FITCH RATES CITY OF PHILADELPHIA'S $45.595MM 2009A AIRPORT REVENUE RFDG BONDS 'A'; STABLE OUTLOOK

Fitch Ratings-New York-16 March 2009: Fitch Ratings assigns an 'A' underlying rating to the City of Philadelphia, Pennsylvania's airport revenue refunding bonds series 2009A (Non-AMT). The series 2009A fixed rate bonds will refund all of the Philadelphia Division of Aviation's (the Division) 2005B variable rate demand obligation bonds and have a final maturity of 2029, extending the maturity date by nine years. The series 2009A bonds are expected to price the first week of April 2009. In addition, Fitch affirms the following series of bonds at 'A':

--$34,780,000 series 1997A;
--$78,075,000 series 1998A;
--$388,500,000 series 1998B;
--$168,660,000 series 2001A;
--$36,315,000 series 2001B;
--$124,985,000 series 2005 A;
--$41,000,000 series 2005B;
--$172,470,000 series 2007A;
--$79,415,000 series 2007B.

The bonds are secured by net operating revenues of the airport. The Rating Outlook is Stable.

The 'A' rating reflects Philadelphia International Airport's (the airport) critical role in providing air service to a stable and highly populous service area that generates a solid base of origination & destination traffic. The rating also incorporates the airport's stable operating profile, modest debt levels and cost per enplaned passenger (CPE) for an airport with this level of international service, and US Airways use of the airport as an international gateway. Credit concerns center on the volatile state of the airline industry and potential impacts on service, primarily from the airport's main service provider US Airways (currently rated 'CCC' with a Negative Outlook by Fitch); the airport's near-term capital plan which calls for significant future debt issuance of $420 million to enhance runway capacity and efficiency in the near-to-medium term; the airport's exposure to US Airways (64% of enplanements); and the significant portion of connecting traffic.

Although the airport maintains a moderate debt per enplaned passenger, the anticipated issuance of $420 million in 2010-2013 could impact the cost structure of the airport should forecasted traffic levels not materialize and non-airline revenues under perform. Fitch recognizes that the airport can defer the plan should traffic or airline performance decline, and airline Majority-In-Interest (MII) approvals are required. Were the airport to move forward with its plan in the face of poor financial overall performance and declining growth, negative rating action would be likely.

The entry of Southwest Airlines to the airport in 2004 furthered a trend to a more diversified marketplace, with low-cost carriers Southwest, AirTran Airways and Frontier Airlines now representing 16% of total enplanements, compared to 2% in fiscal 2002, when AirTran Airways was the sole low cost carrier. However, the airport remains a US Airways' stronghold, comprising 64% of fiscal 2008 passengers. The significant portion of connecting traffic (35%) also represents a concern, as US Airways could opt to route that 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.

Additionally, the airport recently completed on-site capital projects, including the extension of one of its runways and terminal upgrades, which will enable handling of larger aircraft fleets and enhanced terminal efficiencies.

In contrast to the ramp-up in enplanements seen in fiscal 2005, traffic grew at modest rates through fiscal 2008 due to a combination of US Airways service reductions, rising airfares, and the presence of Southwest airlines. Total airport enplanements were relatively unchanged from fiscal 2007 to fiscal 2008, with total enplanements reaching 16.1 million in fiscal 2008, slightly up from 15.9 million in fiscal 2007; however, fiscal 2008 does mark the sixth consecutive year of enplanement growth. For the first six months of fiscal 2009, enplanements are down a relatively modest 2% when compared to the same timeframe in fiscal 2008 and against other U.S. airports. Over the longer term, the airport forecasts that enplanements will grow by 1.8% on average annually through fiscal 2013.

However, Fitch notes that weakening demand could further deteriorate US Airways' financial profile, which poses a considerable risk for the airport. US Airways currently faces significant challenges, including a large number of planned aircraft deliveries and cash obligations tied to upcoming debt maturities, while a weaker-than-expected revenue environment could put heavy pressure on free cash flow later this year. As the airport's dominant carrier, the airport is inextricably linked to the operational health and stability of US Airways. Should the airline implement any modifications to its operating profile at the airport, the airport's financial ratios would likely be adversely affected and current economic conditions are likely to cause a more prolonged recovery.

Through the end of fiscal 2007 the airport utilized a hybrid lease which, in combination with sound financial management, resulted in stable operating margins despite recent changes in the air service market. Revenues and expenses both increased at a 9% rate on average annually since fiscal 2002 and operating income is expected to be $172 million in fiscal 2009, approximately 25% higher than the airport reported in fiscal 2008 which primarily reflects the incorporation of outside terminal A revenues into the Division's revenue base. The cost basis at the airport is moderate for an international gateway, equalling an estimated $8.51 in fiscal 2008 and is estimated to increase slightly to $9.02 in fiscal 2009. Going into 2010-2013, the airport's CPE could rise to the $13 range as long as traffic levels remain constant and future debt plans remain unchanged.

In fiscal 2008 the airport implemented a new use lease agreement which will be in effect through fiscal 2011. The new lease broadens the revenue pledge by including all terminal and passenger revenues, which are pledged to bondholders before being shared with the airlines. Under the terms of the prior lease, the airport was required to set airline rates to ensure that airport revenues were sufficient to meet the required rate covenant of 1.50 times (x) (when excluding interdepartmental charges), or a 1.00x rate covenant when including interdepartmental charges. A notable difference in the new agreement is the airport's ability to use the outside terminal area (OTA) cost center, when calculating both the 1.50x and 1.00x tests, whereas the prior agreement did not permit the use of the OTA cost center in calculating both tests. The airport is also allowed to use rolling coverage account balances when calculating the rate covenant in both the prior and current lease agreement.

Fitch believes that the new lease modernizes the airport's rate setting structure and adds bondholder security by further diversifying the pledged revenue stream. The exclusion of passenger driven revenues such as automobile parking and rental car concessions from the rate-setting mechanism and from the legal bondholder pledge historically resulted in lower levels of liquidity and debt service coverage that would be expected from a comparably facility operating under a hybrid lease. In fiscal 2008 the airport generated 2.68x coverage under the first requirement and 1.62x coverage under the second requirement. The lower debt service coverage under the second test reflects the inclusion of both the airport's net operating expenses as well as all interdepartmental charges. The broader revenue stream under the new lease agreement provides for stronger debt service coverage, expected to be 1.83x under test two in fiscal 2009. The airport's consultant forecast coverage levels through fiscal 2013 (including an additional $420 million of debt expected in 2010) are expected to be at an estimated 2.52x under test one and at or above 1.77x under test two.

The airport's current capital improvement plan (CIP) calls for an additional $420 million in debt in the 2010-2013 timeframe to complete its plan that emphasizes terminal upgrades and additions and airfield improvements. Major funding sources for the plan include additional bonds (70%), AIP Grants (12%, passenger facility charge pay-go (5%), and TSA grants (5%). In addition to its CIP, the Federal Aviation Administration (FAA) is currently conducting an environmental impact study (EIS) regarding the airport's plans for the future redesign of the airfield. The costs and timing of the plan could change based on the EIS findings, and the costs associated with lengthening the runway are not reflected in the airport's total CIP costs. The airport's current plan assumes $420 million in additional debt in 2010.

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