Revenue
New Issue

# Philadelphia, Pennsylvania

## Philadelphia International Airport

### Ratings

#### New Issues

Airport Revenue Bonds, Series 2007A (Alternative Minimum Tax)*† .............................. A
Airport Revenue Refunding Bonds, Series 2007B (Alternative Minimum Tax)*† .............................. A

#### Outstanding Debt

Airport Revenue Bonds* ....................... A

Rating Outlook ..................................... Stable

*The 'A' is the underlying rating. †The bonds are expected to be insured by an insurer whose insurer financial strength is rated 'AAA' by Fitch Ratings.


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### New Issue Details

Approximately $180,000,000 Airport Revenue Bonds, Series 2007A (Alternative Minimum Tax [AMT]), and $85,000,000 Airport Revenue Refunding Bonds, Series 2007B (AMT), are scheduled to price on or about Aug. 8 via negotiation through a syndicate led by UBS Investment Bank.

**Purpose:** The series 2007A bonds will be used to fund capital improvements at Philadelphia International Airport, and the series 2007B bonds will be used to refund portions of outstanding debt for interest rate savings.

### ■ Outlook

The Rating Outlook for the city of Philadelphia's airport revenue bonds is Stable. Philadelphia International Airport (Philadelphia, or the airport) plays an integral role in providing air service to a densely populated service area that generates a solid base of origination and destination (O&D) traffic. The dominant presence of US Airways is a concern, but the improved financial position of that carrier, in addition to service provided by other airlines, partly mitigates the risks related to airline concentration. Any major system reorganization involving US Airways could temporarily affect the airport's enplanement levels and, thus, yield pressure on airport finances; however, recent developments show that the replacement of air service is likely, given the strengths of the airport's market.

### ■ Rating Considerations

The underlying 'A' rating reflects the airport's sound base of passenger demand, recent gains in low-fare service, and sound financial profile characterized by competitive airline costs and moderate levels of leverage. Fitch Ratings also views the airport's new lease agreement positively, noting that it adds additional financial flexibility for the airport while increasing bondholder security. Credit concerns center on the large portion of traffic and significant percentage of connecting traffic generated by a single carrier. Additionally, an increasingly congested airfield may necessitate a significant capital program to enhance runway capacity and efficiency in the next five to 10 years, with a corresponding increase in debt levels.

The entry of Southwest Airlines to the airport in 2004 furthered a trend toward a more diversified marketplace, with low-cost carriers representing 14% of fiscal 2006 enplanements, compared with 2% in fiscal 2002. However, the airport remains a US Airways stronghold as the airline enplaned 63% of Philadelphia's fiscal 2006 passengers. Its significant portion of connecting traffic also represents a concern, as US Airways could opt to route its traffic through other East Coast airports, such as Charlotte-Douglas International. Mitigating the potential shift in connecting traffic is the much stronger base for international service at Philadelphia, which serves as US Airways' largest international gateway.

Traffic growth slowed in fiscal 2006 and fiscal 2007 to date, compared with the large increase in traffic in fiscal 2005, when Southwest ramped up its Philadelphia operations. However, Fitch notes that the airport's operating structure should enable the maintenance of adequate financial and operational margins in the face of slower than forecast enplanement growth over the medium term.

Through the end of fiscal 2007, the airport essentially utilized a residual lease, which, in combination with sound financial management, resulted in stable operating margins, despite recent changes in the air service market. The airport's fiscal 2006 operating margin of 33% was comparable to the average margin experienced over the past five fiscal years. The cost basis at the airport was moderate for an international gateway, equaling an estimated $6.64 in fiscal 2006.

The airport's current capital improvement plan calls for some additional debt through the fiscal 2012 forecast period. Management anticipates issuing approximately $240 million in revenue bonds in fiscal 2009, which, in addition to the series 2007A and previously issued bonds, will fund approximately 55% of a $1 billion capital improvement program (CIP) that runs from fiscal years 2008–2013. Even with the additional series 2009 debt, the airport will still have a moderate debt burden at $73 per enplaned passenger as of fiscal 2006.

Longer-term master and environmental planning is currently ongoing to address the airport's airfield constraints. While the costs and timing of any new airfield construction is dependent on the finalized plan and there may be significant levels of federal funding, based on the airport's current plan, Fitch believes that such a significant capital program will likely result in the use of additional leverage within the next five to 10 years.

## Strengths

- Stable enplanement levels bolstered by strong O&D demand from a densely populated service area.
- Growth in low-fare service, spurred in large part by the commencement of operations at the airport by Southwest Airlines during May 2004.
- Consistent financial results and moderate and stable airline cost base.
- Experienced management team, with a proven ability to respond to bankruptcy filings of major tenant airlines.

## Risks

- Airline concentration risk, with US Airways accounting for 63% of enplanements.
- US Airways' significant portion of connecting traffic (35%), which could be affected by changes in the airline's route network.
- Potentially significant increase in leverage in the next five to 10 years to address airfield capacity needs.

## Debt Structure

Upon issuance of the series 2007A and series 2007B bonds, the city of Philadelphia will have approximately $1.3 billion in outstanding general airport revenue bond debt. The airport's previously outstanding general obligation bonds supported by airport revenue matured during fiscal 2005. Approximately 16% of the airport's $1.2 billion in debt exists as variable-rate debt synthetically hedged to a fixed rate via a series of interest rate swap agreements. An additional 7% of the airport's debt may be swapped, depending on the final structure of the series 2007B bonds.

Under an interest rate swaption entered into between the city and JP Morgan Chase Bank, N.A. (JP Morgan) in fiscal 2002, JP Morgan exercised its swaption rights in 2005 and entered an interest rate swap with the airport on the series 2005C revenue bonds. As payment for swaption rights, the city received approximately $6.5 million in fiscal 2002, which it used, in accordance with an agreement with the signatory airlines, to reduce landing fees and fund various improvements to the airport.

Under the terms of the series 2005C swap, fixed-rate payments made by the city will be based on a series of rates, starting at 6.466% and ending at 1.654%, decreasing over the life of the swap. Variable-rate payments paid by the bank are based on the BMA Municipal Swap Index (BMA index). Of note in the series 2005C swap agreement is that JP Morgan retains the right of optional termination of the swap if the rolling 180-day average on the London Interbank Offered Rate index exceeds 7.0%. At the close of fiscal 2006, the swap had an estimated negative fair value of $14.2 million.

Under the proposed series 2007B swap agreement, variable-rate payments made by UBS AG (the counterparty) will also be based on the BMA index, but final terms of the series 2007B swap, including the fixed rate paid by the airport, have yet to be confirmed. No optional counterparty termination rights exist in the series 2007B swap.

The use of swaps exposes the city to several risks that may affect its long-term credit rating; however, Fitch has reviewed the terms of the swap and found them to be generally consistent with industry standards.

**Security:** The series 2007A and 2007B bonds, as well as outstanding parity airport revenue bonds, are limited obligations of the city payable from amounts available for debt service and secured by pledged amounts. Amounts available for debt service include most revenue derived from the operation of the airport system (project revenue). A change to the airport's lease agreement means that revenues allocable to the outside terminal area (OTA; such as parking and rental car concessions) are now fully pledged to parity revenue bonds.

Passenger facility charge (PFC) revenues, which are collected at the airport at a rate of $4.50 per eligible enplaned passenger, as well as grant proceeds, may be included in amounts available for debt service to the extent pledged. While PFC revenues have been pledged to support a portion of the debt service requirements on the series 1998B and series 2001A bonds, the city has not legally pledged on additional parity revenue bonds. Despite the lack of a legal pledge, the city may opt to apply additional PFC revenues to pay debt service for additional series of bonds.

**Rate Covenant:** The city covenants that it will set rates, together with any aviation operating fund balance carry forward and all other amounts available for debt service received in such fiscal year, equal to the sum of net operating expenses (excluding interdepartmental charges), 150% of parity airport revenue bond debt service, the required amount (if any) due to the sinking fund reserve account, and the required amount (if any) due to the renewal fund; or, the sum of all operating expenses (including interdepartmental charges), 100% of parity airport revenue bond debt service, 100% of general obligation bond debt service (if any), 100% of debt service on subordinated obligations (if any), amounts required to pay intra-fund loans under the general ordinance, required deposits (if any) to the sinking fund reserve account or renewal fund, and all amounts (if any) required to be paid under interest rate swap agreements.

**Debt Service Reserve Fund:** The city is required to maintain an aggregate balance in the parity sinking fund reserve account in an amount equal to the lesser of maximum annual debt service on airport revenue bonds or the maximum amount permitted by the Internal Revenue Code of 1986 to be maintained without yield restriction for bonds, the interest of which may be excluded from gross income for federal income tax purposes. The city intends to use a surety bond to fulfill the reserve requirement.

**Additional Bonds:** Additional parity airport revenue bonds may be issued provided that, among other items, the city obtains a report from a qualified consultant stating that, for either the immediately preceding fiscal year or any consecutive 12-month period during the 18-months preceding the consultant's report, pledged amounts available for debt service were sufficient to satisfy the rate covenant for outstanding and proposed bonds. The additional bonds test may also be met if pledged amounts available for debt service for each of the five fiscal years ended immediately following the issuance of the additional bonds are sufficient to comply with the rate covenant.

## ■ The Philadelphia Airport System

The airport system, which is owned by the city and operated by the division of Philadelphia's department of commerce, consists of the airport, the main revenue generating asset of the system and principal passenger airport serving the Philadelphia metropolitan area, and Northeast Philadelphia Airport, a general aviation reliever facility.

The airport occupies a 2,300-acre site in Philadelphia and Delaware counties, about eight miles southwest of central Philadelphia. The airport benefits from both direct highway access and Southeastern Transportation Authority rail access to downtown Philadelphia. Northeast Philadelphia Airport, which handles the majority of the region's general and business activities, is located on a 1,240-acre site roughly 13 miles northeast of the city.

The airport has four runways, the longest of which is 10,500 feet, and an associated system of taxiways. The passenger terminal complex, located just north of the airfield, consists of seven terminal units providing 120 aircraft parking positions. Terminals A East and A West, which opened in May 2003, serve international airline operations with 23 gates. Terminals B–F provide facilities mainly for domestic airline operations, with Terminal D, E, and F providing 16, 11, and 38 gates, respectively. Terminals B and C, which together account for 30 gates, are leased to US Airways for its hubbing operation at the airport. Both terminals were extensively renovated during fiscal 1998 and currently house the airport's newest food, beverage, and retail concessions.

A 50-acre site north of the terminal complex, designated the OTA, houses airport parking garages, a hotel, rental car storage and maintenance areas for six on-site rental agencies, commercial ground transportation, and other facilities. Public parking consists of approximately 17,800 spaces, including

12,200 located in five multistory parking garages adjacent to the terminal and 5,600 remotely located in an economy lot accessible from the terminal via shuttle bus. The Philadelphia Parking Authority operates parking at the airport under a contract and lease agreement that extends to 2030. Under this agreement, net revenues, which include gross revenues (after a 15% city tax) less operating expenses, allocated authority administrative expenses, and authority parking debt service, are remitted to the city.

## ■ Airline Market

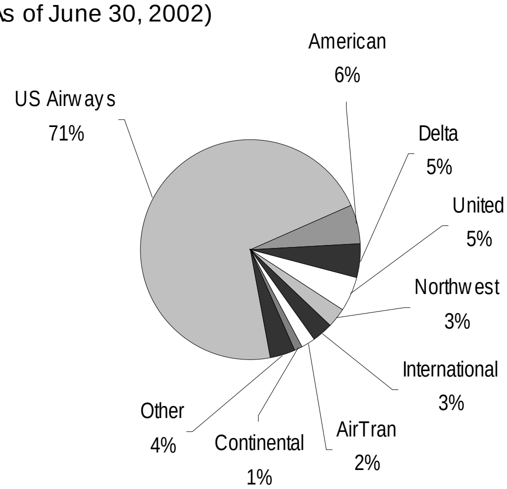
Philadelphia is served by 32 airlines currently providing a total of 575 domestic and 45 international daily nonstop flights. The airport's largest carrier, US Airways, enplaned 63% of the airport's 15.6 million enplaned passengers in fiscal 2006. This share is down slightly from 71% in fiscal 2002, but Fitch expects the airport will be a US Airways stronghold for the foreseeable future.

Recent concerns stemming from US Airways' multiple chapter 11 bankruptcy filings (August 2002 and September 2004), as well as its merger with America West Airlines (completed September 2005), have been largely alleviated with the airline returning to profitable operations. The 'B–' long-term issuer default rating of US Airways Group Inc. (upgraded from 'CCC' on March 16, 2007) reflects the substantial improvement in the airline's credit profile. Over the past year, US Airways posted relatively strong financial results, translating into credit metrics that place it among the better performing hub-and-spoke airlines. Additionally, its strengthened liquidity position and lack of significant debt maturities over the next several years have significantly reduced the probability of a near-term cash crisis. In addition, with the withdrawal of its acquisition offer for Delta Air Lines, Inc. in late January 2007, US Airways can focus on the few remaining tasks necessary to complete its full integration with America West's operating units. Fitch does not expect US Airways to seek another acquisition in the near term.

Despite the improving financial condition of Philadelphia's dominant carrier, US Airways, the airline's large market share and high percentage of connecting traffic expose the airport to financial pressure arising from a service reduction by the carrier in the near to medium term. However, over the longer term, the airport's low costs, manageable debt level, strengthening service area, and advantageous southeastern location will likely attract service by other air carriers, including low-cost carriers (LCCs).

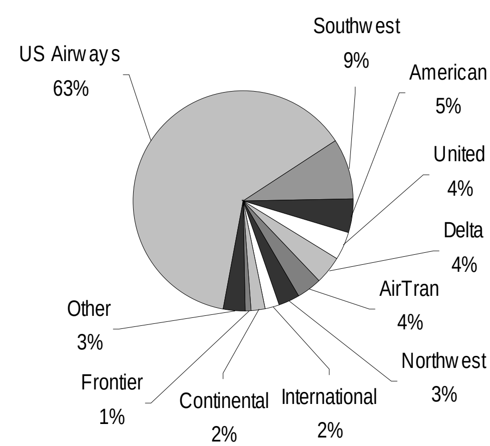
Service provided by LCCs had historically accounted for as little as 2% of Philadelphia's total market share as recently as fiscal 2002, but that percentage equaled 14% in fiscal 2006. Starting with AirTran Airways in fiscal 2002, the airport has since attracted service by Frontier Airlines (1% of the airport's fiscal 2006 total market share) and Southwest Airlines (9%). Strong O&D traffic generated by the airport's local market,

**Philadelphia International Airport Market Share**
(As of June 30, 2002)



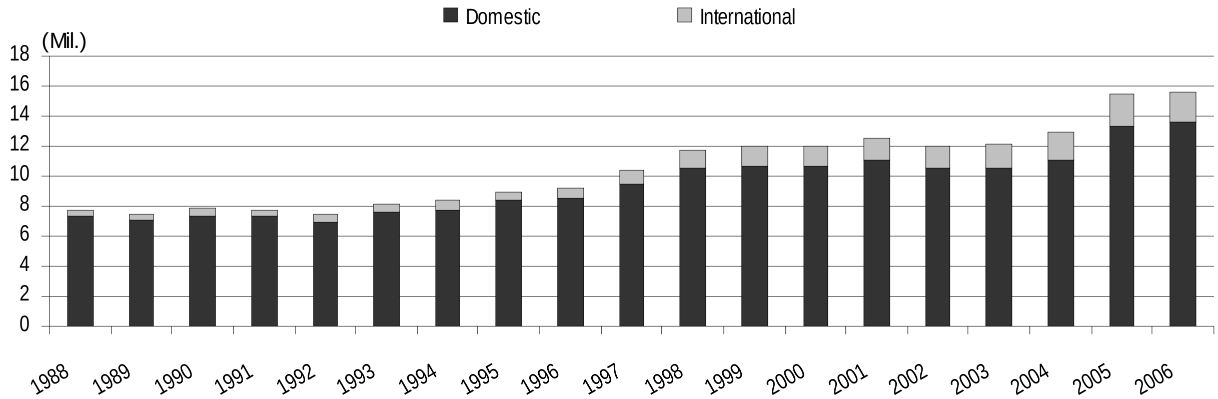

Source: Philadelphia International Airport.

**Philadelphia International Airport Market Share**
(As of June 30, 2006)




Source: Philadelphia International Airport.

**Enplanement History**
(Fiscal Years Ended June 30)




Source: Philadelphia International Airport.

coupled with a historically stable base of air service provided by other carriers, is also a key factor helping to mitigate exposure to US Airways. Other airlines with a presence at the airport include American Airlines (5%), United Airlines (4%), and Delta Air Lines (4%). Foreign flag carriers — British Airways Plc, Lufthansa AG, and Air France — accounted for 2% of the airport's enplanement base in fiscal 2006.

## Enplanement Trends

The 15.6 million passengers enplaned at Philadelphia in fiscal 2006 rank it as approximately the 16th largest airport in the nation. In contrast to the ramp-up in enplanements seen in fiscal 2005, which reflected the 2004 entry of Southwest Airlines, traffic grew at modest rates in fiscal years 2006–2007 due to a combination of seat capacity reductions at US Airways and a national trend toward higher airfares. Total airport enplanements were little changed from fiscal years 2005–2006 and showed a 1.7% increase through the first 11 months of fiscal 2007.

Originating enplanements, which account for 65% of passengers, grew 24% in fiscal 2005 due to Southwest and were flat in fiscal 2006. Connecting enplanements, largely on US Airways, increased 10% in fiscal 2005 and shrank a small 0.6% in fiscal 2006. Fitch notes that the airport's connecting base received a significant 15% boost in fiscal 2003 when US Airways closed its hub at Pittsburg International Airport and re-routed some of that traffic through Philadelphia, indicating the importance of its Philadelphia hub operation. Despite the slower growth rate of the past two fiscal years, the airport has seen a significant benefit from the entry of Southwest Airlines, as well as other LCCs. Southwest has a significant presence at the airport and currently operates 64 daily flights to 18 destinations. The entry of Southwest not only caused a significant boost in traffic, but also helped to lower the average market fare at the airport as other airlines attempted to match fares in certain markets. Despite the trend of higher fares in the past 12 months, the average fare at the airport fell to $151 in fiscal 2006 from $174 in fiscal 2002.

Taking into account the entrenched presence of US Airways, as well as the rapid expansion of Southwest, the airport's consultant forecasts that traffic will grow an average 3.1% annually between fiscal years 2008 and 2012. This rate is in-line with the average annual rate of growth in enplanements for the airport from fiscal years 1988–2006 (3.5%). Fitch notes that the airport's operating structure should enable the maintenance of current financial and operational margins, even if enplanements over the medium term grow at rates somewhat below the projected 3.1%.

## Airline Use and Lease Agreements

The city recently executed lease agreements with 14 of its 16 major carriers, representing more than 98% of passenger enplanements. This new lease takes effect at the start of fiscal 2008 and runs through fiscal 2011. Under the terms of the prior hybrid lease, airfield charges were based on a residual rate-setting methodology, while airline terminal charges were set using a compensatory methodology. The prior rate

### Debt Service Coverage

($000, Audited Fiscal Years Ended June 30)

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|---|---|
| **Net Revenue Coverage** | | | | | | | |
| Project Revenue | 130,427 | 147,982 | 146,466 | 168,325 | 183,308 | 189,032 | 200,787 |
| Pledged PFC Revenue | 0 | 0 | 16,796 | 31,234 | 32,777 | 32,908 | 32,592 |
| Amounts Available for Debt Service | 130,427 | 147,982 | 163,262 | 199,559 | 216,085 | 221,940 | 233,379 |
| Less: Net Operating Expenses | (51,755) | (59,582) | (56,316) | (66,977) | (71,863) | (75,254) | (77,152) |
| Net Amounts Available | 78,672 | 88,400 | 106,946 | 132,582 | 144,222 | 146,687 | 156,227 |
| Revenue Bond Debt Service | 36,514 | 44,813 | 64,068 | 83,175 | 89,653 | 88,081 | 88,126 |
| Debt Service Coverage (x) | 2.15 | 1.97 | 1.67 | 1.59 | 1.61 | 1.67 | 1.77 |
| Debt Service Coverage Requirement (x) | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 |
| **Total Obligation Coverage** | | | | | | | |
| Project Revenue | 130,427 | 147,982 | 146,466 | 168,325 | 183,308 | 189,032 | 200,787 |
| Pledged PFC Revenue | 0 | 0 | 16,796 | 31,234 | 32,777 | 32,908 | 32,592 |
| Amounts Available for Debt Service | 130,427 | 147,982 | 163,262 | 199,559 | 216,085 | 221,940 | 233,379 |
| Less: Operating Expenses | (51,755) | (59,582) | (56,316) | (66,977) | (71,863) | (75,254) | (77,152) |
| Less: Interdepartmental Expenses | (35,327) | (36,038) | (39,685) | (46,147) | (52,218) | (57,555) | (57,860) |
| Net Amounts Available | 43,345 | 52,362 | 67,261 | 86,435 | 92,004 | 89,132 | 98,367 |
| Revenue Bond Debt Service | 36,514 | 44,813 | 64,068 | 83,175 | 89,653 | 88,081 | 88,126 |
| GO Bond Debt Service | 5,688 | 5,743 | 2,050 | 1,436 | 1,051 | 876 | 0 |
| Total Debt Service | 42,202 | 50,556 | 66,118 | 84,611 | 90,704 | 88,957 | 88,126 |
| Debt Service Coverage (x) | 1.03 | 1.04 | 1.02 | 1.02 | 1.01 | 1.00 | 1.12 |
| Test Debt Service Coverage Requirement (x) | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |

PFC – Passenger facility charge. Note: Numbers may not add due to rounding.

covenant required that airline rates and charges either provide 1.50 times (x) coverage of project operating expenses and debt service or that total airport revenues (including the OTA) provide 1.00x coverage of project operating expenses, debt service, and interdepartmental charges paid to the city. In fiscal 2006, the airport generated 1.77x coverage under the first requirement and 1.12x coverage under the second requirement. Although the revenue bond rate covenant only requires the city to meet one of two tests, Fitch believes the second test, which incorporates all airport system operating revenues and expenses, is the more important covenant.

However, unlike many standard compensatory terminal agreements, passenger-driven revenues, such as automobile parking and rental car concessions, were excluded from the rate-setting mechanism and the first test in the legal bondholder pledge; this has historically resulted in lower levels of liquidity and debt service coverage than would be expected from a comparable facility operating under a hybrid lease. Under the new lease, all airport terminal and passenger revenues are pledged to bondholders. Forecasted debt service coverage levels from fiscal years 2008–2012 (including an additional $240 million of debt expected in fiscal 2009) are expected to be at or above 2.30x under Test 1 and at or above 1.65x under Test 2. Fitch believes the new lease modernizes the airport's rate-setting structure and adds additional bondholder security to bring the airport's rate-setting mechanism in-line with those of comparable facilities.

In addition to changes in the rate covenant, the new leases effectively convert all of the airport's gates to either preferential or common use, with no gates remaining under exclusive use. Of the airport's 120 gates, 97 are preferential and 23 are common use. Thresholds exist that allow airport management to reassign a gate if usage levels fall below the range of 4.00–5.75 gate turns per day. The airport estimates that US Airways averages five gate turns per day, while Southwest averages close to eight turns per day. Although management retains the full legal right to reassign a gate if an airline fails to achieve its threshold usage level, the airport likely would first attempt to work collaboratively with a tenant airline before reassigning a gate.

## ■ Financial Profile

While the airport's prior lease did not allow for high coverage levels, cash flow, or liquidity buildup, it has resulted in extremely stable operating performance. Revenues and expenses both increased an average 9% annually since fiscal 2002 to achieve a net revenue total of $77 million in fiscal 2006. Airline revenues made up the majority (65%) of total airport system revenues and have increased at an average annual rate of 3% since

## Projected Debt Service Coverage
($000, Fiscal Years Ending June 30)

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|
| **Net Revenue Coverage – Test 1** | | | | | | |
| Project Revenue | 204,813 | 249,632 | 269,908 | 285,492 | 310,502 | 352,246 |
| Pledged PFC Revenue | 32,921 | 32,926 | 33,027 | 33,096 | 33,043 | 33,047 |
| Other Available Funds | 10,000 | 48,815 | 50,262 | 52,291 | 55,126 | 62,998 |
| Total Amounts Available for Debt Service | 247,734 | 331,373 | 353,197 | 370,879 | 398,671 | 448,291 |
| Less: Net Operating Expenses | (84,552) | (114,018) | (113,476) | (120,657) | (128,657) | (134,786) |
| Net Amounts Available | 163,182 | 217,355 | 239,721 | 250,222 | 270,014 | 313,505 |
| **Debt Service** | | | | | | |
| Outstanding Bonds | 84,533 | 84,001 | 80,974 | 81,058 | 83,568 | 83,602 |
| Series 2007 Bonds | 0 | 0 | 13,504 | 15,397 | 23,999 | 25,686 |
| Series 2009 Bonds | 0 | 0 | 0 | 0 | 795 | 24,641 |
| Total Debt Service | 84,533 | 84,001 | 94,478 | 96,455 | 108,362 | 133,929 |
| Bond Debt Service Coverage (x) | 1.93 | 2.59 | 2.54 | 2.59 | 2.49 | 2.34 |
| Coverage Requirement (x) | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 |
| Airline Cost per Enplanement ($) | 7.45 | 8.20 | 8.58 | 8.89 | 9.76 | 11.55 |
| Enplanements (000) | 15,800 | 16,500 | 17,200 | 17,600 | 18,000 | 18,400 |
| **Total Revenue Coverage – Test 2** | | | | | | |
| Project Revenue | 204,813 | 249,632 | 269,908 | 285,492 | 310,502 | 352,246 |
| Pledged PFC Revenue | 32,921 | 32,926 | 33,027 | 33,096 | 33,043 | 33,047 |
| Other Available Funds | 10,000 | 48,815 | 50,262 | 52,291 | 55,126 | 62,998 |
| Total Amounts Available for Debt Service | 247,734 | 331,373 | 353,197 | 370,879 | 398,671 | 448,291 |
| Less: Operating Expenses | (84,552) | (114,018) | (113,476) | (120,657) | (128,657) | (134,786) |
| Less: Interdepartmental Charges | (67,317) | (71,630) | (80,648) | (84,871) | (88,839) | (92,993) |
| Net Amounts Available | 95,865 | 145,725 | 159,073 | 165,351 | 181,175 | 220,512 |
| **Debt Service** | | | | | | |
| Outstanding Bonds | 84,533 | 84,001 | 80,974 | 81,058 | 83,568 | 83,602 |
| Series 2007 Bonds | 0 | 0 | 13,504 | 15,397 | 23,999 | 25,686 |
| Series 2009 Bonds | 0 | 0 | 0 | 0 | 795 | 24,641 |
| Total Debt Service | 84,533 | 84,001 | 94,478 | 96,455 | 108,362 | 133,929 |
| Total Debt Service Coverage (x) | 1.13 | 1.73 | 1.68 | 1.71 | 1.67 | 1.65 |
| Coverage Requirement (x) | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| Airline Cost per Enplanement ($) | 7.45 | 8.20 | 8.58 | 8.89 | 9.76 | 11.55 |
| Enplanements (000) | 15,800 | 16,500 | 17,200 | 17,600 | 18,000 | 18,400 |

Note: Numbers may not add due to rounding.

fiscal 2002, rising from $108.9 million to $124.5 million for fiscal 2006. Despite the legal hybrid agreement in place, the functionally residual nature of the agreement resulted in debt service coverage levels equaling 1.12x for fiscal 2006, when all debt service, project operating expenses, and interdepartmental charges are included.

Philadelphia's airline cost per enplanement remained moderate for an international gateway hub, equaling approximately $6.64 for fiscal 2006. As the airport continues to gain service by LCCs, maintenance of competitive airline rates and charges is critical. The airport's unrestricted liquidity equaled $95 million as of fiscal 2006, correlating to 8% of outstanding revenue bond debt. This ratio is in-line with those of comparable facilities.

Under base case enplanement projections, total project revenues are forecast to grow at an average annual rate of 9% from $205 million for fiscal 2007 to $352 million for fiscal 2012, largely reflecting incorporation of OTA revenues into the rate structure and increases in airline charges to support the 2007 and anticipated 2009 debt. Total airport operating expenses are forecast to rise by a much lower 4% during this period, with the airport projected to achieve operating margins ranging from 26–35%. Debt service coverage of all obligations is expected to be at or above 1.65x from fiscal years 2008–2012, a level in-line with comparable facilities. Fitch notes that coverage levels would be at or above 1.45x if operating expenses were to rise at a higher 8% rate during this period. The resulting cost per enplaned passenger in fiscal 2012 is expected to be nearly $11.50 per passenger, which would be considered moderate after taking projected levels at other facilities into account.

## ■ Capital Improvement Program

After curbing its capital improvement program (CIP) in the past several fiscal years as US Airways

## Financial Summary

($000, Audited Fiscal Years Ended June 30)

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|---|---|
| **Balance Sheet** | | | | | | | |
| Unrestricted Cash and Cash Equivalents | 70,175 | 72,926 | 75,722 | 57,882 | 71,137 | 89,936 | 94,912 |
| Total Current Assets | 80,948 | 84,923 | 89,800 | 79,143 | 82,997 | 104,985 | 108,421 |
| Property, Plant, and Equipment | 705,066 | 802,089 | 1,277,756 | 1,426,322 | 1,412,997 | 1,401,016 | 1,396,347 |
| Current Maturities of GO Bond Debt | 11,626 | 3,666 | 2,568 | 2,709 | 2,373 | 0 | 0 |
| Current Maturities of Revenue Bond Debt | 19,184 | 26,625 | 27,745 | 33,605 | 35,400 | 35,495 | 29,800 |
| Current Liabilities | 116,957 | 125,991 | 131,442 | 154,288 | 114,584 | 124,517 | 101,762 |
| GO Bonds | 11,317 | 7,650 | 5,082 | 2,373 | 0 | 0 | 0 |
| Outstanding Revenue Bonds | 942,985 | 916,360 | 1,124,120 | 1,090,515 | 1,055,115 | 1,066,255 | 1,161,410 |
| Total Long-Term Debt | 954,302 | 924,010 | 1,129,202 | 1,092,888 | 1,055,115 | 1,066,255 | 1,161,410 |
| **Income Statement** | | | | | | | |
| Operating Revenue: | | | | | | | |
| Airport Project Revenue | | | | | | | |
| Prior Year's Credit to Scheduled Airlines | 17,753 | 16,838 | 18,105 | 28,341 | 17,768 | 18,688 | 19,162 |
| Landing Fees | 27,168 | 34,702 | 32,581 | 30,945 | 35,963 | 36,314 | 29,622 |
| Terminal Space Rentals | 33,267 | 35,400 | 36,190 | 40,444 | 39,055 | 44,883 | 47,947 |
| Terminal Payments-in-Aid | 5,017 | 8,200 | 10,681 | 10,534 | 19,421 | 13,884 | 9,719 |
| Ramp Area Rentals | 2,238 | 1,753 | 1,304 | 1,053 | 1,144 | 1,482 | 1,128 |
| Other Operating Revenue | 236 | 230 | 181 | 76 | 141 | 982 | 0 |
| International and Charter Airline Charges | 9,818 | 10,592 | 9,892 | 10,187 | 24,619 | 19,553 | 16,919 |
| Total Scheduled Airline Revenue | 95,497 | 107,715 | 108,934 | 121,580 | 138,111 | 135,786 | 124,497 |
| Non-Airline Revenue | 51,768 | 58,372 | 65,873 | 64,513 | 63,885 | 71,599 | 84,187 |
| Less: Scheduled Airline Revenue Deferred to Subsequent Fiscal Year | (16,838) | (18,105) | (28,341) | (17,768) | (18,688) | (22,258) | (9,621) |
| Total Airport Project Revenue | 130,427 | 147,982 | 146,466 | 168,325 | 183,308 | 185,127 | 199,063 |
| Revenue from City Cost Centers: | | | | | | | |
| Deferred Revenue | (354) | (285) | (269) | (128) | (26) | (15) | (149) |
| OTA Public Parking | 21,894 | 23,731 | 15,327 | 11,629 | 14,539 | 27,239 | 30,187 |
| Rental Cars | N.A. | N.A. | N.A. | N.A. | 1,204 | 2,029 | 2,636 |
| Other OTA Revenue | 6,188 | 6,343 | 5,861 | 5,830 | 4,935 | 4,897 | 5,395 |
| General Fund Transfer | 0 | 0 | 0 | 0 | 0 | (909) | 0 |
| Overseas Terminal | 319 | 214 | 258 | 247 | 202 | 44 | 194 |
| Revenue Deferred to Following Fiscal Year | 285 | 269 | 128 | 26 | 15 | 149 | 227 |
| Net City Cost Center Revenue | 28,332 | 30,272 | 21,303 | 17,605 | 20,868 | 33,434 | 38,490 |
| Total Airport System Revenue | 158,759 | 178,254 | 167,769 | 185,930 | 204,176 | 218,561 | 237,553 |
| Operating Expenses: | | | | | | | |
| Terminal Building | 53,647 | 60,265 | 59,419 | 68,088 | 79,670 | 85,910 | 86,341 |
| Airfield Area | 23,008 | 23,981 | 25,612 | 31,686 | 29,737 | 31,055 | 33,990 |
| Cargo City | 2,924 | 3,230 | 3,310 | 4,244 | 4,953 | 5,228 | 5,090 |
| Other Areas | 4,485 | 4,610 | 4,664 | 5,732 | 5,660 | 6,010 | 5,958 |
| Northeast Philadelphia Airport | 3,003 | 3,527 | 2,988 | 3,366 | 4,038 | 4,583 | 3,614 |
| Airport Services | 16 | 6 | 9 | 8 | 25 | 23 | 20 |
| Aviation Subtotal | 87,083 | 95,619 | 96,002 | 113,124 | 124,081 | 132,809 | 135,012 |
| Outside Terminal Area | 12,066 | 13,558 | 15,728 | 18,595 | 18,378 | 19,588 | 24,909 |
| Overseas Terminal | 207 | 116 | 105 | 138 | 136 | 154 | 272 |
| Total Airport System Operating Expenses | 99,356 | 109,294 | 111,834 | 131,857 | 142,596 | 152,551 | 160,194 |
| Operating Income | 59,403 | 68,961 | 55,935 | 54,073 | 61,580 | 66,010 | 77,360 |
| Depreciation | 45,332 | 49,275 | 55,352 | 56,496 | 62,914 | 70,670 | 74,228 |
| Net Income/(Loss) | 14,071 | 19,686 | 583 | (2,423) | (1,334) | (4,660) | 3,132 |
| Non-Operating Revenue/(Expenses): | | | | | | | |
| Operating Grants | 21 | 13 | 2,263 | 267 | 1,935 | 1,410 | 1,955 |
| Passenger Facility Charges | 33,603 | 38,122 | 46,469 | 47,429 | 52,096 | 61,951 | 63,125 |
| Interest Income | 6,835 | 17,002 | 13,728 | 11,996 | 3,624 | 4,836 | 20,446 |
| Net Pension Obligation | 0 | 0 | 0 | 0 | 0 | (3,202) | (3,308) |
| Interest Expense | (20,049) | (30,194) | (31,147) | (57,870) | (56,657) | (49,736) | (67,187) |
| Loss on Disposal of Assets | (3,493) | (611) | (264) | (38) | (2,667) | 3,876 | (293) |
| Other Revenue/(Expenses) | 3,256 | 0 | 0 | 0 | 0 | 24 | (9) |
| Net Non-Operating Revenue/(Expenses) | 20,172 | 24,333 | 31,048 | 1,784 | (1,669) | 19,160 | 14,729 |
| Capital Contributions | 2,811 | 9,059 | 20,569 | 17,241 | 20,947 | 20,745 | 25,288 |
| Change in Net Assets | 37,054 | 53,077 | 52,200 | 16,602 | 17,944 | 35,245 | 43,149 |

Note: Numbers may not add due to rounding.

underwent bankruptcy restructuring, the airport reactivated many of its demand-driven plans to address terminal modernization and upgrades, as well as a potential airfield expansion. The plan for fiscal years

## Selected Financial and Operating Statistics

(Audited Fiscal Years Ended June 30)

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|---|---|
| Operating Margin (%) | 37 | 39 | 33 | 29 | 30 | 30 | 33 |
| Enplanements | 11,979 | 12,824 | 12,002 | 12,137 | 13,089 | 15,491 | 15,575 |
| Landed Weight (Mil. Pounds) | 21,912 | 23,442 | 22,675 | 22,017 | 22,288 | 22,288 | 25,878 |
| Airline Cost per Enplanement ($) | 6.49 | 7.09 | 7.57 | 7.68 | 9.19 | 7.44 | 6.64 |
| Unrestricted Cash and Cash Equivalents/Long-Term Debt (%) | 7 | 8 | 7 | 5 | 7 | 8 | 8 |
| Unrestricted Cash and Cash Equivalents/Pro Forma Debt (%) | 6 | 6 | 7 | 5 | 6 | 8 | 8 |
| Days Cash on Hand | 258 | 244 | 247 | 160 | 182 | 215 | 216 |
| Non-Airline Revenue as % of Total Airport System Revenue | 33 | 33 | 39 | 35 | 31 | 33 | 35 |
| Debt Service as % of Total Airport System Revenue | 27 | 28 | 39 | 46 | 44 | 41 | 37 |

2008–2013 identifies $1 billion in future facility needs. Projects in the plan include the extension of one of the airport's regional jet runways to allow for use by larger jets, improvements and expansion of Terminals D and E, expansion of Terminal F, and the addition of several in-line explosive detection machines.

Management anticipates issuing approximately $240 million in fiscal 2009, which, in addition to the series 2007A and previously issued bonds, will fund about 55% of the CIP. Other funding sources include passenger facility charge pay-as-you-go (18% of total sources), state and federal grants (24%), and airport reserves (3%).

As part of its airport master planning process, the city is currently studying the capital needs of the airport beyond fiscal 2012. One of the major projects under study is a possible reconfiguration of Philadelphia's airfield to alleviate growing congestion and reduce traffic delays. Current national estimates place the airport as the fourth most delayed airport nationally, adding significant cost and inefficiency to both airport and airline operations. Proposals under review include lengthening airport runways, constructing additional runways, or an entire redesign of the airport's terminals and runways for optimal efficiency. The airport anticipates completing the Environmental Impact Statement process in late 2008 and issuing a record of decision in 2010. While the costs and timing of the airfield program are dependent on the plan eventually approved through the EIS process and the level of federal funding offsets are unknown at this time, based on the airport's current plan, Fitch believes such a significant capital program will likely result in the use of additional debt financing within the next five to 10 years.

## ■ Service Area

The airport's primary service area consists of 11 counties — five in Pennsylvania (including Philadelphia County), four in New Jersey, one in Delaware, and one in Maryland — with an approximate 2005 population of 5.8 million. Reflecting high urbanization, the area's population is forecast to increase slightly, at an average annual rate of 0.5% through 2010, compared with 0.9% for the nation.

Employment within the service area has historically lagged the U.S. level, increasing at only a 0.5% average annual rate over the past decade. Despite the slow growth in employment, the service area's developed economic base and above-average incomes should provide support for continued O&D traffic growth. From fiscal years 1996–2005, personal income on a per capita basis grew at a 4.9% average annual rate, comparable to the 5.1% rate seen for the U.S. during the same period. The 2005 per capita personal income was $40,727 and 118% of the national level. Overall, Fitch expects that the airport's service region will experience slow but stable economic growth at rates equal to or slightly less than that of the national average in the next several years.