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Summary: Philadelphia, Pennsylvania Philadelphia International Airport; Airport

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Rationale

Standard & Poor's Ratings Services has affirmed its 'A+' underlying rating (SPUR) on Philadelphia, Pa.'s airport revenue bonds and airport revenue refunding bonds, issued for Philadelphia International Airport. The outlook is stable.

The ratings reflect the airport's relatively large origin and destination (O&D) market, strong competitive position, good historical enplanement trends, and a moderate cost structure and manageable debt burden. Somewhat offsetting these strengths is the potential for the airport's debt burden to significantly increase as a result of it debt-financing a portion of capacity enhancement projects if passenger levels continue to climb.

Supporting the ratings are the airport's:

- Large O&D market that spans 11 counties across Pennsylvania, New Jersey, Delaware, and Maryland. It provides a good base for local air travel demand that in fiscal 2008 totaled an estimated 10.1 million O&D enplaned passengers, or approximately 63% of the 16.1 million passengers enplaned;
- Generally resilient air travel demand, resulting from the airport's strong competitive position, itself due to limited competition from other major airports and growth in low-cost carrier service after Southwest Airlines' expansion at the airport;
- Historically good enplanement trends, as evidenced by enplaned passengers increasing an estimated 1.3% in fiscal 2008, 1.8% in fiscal 2007, and 0.5% in fiscal 2006 after experiencing increases of 7.8% and 18.4% in fiscals 2004 and 2005, respectively; and
- Moderate cost structure and manageable debt burden--estimated to be $8 and $80 per enplaned passenger, respectively, for fiscal 2008.

Offsetting credit weaknesses include the airport's:

- Debt burden potentially increasing significantly as a result of it debt-financing capacity enhancement projects if

passenger levels continue to climb, placing pressure on coverage levels and its moderate cost structure;
- Relatively high carrier concentration--with US Airways Inc. (B-/Negative/--) and its affiliated commuter carriers representing about 63.1% of fiscal 2008 total enplanements, although Southwest Airlines' (BBB+/Stable/--) increasing presence at the airport (11.6% of fiscal 2008 enplanements) tempers this; and
- Moderate exposure to connecting passengers, which constituted about 27% of total enplaned passengers in fiscal 2008.

As a result of market conditions and the credit quality of MBIA Insurance Corp. (AA/Negative/--), the city is planning to remarket its airport revenue refunding bonds series 2005C bonds in the near term. Approximately $178.6 million of the bonds remain outstanding. They were originally issued as variable-rate demand bonds (VRDB) insured by MBIA with a JPMorgan Chase Bank N.A. (AA/Negative/A-1+) standby bond purchase agreement (SBPA). The series 2005C bonds are swapped to a fixed rate of 6.04% with JPMorgan as the counterparty. The city is planning to remarket the bonds with a direct-pay letter of credit from TD Bank, N.A. (AA-/Stable/A-1+). The city will then terminate the MBIA policy and JPMorgan SBPA. The fixed rate swap will remain in place since the city will keep the bonds as weekly VRDBs that will be synthetically fixed via the swap. By the end of the year, the city is also planning to do a fixed rate refunding of its series 2005B VRDBs, of which $41 million remains outstanding. These bonds are also MBIA-insured with a JPMorgan SBPA. The series 2005B bonds are unhedged variable-rate bonds.

The airport's near-term capital needs are manageable. These include two bond issues that could occur in fiscal 2009 and 2010 with a combined par amount of approximately $406 million in general airport revenue bonds (GARBs). More specifically, in fiscal 2009, the airport might issue $70 million-$75 million in GARBs (not backed by passenger facility charge [PFC] revenue) to debt-finance the $50 million-$60 million acquisition of 135 acres of land in the western part of the airport. The airport, however, cannot acquire this land without approval from signatory airlines and city council. As a result of market conditions and the economy, the airport has decided to prudently defer its expected $331 million bond issue to 2010 from 2009. The proceeds from this postponed bond issue will fund approximately $240 million in capital costs related to expanding Terminal F, a baggage system for Terminals B and C, eastside and westside taxiways, resurfacing of and navaids for runway 9L-27R, an airport maintenance facility, and a central utility plant. The airport has approximately $1.3 billion in GARBs outstanding.

Beyond these two bond issues, there is the potential for the airport's debt burden to increase significantly as result of it debt-financing a large portion of the airport's multibillion-dollar airfield capacity enhancement program (CEP). A draft copy of the airport's Environmental Impact Statement for the CEP presents three alternatives: the No-action Alternative, Alternative A, and Alternative B. The no-action alternative introduces no new costs, while Alternatives A and B would introduce $5.2 billion and $5.4 billion (in 2006 dollars) in new costs, respectively. The no-action alternative involves only periodic maintenance and minor enhancements needed to maintain safe operations at the airport. Alternative A includes five runways connected by a redesigned and more efficient taxiway system than the no-action alternative. A fifth runway would be constructed under Alternative A. Alternative B includes four runways connected by a redesigned and more efficient taxiway system; eliminating the airport's existing intersecting runway; and one new runway, resulting in a very efficient configuration that will include four parallel runways.

If officials choose Alternative A, traffic forecasts are realized, demand warrants, and the Division of Aviation obtains needed approvals from city council and the airlines, the airport would need to issue approximately $4.9 billion in bonds to pay for approximately $3.7 billion escalated project costs related to capacity enhancement and master plan projects through fiscal 2020. However, since the timing of these projects depend the outcome of the ongoing environmental impact statement process and their implementation schedule depends on traffic levels, demand, financing capacity, city council approvals, and airline majority-in-interest approvals, it is difficult to provide a detailed schedule of bond issuances for the CEP and associated landside projects. Furthermore, if any of these conditions are not met, the projects would be staggered and spread out over a longer timeframe. After the airport receives the FAA's decision, which we expect by spring 2010, the design and permitting work could require an initial bond issuance in the $100 million range within the next five-to-six years. The earliest this bond issuance would occur is in fiscal 2011. Under this scenario, the debt service for this initial bond issuance would not affect the rate base until fiscal 2013 or 2014, when the capitalized period ends. The airport plans to use PFC revenues to pay a portion of debt service on any of these new bonds. The time and sizing of this first bond issue are subject to chance as they depend on the alternative selected and the implementation schedule.

Securing the bonds are net project revenues; amounts payable to the city under a qualified swap; and all amounts on deposit in, or credited to, certain aviation funds. Project revenues include all revenues from occupants and users of the airport system, which consists of the airport and the Northeast Philadelphia Airport. Net project revenues do not include government grants for capital projects and rent payments for special-purpose facilities. Net project revenues are net of net operating and maintenance expenses. Net operating and maintenance expenses are operating and maintenance expenses net of interdepartmental charges, which are subordinate to debt service. A portion of PFCs are pledged to pay debt service for only the airport's series 2001A and 1998B bonds. The bonds are also secured by a sinking fund reserve account with a reserve requirement equal to the lesser of maximum annual debt service (MADS) or the maximum amount permitted by law.

Since July 1, 2007 (the beginning of fiscal 2008), revenues and costs related to the outside terminal area and overseas terminal are part of project revenues, which we expect to boost coverage levels while allowing the airport to maintain higher liquidity levels. As a result of these changes, we expect the airport's financial profile to improve from fiscals 2009-2013 (the forecast period). Before July 1, 2007, the airport's airport revenue bonds were secured by net project revenues that excluded revenues generated from the overseas terminal and the outside terminal area. We view the changes to the GARB ordinance and new airline agreement by airport management favorably, because they provide improved coverage and make additional funds available for debt service. However, revisions to subsequent airline agreements or future amendments to the general ordinance that detract from these enhancements would be a credit concern.

The combination of including revenues and costs allocated to the airport's outside terminal area and changes under new airline lease agreements that took effect July 1, 2007, allows the airport to accumulate funds available for debt service, an amount that is currently forecast to increase to $64.9 million in fiscal 2013 from $50.3 million in fiscal 2009. These funds alone are projected to cover estimated annual debt service 0.47x-0.54x over the forecast period (2009-2013). We also expect coverage to improve. Based on forecasts from May 2008, we expect total fixed-charge coverage (Standard & Poor's-calculated) to range from 1.09x-1.14x during the forecast period; if the estimated combined balance of funds available for debt service is included, coverage is no lower than 1.60x. If interdepartmental charges (which are subordinate to debt service) are excluded from the calculation, coverage ranges from 1.87x-2.05x during the forecast period; if the estimated combined balance of funds available for debt service is included, coverage is no lower than 2.34x. All coverage calculations include the portion of PFC revenues on which the city has pledged to pay debt service on bonds issued to finance PFC-eligible projects. However, since these forecasts were done in May, they assume the airport issuing approximately $331 million in GARBs in 2009 and related debt service for such bonds appearing in fiscals 2012 and 2013 after capitalizing interest through fiscal 2011.

Since then, the airport has decided to postpone this issue to 2010. As a result, debt service for these bonds would not appear until 2013. The forecasts also do not reflect the result of the airport potentially issuing $70 million-$75 million in additional GARBs to finance the cost of acquiring land costing $50 million-$60 million. The timing of this other bond issue, however, is not definite because it requires approvals from the airlines and city council.

The airport's cost structure, based on the May 2008 forecast, is projected to steadily increase to about $12 by fiscals 2012 and 2013 from about $9 in fiscal 2009. We also expect the airport's debt structure to increase but remain manageable. Based on an estimated 16.1 million enplanements for fiscal 2008, debt per enplanement is approximately $80, although that jumps to $106 if the airport was to issue approximately $406 million in additional bonds today.

The airport has experienced generally good air travel demand. In the past 10 fiscal years, enplanements rose at a compound annual growth rate of 3.2%. The combination of the airport's large O&D market, US Airways' continued commitment to operate a major hub at the airport, limited competition from other airports, and the expansion of Southwest Airlines service have contributed to the airport's recent strong enplanement growth. In fiscals 2004 and 2005, enplanements increased 7.8% and 18.4%, respectively, resulting in enplanement levels surpassing pre-September 2001 historical highs. The strong growth is mainly attributable to Southwest initiating service at the airport in 2004. Since fiscal 2006, enplanements levels have continued to climb, but slower, by 0.5% in fiscal 2006, 1.8% in fiscal 2007, and an estimated 1.3% in fiscal 2008. However, as a result of capacity reductions by airlines due to record high jet fuel prices this past summer and a weak economy, we expect air travel demand to soften. For the two months ended Aug. 31, 2008 (fiscal year to date), enplanements dropped 1.1% compared with the same period the previous year. Information obtained from the Official Airline Guide (OAG) online database in October 2008 shows Southwest increasing scheduled seats in October, November, and December this year, while US Airways/US Airways Express, and other airlines will reduce seats. This analysis shows overall fourth-quarter 2008 reductions of 2.1%, 5.6%, and 3.2% in average daily scheduled seats at the airport in October, November, and December, respectively.

The base forecast done in May 2008 assumes zero growth in enplanements in fiscal 2009, followed by a 2.3%-2.5% annual increase from fiscals 2010-2013. Standard & Poor's considers this forecast as slightly aggressive, assuming a compound annual growth rate of 1.9% from fiscals 2008-2013, which is higher than the 1.2% rate the airport experienced from fiscals 2005-2008. A sensitivity case was also done in May 2008, which assumes a 31% reduction in total enplaned passenger to 11 million in fiscal 2010 as a result of US Airways drastically reducing connecting service effective July 2009. From fiscals 2011-2013, the sensitivity case assumes a rebound in enplanements, increasing 9.1%, 13.3%, and 2.2% in fiscals 2011, 2012, and 2013, respectively, from replacement service by other airlines and enhanced local air travel demand due to the expansion of low-fare airlines such as AirTran and Southwest. Cost per enplaned passenger is projected to increase 46% to $13.63 in fiscal 2010 from $9.34 in fiscal 2009 under this sensitivity case. Indenture coverage under this sensitivity case drops to a low of 1.62x, or about 1.07x based on our calculation excluding revenues carried forward from the prior year or other available fund balances.

The airport benefits from the lack of nearby competing facilities--there is no major airport within a one-hour drive. Baltimore/Washington International Airport (102 miles to the southwest) and Newark Liberty International Airport (106 miles to the northeast) are the airport's primary competitors. Since 2004, when Southwest Airlines initiated service in Philadelphia, the airport's competitive position has improved. Average airfares at the airport have decreased, stimulating air travel demand within its market. For fiscal 2005, the first full year of Southwest service, originating passenger numbers increased 24%, while average domestic airfares decreased 19%. Since fiscal 2005, the number of originating passengers at Philadelphia has exceeded the number of originating passengers at Baltimore.

We have assigned the airport a Standard & Poor's Debt Derivative Profile (DDP) score of '1' on a scale of '1' to '4', with '1' representing the lowest risk. The overall DDP score of '1' indicates that the swaps are a minimal risk. The score incorporates one floating-to-fixed-rate swaption that JPMorgan exercised June 15, 2005. In April 2002, the airport entered a swaption with JPMorgan in exchange for an upfront payment of $6.5 million to the airport. Under the swap, the airport pays multiple fixed-swap rates, while JPMorgan pays a variable rated based on the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index. The swap has a notional amount of $178.6 million and synthetically fixes 100% of the airport's series 2005C bonds. As of Oct. 31, 2008 the swap had a negative value of approximately $23.1 million (excluding accrued interest of $4 million), not in favor of the airport. Since June 15, 2007, JPMorgan Chase has had the option to terminate the swap if the rolling 180-day average of SIFMA Municipal Swap Index exceeds 7%. We consider this remote, given the high interest-rate barrier. The airport's net variable-rate percentage is a manageable 3.2%.

The airport has maintained an unrestricted cash position that has provided 201 days' cash on hand, on average, for fiscals 2004-2008. As of Oct. 31, 2008, the airport's unrestricted cash and cash equivalents totaled approximately $99.8 million, which equals 187 days' cash on hand based on the airport's fiscal 2009 operating budget of $194 million.

Outlook

The stable outlook reflects our expectation that air travel demand will remain sound overall, despite potentially modest service reductions by US Airways or other carriers. The outlook also reflects our expectation that the airport will maintain good coverage levels and moderate cost structure, while prudently managing its capital needs as dictated by changing industry conditions. An outlook revision to negative or rating adjustment downward could occur if drastic service reductions by US Airways occur or become likely.

Ratings Detail (As Of November 18, 2008)		
Philadelphia, Pennsylvania		
Philadelphia International Airport, Pennsylvania		
Philadelphia (Philadelphia Intl Arpt)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Philadelphia (Philadelphia Intl Arpt) VRDB ser 2005B		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Long Term Rating	AA/A-1+/Negative	Affirmed
Philadelphia (Philadelphia Intl Arpt) VRDB ser 2005C		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Long Term Rating	AA/A-1+/Negative	Affirmed
Philadelphia Auth for Indl Dev, Pennsylvania		
Philadelphia International Airport, Pennsylvania		
Philadelphia Auth for Indl Dev (Philadelphia Arpt Sys) (MIRROR BONDS)		

Ratings Detail (As Of November 18, 2008) **(cont.)**		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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