liquidity has fallen below historic levels at the airport due to revised budgeting practices and unbudgeted expense increases in FY2014, but will be largely recovered over the next four years through an agreement with the airlines. Liquidity, as calculated by Moody's, has fallen to 127 days cash on hand in FY2014 from 266 days cash on hand in FY2011. By the airport's calculation, that metric has fallen to 130 days from 180 days over the same period. The key difference in the calculation is Moody's inclusion of the airport's operating fund which includes, among other things, values over-collected but due back to the airlines under the residual rate making over the course of the next year, which the airport considers more akin to restricted funds. Moody's includes these amounts as they are still available to cover increased expenses until they are returned to the airlines. Moody's feels that the lowered liquidity leaves the airport's credit significantly weaker in the near term but that the mechanism to recover the funds supports the rating affirmation.

DEBT AND OTHER LIABILITIES

The airport's long-term capital enhancement program (CEP) includes airside work to increase capacity and reduce delays, terminal development to improve capacity and upgrade facilities, as well as ground transportation including a people mover system. The current \$6.4 billion CEP is the result of the NEPA planning process and provides only a broad framework for the sequencing of projects. The last two-year extension to the lease agreement included \$1.4 billion of spending spread over 5 years, \$700 million of which will be debt funded. The new agreement adds approximately \$175 million of new airfield and terminal projects to be funded over 5 years. Additionally, the airlines must choose one of three enabling projects for the broader CEP, but can choose all three if they desire them. Addition of those projects would add between roughly \$200 and \$750 million of capital spending. However, the \$320 million ground transportation center will be funded through a combination of pay-go and debt backed by the newly instituted Customer Facility Charge and will not be funded through GARB debt.

The airport consultant report anticipates additional debt of \$535 million in 2017 and \$370 million in 2020. The airport's current low level of leverage (\$141.78 debt per origination and destination passenger) and declining annual debt service requirements provide opportunity to increase leverage while avoiding large increases in airline costs. Leverage is expected to increase to around \$240 debt per O&D enplanement by 2020. While the expected value is higher than the FY2013 median of \$185 for large hub airports, it compares approximately to the median for A2 rated large hub airports of \$229 in FY2013.

Debt Structure

Annual debt service requirements on existing debt decline annually through 2019 before remaining flat through 2025. Requirements again fall after that. Fixed rate debt accounts for 89% of long term debt while the remaining portion is variable rate demand debt supported by letters of credit and is hedged through a swap. The airport

additionally has a commercial paper program authorized up to \$350 million, of which \$167.5 million is currently outstanding. The program is supported by three letters of credit that expire on January 7, 2016. The airport has begun discussions with each on an extension to the facilities

Debt-Related Derivatives

The airport entered into a fixed rate interest rate swap associated with the 2005 Series C bonds. The termination option by the counterparty is limited to events that, in Moody's opinion, are unlikely, such as a downgrade of the airport's debt rating below Baa3. Under the airport's bond ordinance, payments relating to debt service on the swaps are on parity with the payments for the associated bonds; termination payments are subordinate. The swap counterparty is JPMorgan Chase Bank, N.A (counterparty risk assessment Aa2(cr)). The market value of the swap as of December 31, 2014 was \$18.0 million in favor of the counterparty.

Pensions and OPEB

The financial impact of unfunded and OPEB obligations of this issuer are minor and thus not currently a major factor in our assessment of its credit profile.

MANAGEMENT AND GOVERNANCE

The airport system (PHL and NEP) are owned by the city and operated by the Division of Aviation. The Chief Executive Office of the Division of Aviation is responsible for the operations of the system.

Operations and revenues at the airport are additionally governed by the terms of the recently signed use and lease agreement. The agreement establishes residual cost center rate making to terminal and airfield cost centers. Revenues from other non-terminal projects (i.e. parking, hotel) are subject to equal revenue share on amounts above \$7 million.

Parking at the airport is managed by the Philadelphia Parking Authority (PPA). Revenues from the on-airport parking are first used to pay ground rent, operating expenses, and debt service on the bonds PPA issued to construct the facility before flowing to the airport. Parking rates are determined by the PPA.

KEY STATISTICS

- Type of Airport: Hub
- Rate-making methodology: Residual
- FY2014 Enplanements: 15,316
- 5-Year Enplanement CAGR 2009-2014 -0.1%
- FY 2014 vs FY 2013 Enplanement growth: 0.7%
- % O&D vs. Connecting, FY 2014: 57.4%
- Largest Carrier by Enplanements, FY 2014: American/Us Airways, 77%
- Airline Cost per Enplaned Passenger, FY 2014: \$11.74
- Total Debt per O&D Enplaned Passenger, FY 2014: \$137.09
- Total Debt per Enplaned Passenger, FY2014: \$78.69
- Bond Ordinance Debt Service Coverage, after interdepartmental charges FY 2014: 1.54x
- Days Cash on Hand, FY2014: 127
- Utilization Factor, FY 2014: 1.33x

METHODOLOGY SCORECARD FACTORS:

The scoring below is based on audited FY2014 data.

Factor 1 - Market Position- Total Enplanements ('000): Aaa (15,316)

Factor 1 - Market Position- Size of Service Area ('000): Aaa (6,051)

Factor 1 - Market Position- Economic Strength/Diversity of Area: Aa

Factor 1 - Market Position- Competition for Travel: A

Factor 2 - Service Offering- Carrier Base (Primary): Baa (US Airways, 65.4%)

Factor 2 - Service Offering- Enplanement 5-year CAGR: Baa (-0.1%)

Factor 2 - Service Offering- O&D Passenger Mix: Baa (55%)

Factor 3 - Capacity and Capital- Growth & Operational Restrictions: Baa

Factor 3 - Capacity and Capital- Construction Risk: Baa

Factor 4 - Financial Metrics - Airline Cost per Enplanement: Aa (\$10.74)

Factor 4 - Financial Metrics - Debt Service Coverage: Baa (0.91x)

Factor 4 - Financial Metrics - Debt per O&D Passenger: Baa (\$137.09)

Notching: -1 Notch Change for Liquidity; 0 Notch Increase for Revenue Diversity

Scorecard Indicated Rating: A3

The assigned A2 rating is above the grid indicated rating of A3. The assigned rating reflect our expectation that liquidity will recover to adequate levels, which would remove the negative notch.

Note: The grid is a reference tool that can be used to approximate credit profiles in the airport industry in most cases. However, the grid is a summary that does not include every rating consideration. Please see Airports with Unregulated Rate Setting for information about the limitations inherent to grids.

OBLIGOR PROFILE

The primary source of revenues comes from the operations of PHL, a large hub airport as classified by the FAA. The airport contains approximately 2,410 acres of land, 7 terminals providing 125 aircraft gates, 4 runways, approximately 18,900 parking spaces (operated by PPA), rental car areas, and a hotel.

LEGAL SECURITY

Net airport revenues; rate covenant requires 1.5 times senior lien debt service coverage by net revenues, excluding interdepartmental charges or 1.0 times debt service coverage for all debt, net of interdepartmental charges. The additional bonds test requires the 1.5 times rate covenant to be met for the current fiscal year and five fiscal years after the issuance of the bonds. A debt service reserve is provided and sized at the lesser of maximum annual debt service or the maximum permitted by the IRS. The debt service reserve fund is currently funded with 38% cash, 37% through a letter of credit provided by TD Bank N.A (counterparty risk assessment Aa2(cr)), and 25% through a letter of credit provided by Wells Fargo Bank, N.A (counterparty risk assessment Aa1(cr)). Other reserves are also pledged, including a renewal fund, a bond redemption and improvement account (debt service coverage account), and an O&M reserve account.

USE OF PROCEEDS

The proceeds of the bonds will be used to current refund all of the outstanding Series 2005A bonds and pay costs of issuance.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was Airports with Unregulated Rate Setting published in July 2011. Please see the Credit Policy page on www.moody.com for a copy of this methodology.

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