

New Issue: Philadelphia (City of) PA Airport Enterprise

MOODY'S ASSIGNS A2 RATING TO CITY OF PHILADELPHIA AIRPORT REVENUE BONDS, SERIES 2007A AND SERIES 2007 B AND UPGRADES TO A2 FROM A3 THE RATINGS ON ITS OUTSTANDING AIRPORT REVENUE BONDS; OUTLOOK IS STABLE

CITY OF PHILADELPHIA HAS A TOTAL OF \$1.4 BILLION RATED AIRPORT REVENUE BONDS OUTSTANDING

Airport
PA

Moody's Rating

ISSUE	RATING
Airport Revenue Bonds, Series 2007 A & 2007 B	A2
Sale Amount \$299,200,000	
Expected Sale Date 08/08/07	
Rating Description Airport Revenue Bonds, Series 2007 A & 2007 B	

Moody's Outlook Stable

Opinion

NEW YORK, Jul 31, 2007 -- Moody's Investors Service has assigned an A2 rating to the City of Philadelphia's Airport Revenue Bonds Series 2007A and Airport Revenue Refunding Bonds Series 2007 B. The City may issue the 2007B Bonds simultaneously with the 2007A Bonds, however, depending on market conditions, the 2007B Bonds may be issued at a later time as variable rate demand or auction rate obligations, and the City may enter into an interest rate swap with respect to such 2007B Bonds.

We are also upgrading to A2 from A3 the ratings on the city's outstanding airport revenue bonds. The outlook is stable. The upgrade is based on the growth in enplanements since the commencement of service by Southwest Airline (senior unsecured rating Baa1) in April 2004, the new airline use and lease agreement which provides for greater gate control by the airport and the inclusion of outside terminal area revenues, including parking, hotel and some car rental revenues, in the revenue pledge. The rating also considers the reliance on US Airways at the airport.

USE OF PROCEEDS: Fund the 2007 capital projects at the airport and refund portions of its 1997 A and 1997 B bonds for net present value savings of at least 3%.

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. Other reserves are also provided, including a renewal fund, a bond redemption and improvement account (debt service coverage account), and an O&M reserve account.

INTEREST RATE DERIVATIVES: The airport entered a fixed to variable rate interest rate swap associated with the \$189.5 million 2005 Series C bonds. The termination option by the counterparty is limited to unlikely events, such as a downgrade of the airport's debt rating below Baa2. 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.

STRENGTHS

* Entry of low cost carrier Southwest Airlines has generated enplanement growth and has resulted in lower fares; during the first full year of service in FY 2005, originating passenger enplanements increased 24%

* Very large and economically stable service area of 5.6 million

* Improving financial strength of US Airways; US Airways share of total enplanements has decreased from nearly 70% in 2003 to 64% in 2006, but the airport remains a strong hub for them

* New airline use and lease agreement provides for better airport gate control; gates converted from exclusive use to common or preferential-use

* Increasing non-airline revenues

* Outside Terminal Area revenues are now pledged revenues, which will improve debt service coverage

* Experienced airport management team

CHALLENGES

* Large long term capital improvement plan including re-alignment of runways is estimated in excess of \$2 billion; near term capital is minimal through 2009

* Significant airfield congestion; Philadelphia International Airport (PHL) experiences some of the longest delays when compared with other domestic airports

* Competition from nearby airports in the New York and Baltimore metropolitan area

MARKET POSITION/COMPETITIVE STRATEGY: LARGE AND STABLE SERVICE AREA; ARRIVAL OF SOUTHWEST HAS SPURRED ENPLANEMENT GROWTH

Enplanements have increased dramatically since the commencement of service by Southwest Airlines at the Airport in April 2004. The airline has grown to over 9% of enplanements at the airport. Increased competition among airlines, spurred by Southwest, has reduced fares and increased demand. Additionally, in fiscal year 2005, the first full year of Southwest service, originating passengers increased 24% and domestic airfares reportedly decreased by 19%. The airport's 5-year compounded annual growth rate (2001 to 2006) was a strong 4.2%, however, growth appears to be moderating, with growth from 2005 to 2006 increasing less than 1%. The airport's consultant forecasts include average annual increases in enplanements between 2006 and 2012 of 2.8%.

Philadelphia is the 16th largest airport in the country and serves a large origination & destination (O&D) base of over 5 million people. O&D passengers increased to 65% in 2006 from 59% of total enplanements in fiscal 2004. In Moody's opinion, this sizeable O&D base makes PHL less vulnerable over the long term to changes in connecting activity by US Airways. Major competing airports are Baltimore-Washington International Airport (BWI) to the south and Newark to the north. The lower fares at PHL, which have fallen about 25% since 2001, have made it much more competitive with these airports. BWI, however, offers lower domestic one-way airfares while Newark is more expensive when compared to PHL. In Moody's opinion, the decreased air fares have likely broadened the geographical base from which PHL attracts passengers.

While the increased competition is clearly a positive credit factor, in Moody's opinion the airport still must manage the risk posed by its reliance on US Airways, which emerged from bankruptcy in 2005 after its merger with America West. The carrier comprised 64% of total enplanements in fiscal 2006, down from nearly 70% in 2003. Although increased competition has eroded US Airways market share of both total and O&D enplanements, the airline remains dominant. The airport is US Airways primary northeastern hub and US Airways increased service at PHL as it has decreased service at Pittsburgh. In fact, the carrier had 433 daily departures in April of 2007, up 14% from April 2004. Finally, US Airways provides the majority of the Airport's international service, which has also experienced growth, reaching 13% of total enplanements in 2006.

The airport recently entered into a new airline use and lease agreement, effective through June 30, 2011. The new agreement reflects the experienced management team's goals for improving facility utilization and enhancing airport finances. The agreement provides the airport with greater flexibility to manage the airport facilities, including greater gate control. All of the gates have been converted to either common use or preferential use gates and there are no longer gates exclusively controlled by the airlines. This favorably addresses a long standing concern regarding gate control at the airport. Additionally, the Airport has instituted contingency plans to take over key operations, such as de-icing and ramp control, currently managed by US Airways. Nonetheless, in Moody's opinion the Airport remains exposed to transition risk, should US Airways dramatically decrease operations or liquidate.

FINANCIAL POSITION AND PERFORMANCE: STRONG DEBT SERVICE COVERAGE IS PROJECTED AND SUPPORTS THE UPGRADE

Debt service coverage is expected to improve going forward due to a change in the revenues pledged to bondholders. The seventh supplemental bond ordinance now includes revenues from the outside terminal area cost center in the revenue pledge. These revenues include parking, hotel and some car rental revenues and are estimated to be about 16% of total revenues in 2008. Debt service coverage is expected to increase from 1.13 times (x) in 2007 to 1.73 x in 2008 (without consideration of the reserves funds which can be applied to the bond debt service coverage calculation) and is expected to remain near this level through the forecast period. This is a considerable improvement over the sum-sufficient debt service coverage previously maintained

The airport has an improving liquidity position. The balances in the O&M account, which is expected to grow to \$20 million by 2011 and the bond redemption and improvement account along with discretionary account funds provide additional bondholder security.

The airport's 2006 airline costs per enplaned passenger were \$6.64 in 2006, which is slightly higher than Moody's median of \$5.87 for all rated airports. Costs are also slightly higher than Philadelphia's peer group of large hub airports, which have a median cost of \$6.40. However, Moody's believes this is manageable, given the increasing diversity of carriers and, more significantly, the large and economically stable metropolitan region. Debt per enplaned passenger was \$73.60 in fiscal 2006 which was below the median of nearly \$114 for Moody's rated hub airports and debt per O&D passenger of \$113, compares very favorably to the median of nearly \$193 for rated hub airports.

CAPITAL PROGRAM: CURRENT PLAN IS VERY MANAGEABLE; LONGER TERM CAPACITY CONSTRAINTS WILL REQUIRE SIGNIFICANT CAPITAL INVESTMENT

The Series 2007 A bonds will fund a portion of the airports 2007 capital projects, estimated to cost \$182 million, including Terminal A gate reconfiguration, Terminal F expansion design, terminal B-C baggage system design, infrastructure improvements and land acquisition. Additionally, the airport will use passenger facility charges (currently \$4.50 per passenger) to fund a portion of its capital needs. The airport also has planned nearly \$350 million in capital for its 2009 projects, which include the Terminal F expansion and renovation, B-C baggage system construction, new taxiways and pavement resurfacing projects, all of which will require airline approval.

Longer term, the airport will address its capacity constraints, which cause average delays of almost 10 minutes per operation. To reduce delays and meet long-term capacity, the airport is studying several approaches to reconfigure its runways, each of which is expected to cost in excess of \$2 billion. Environmental approval has yet to be attained, and any plan will likely require significant mitigation. The airport does not expect implementation of this significant, multi-year project to begin before 2011. Moody's notes the capacity constraints facing the airport and the substantial capital that will be needed to implement the long term plan will introduce additional risk.

Outlook

Moody's outlook is stable, based on the expectation that competition among airlines for the sizeable O&D base will continue to result in long-term stability for the airport as it faces the challenge of concentration in its dominant carrier, US Airways.

What could change the rating - UP:

Sustained growth in enplanements combined with continued stability of US Airways and the implementation of a capital improvement program that results in manageable airline costs could put positive pressure on the credit rating.

What could change the rating - DOWN:

A significant decrease in enplanements at PHL and the significant capital investment required to address capacity constraints could put negative pressure on the rating.

KEY INDICATORS

Type of Airport: Hub

Rate-making methodology: Residual

FY 2006 Enplanements: 15,574,997

5-Year Enplanement CAGR 2001-2006:4.2%

FY 2006 vs. FY 2000 Enplanement growth: 23%

FY 2006 vs. FY 2005 Enplanement growth: 0.5%

% O&D vs. Connecting, FY 2006 (5 YR AVG):65% (63%)

Largest Carrier by Enplanements, FY 2006 (share): US Airways (62.2%)

Airline Cost per Enplaned Passenger, FY 2006 (5 YR AVG): \$7.50 (\$7.79)

Debt per Enplaned Passenger, FY 2006 (5 YR AVG): \$92.05 (\$80.71)

Bond Ordinance Debt Service Coverage, FY 2006 (5 YR AVG): 1.12x (1.03x) - after interdepartmental charges

Utilization Factor, FY 2006 (5 YR AVG): 1.7 (1.5)

RATED DEBT (000):

Total: 1,446,000,000

1997A, \$38,775,000

1997 B, \$81,435,000

1998A, \$83,835,000

1998B, \$308,500,000

2001A,\$168,660,000

2001B, \$37,140,000

2005A, \$124,985,000

2005 B \$41,000,000

2005C, \$182,700,000

2007 A & B \$299,200,000 (preliminary, subject to change)

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