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RESEARCH

Philadelphia, Pennsylvania
Philadelphia International Airport; Airport

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Credit Profile

US$171.08 mil arpt rev bnds (Philadelphia International Airport) ser 2007-A(AMT) due 06/15/2037		
Long Term Rating	A+/Stable	New
US$83.245 mil arpt rev rfdg bnds (Philadelphia International Airport) ser 2007-B due 06/15/2027		
Long Term Rating	A+/Stable	New
Philadelphia, Pennsylvania		
Philadelphia International Airport, Pennsylvania		
Philadelphia (Philadelphia Arpt) (FGIC)		
Unenhanced Rating	A+(SPUR)/Stable	Upgraded

Rationale

Standard & Poor's Ratings Services raised its underlying rating (SPUR) on Philadelphia, Pa.'s parity debt, issued for Philadelphia International Airport, to 'A+' from 'A'.

At the same time, Standard & Poor's assigned its 'A+' rating to Philadelphia's series 2007A and 2007B airport revenue bonds, also issued for the airport. The outlook is stable.

The 'A+' rating reflects the airport's improved competitive position due to the expansion of Southwest Airlines, which has stimulated air travel demand in the airport's relatively large origin and destination (O&D) market. The upgrade also acknowledges steps taken by management to improve coverage and accumulate funds available for debt service. US Airways' improved financial health, along with its continued commitment to operate a major hub at the airport, further supports the rating.

The rating also reflects the airport's:

- Large O&D market, which spans 11 counties across Pennsylvania, New Jersey, Delaware, and Maryland, providing nearly 10 million enplaned passengers, or 64% of total enplaned passengers, in fiscal 2006;
- Strong competitive position due to limited competition from other major airports and growth in low-cost carrier service because of Southwest Airlines' expansion at the airport;
- Historically strong enplanement growth, as evidenced by a 4.7% yearly increase in enplaned passengers over the past five fiscal years (2002-2006); and
- Moderate cost structure and manageable debt burden--estimated to be $8 and $83 per enplaned passenger, respectively--after this bond issue.

These strengths are somewhat offset by the potential for higher capital needs or an acceleration of the airport's capital improvement program (CIP) if strong growth continues, placing pressure on the airport's moderate cost structure. Near-term capital needs are manageable. In 2009, airport management plans to issue approximately $331 million in debt, most of which will be used to finance the expansion of Terminal F and a baggage system for terminals B and C. In addition, the airport's relatively high carrier concentration--with US Airways Inc. (B/Positive) and its affiliated commuter carriers representing about 64% of fiscal 2006 total enplanements--leaves the airport susceptible to service-level decisions by US Airways. However, Southwest Airlines' (A/CreditWatch Negative) increasing presence in Philadelphia mitigates this concern.

The bonds are secured by 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 derived from occupants and users of the airport system, which consists of the Philadelphia International Airport (the airport) and the Northeast Philadelphia Airport. Net project revenues do not include government grants for capital projects and rent payments received for the use of 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 passenger facility charge revenues (PFCs) are pledged to pay debt service for 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 the Internal Revenue Code of 1986.

Until 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. Airport management prudently decided to include revenues and costs related to the outside terminal area and overseas terminal as part of project revenues and took steps to ensure higher levels of liquidity over time; as a result, the airport's financial profile is expected to improve from fiscals 2008-2012 (the forecast period). These changes became effective July 1, 2007 (the beginning of fiscal 2008).

The combination of including revenues and costs allocated to the airport's outside terminal area and changes under the new airline lease agreement allow the airport to accumulate funds available for debt service, an amount that is forecasted to grow to $63.2 million in fiscal 2012 from $48.8 million in fiscal 2008. These funds alone are projected to cover estimated annual debt 0.47x-0.58x over the forecast period. Coverage is also expected to improve. Based on reasonable forecasts, total fixed-charge coverage, as calculated by Standard & Poor's, is expected to range from 1.12x-1.15x over 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 1.8x-2.0x over the forecast period; if the estimated combined balance of funds available for debt service is included, coverage is no lower than 2.3x. 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. The changes made to the general airport revenue bond ordinance and new airline agreement by airport management are viewed favorably by Standard & Poor's since they provide improved coverage and make additional funds available for debt service. However, revisions made to subsequent airline agreements or future amendments to the general ordinance that would retract from these enhancements would be a credit concern.

The airport has experienced relatively strong air travel demand historically. Over the past 10 fiscal years, enplanements grew an average of 6.6% per year, outpacing the 2.8% national average over that same period. 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 have contributed to the airport's recent strong growth in enplanements. In fiscals 2004 and 2005, enplanements increased 7.8% and 18.4%, respectively, resulting in enplanement levels surpassing pre-September 2001 historical highs in fiscal 2004. Enplanements in fiscal 2006 reached 15.6 million, a new historical peak. For the first 11 months of fiscal 2007, enplanements continue to increase, and are up 1.7% compared with the same period in fiscal 2006.

The airport benefits from the lack of nearby competing facilities--no major airport exists within a one-hour drive of the airport. Baltimore/Washington International Airport (102 miles to the southwest) and Newark Liberty International Airport (106 miles to the northeast) are Philadelphia International Airport's primary competitors. Since 2004, when Southwest Airlines initiated service in Philadelphia, the airport's competitive position has improved. As a result of Southwest Airlines' presence, average airfares at Philadelphia International Airport have decreased, stimulating air travel demand within the airport's 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.

The series 2007A bond proceeds will be used to fund all or a portion of the reconfiguration of aircraft gates at Terminal A-West, design for the expansion and renovation of Terminal F, design for an upgraded baggage system for terminals B and C, an infrastructure improvement program, terminal upgrades, operational upgrades, and a land acquisition program. The series 2007B bond proceeds will be used to refund all of the airport's series 1997B bonds. The airport will have about $1.3 billion in general airport revenue bonds outstanding after the series 2007 bonds are issued and the refunding of the series 1997B bonds occurs.

After the series 2007 bond issue, airport management is planning to issue approximately $331 million in additional debt in 2009, assuming the airport receives airline approval. If approved, the majority of the series 2009 bond proceeds will be used to finance the expansion of Terminal F and a baggage system for terminals B and C.

Beyond the 2009 bond issue is the airport's multibillion-dollar airfield capacity enhancement program (CEP). Estimated funding sources for the airport's CEP currently include Airport Improvement Program (AIP) entitlement grants, AIP discretionary grants, PennDOT grants, PFC revenues used on a pay-as-you-go basis, PFC-backed bonds, internally generated funds, third party financing, and revenue bond financing. The period over which the CEP will be financed will not be determined until the reauthorization of AIP and PFC funding occurs. Standard & Poor's expects a more detailed plan of finance for the CEP at the time of the 2009 bond issue.

The airport's cost structure is forecasted to steadily increase to $11.55 in 2012 from about $8.20 in 2008. The airport's debt structure is also expected to increase but remain manageable as a result of the 2007 bond issue and the 2009 bond issue. Based on an estimated 15.8 million enplanements for fiscal 2007, debt per enplanement is approximately $84 after this bond issue and $102 if the airport was to issue the 2009 bonds now.

The airport has been assigned a Standard & Poor's Debt Derivative Profile (DDP) score of '1' on a scale of '1' to '4', with '1' representing the lowest risk and '4' the highest. The overall DDP score of '1' indicates that the swaps are a minimal risk. The DDP score incorporates one floating-to-fixed-rate swaption that was exercised on June 15, 2005. If market conditions are favorable, the airport will issue the series 2007B bonds as auction-rate securities and synthetically fix 100% of the series 2007B bonds with a BMA swap. If the airport was to enter into this proposed BMA swap, the resulting overall DDP score would remain at '1', based on Standard & Poor's review of draft terms of the proposed swap. The airport's net variable-rate percentage is below 4%, which is considered manageable.

Outlook

The stable outlook reflects the expectation that the airport's large O&D market and improved competitive position will continue to produce favorable enplanement trends, allowing the airport to sustain its improved financial profile. The stable outlook is also predicated on management prudently handing the growth of the airport and its ensuing capital planning pressures while maintaining a moderate cost structure.

Airport Description

The airport system consists of Philadelphia International Airport and the Northeast Philadelphia Airport; it is owned by the city and operated by the Division of Aviation. The Federal Aviation Administration (FAA) classifies the Philadelphia International Airport as a large air traffic hub. According to the Airport Council International, the airport ranked 16th among U.S. airports in passenger traffic for calendar year 2006, serving a total of approximately 31.8 million total passengers that year. Northeast Philadelphia Airport currently has no scheduled commercial service and has historically operated at a loss.

Philadelphia International Airport occupies approximately 2,302 acres and is located about eight miles from Center City, Philadelphia's downtown area. The airport currently has four runways, including two parallel runways (9R-27L and 9L-27R) that stretch 10,500 feet and 9,500 feet; a 5,400-foot-long crosswind runway (17-35); and a 5,000-foot-long commuter runway (8-26). The maximum capacity of the existing runway configuration is about 616,000-620,000 annual operations. For calendar 2006, annual operations totaled 515,000. Presently, Philadelphia is the fourth most delayed U.S. airport (behind Newark, LaGuardia, and Chicago O'Hare), with an average delay of 10.3 minutes per operation. The passenger terminal complex, which consists of seven terminal units, provides a total of approximately 2.4 million square feet of space and 120 aircraft parking positions and gates.

All food, beverage, and retail concessions in the terminal buildings are managed and operated under a management agreement between the city and Marketplace Redwood Limited Partnership. The management agreement extends through 2013. The agreement covers the development and management of approximately 115,000 square feet of public food, beverage, and retail concession space in the passenger terminals. Revenues received by the city from Marketplace Redwood consist of a minimum annual guarantee plus a graduated profit-sharing amount. The minimum annual guarantee is calculated on the basis of the number of enplaned passengers in terminals A-East through E and is as high as $0.71 for each enplaned passenger past 11 million. The profit-sharing amount is calculated for food, beverage, duty-free, and retail gross sales as a percentage according to a graduated scale. In fiscal 2006, the city received $11.8 million, of which $7.0 million was the minimum annual guarantee and $4.8 million was from profit sharing.

A 50-acre site north of the terminal complex, designated as the outside terminal area, accommodates the parking garages, a 420-room Marriott hotel, rental car storage and maintenance sites, commercial ground transportation, and other facilities.

Public automobile parking facilities at the airport are operated by the Philadelphia Parking Authority, which is responsible for airport parking under the provisions of a contract and lease agreement that extends to 2030. On-airport public parking facilities consist of approximately 11,500 spaces across five multistory garages and surface lots and a 6,000-space remote surface lot. In addition, approximately 17,000 parking spaces are provided off airport property by private operators. The

Division of Aviation and the Philadelphia Parking Authority intend to provide approximately 1,000 additional surface spaces in 2007. The city received $33 million in net parking revenues for fiscal 2007. Net parking revenues are gross parking revenues (after a 15% city tax) less direct operating expenses, allocated authority administrative expenses, and debt service on bonds issued by the authority for airport parking facilities.

Seven car rental companies (Avis, Budget, Dollar, Enterprise, Hertz, National, and Alamo) serve the airport. These seven rental car companies operate under the terms of a city commercial ground transportation regulation that requires companies to pay a concession fee of 10% of gross revenues plus ground rent for their facilities. Concession fees from Avis, Budget, Dollar, Hertz, and National are allocated to the terminal building cost center, while concession fees from Alamo and Enterprise are allocated to the OTA cost center. The ground rent from all seven rental car companies, as provided for in leases expiring in 2009, is allocated to the OTA cost center.

The airport serves as an international air cargo hub for UPS Air Cargo. UPS Air Cargo occupies a 210-acre site at the south side of the airport, on which the company operates its East Coast package handling and sorting hub from a 670,000-square-foot building.

General and business aviation facilities are located on a 30-acre area on the east side of the airport. Commercial fixed-base operator services are provided by Atlantic Aviation. Approximately 30 general aviation aircraft are based at the airport. Approximately 25,000 general aviation operations (landings and takeoffs) occur annually.

The Northeast Philadelphia Airport provides for general aviation, air taxi, corporate, and occasional military use. The airport is located on a 1,150-acre site about 13 miles northeast of Center City, Philadelphia. Approximately 215 aircraft are based at the airport, which has two runways, one 7,000 feet long and the other 5,000 feet long. The airport handles approximately 110,000 general aviation operations annually.

Air Travel Demand: Strong

Philadelphia International Airport has enjoyed relatively strong air travel demand historically. More specifically, over the past 10 fiscal years, enplanements at the airport grew an average of 6.6% annually, outpacing the 2.8% national average over that same period.

Over the past five fiscal years, enplanements have increased 4.7% on average per year, despite US Airways entering into and emerging from bankruptcy twice, rising jet fuel prices, and a nationwide softening in air travel demand that occurred due to the effects of Sept. 11, 2001. In fiscals 2004 and 2005, enplanements increased 7.8% and 18.4%, respectively, resulting in enplanement levels surpassing pre-September 2001 historical highs in fiscal 2004. The airport's large O&D market, US Airways' continued commitment to operate a major hub at the airport, limited competition from other major airports, and the expansion of Southwest Airlines contributed to the airport's recent strong growth in enplanements. Enplanements in fiscal 2006 reached 15.6 million, a new historical peak. Enplanements have continued to rise in the first 11 months of fiscal 2007, and are up 1.7% from the same period in fiscal 2006.

Until fiscal 2004, the number of connecting passengers increased at a higher rate than the number of originating passengers as a result of the development of the airport as a US Airways hub. Since 2004, when Southwest Airlines initiated service in Philadelphia, the airport's growth in O&D passengers has been strong and the airport's competitive position has improved. As a result of Southwest Airlines presence, average airfares at Philadelphia International Airport have decreased, causing an increase in air travel demand due, in part, to capturing some business away from Baltimore-Washington International Airport. The strong growth in O&D passengers is attributable to a combination of a reduction in average airfares at the airport, added service by Southwest Airlines and US Airways, and limited competition from other airports. For fiscal 2005, the first full year of Southwest service, originating passenger numbers increased 24% as average domestic airfares decreased 19%. Since fiscal 2005, the number of originating passengers at Philadelphia has exceeded the number of originating passengers at Baltimore (see Chart 1).

Chart 1

From fiscals 2007-2012, enplanements are forecasted to grow 2.8% on average per year, which is considered reasonable since enplanements over the past five years and past 10 years experienced average annual growth rates of 4.7% and 6.6%, respectively.

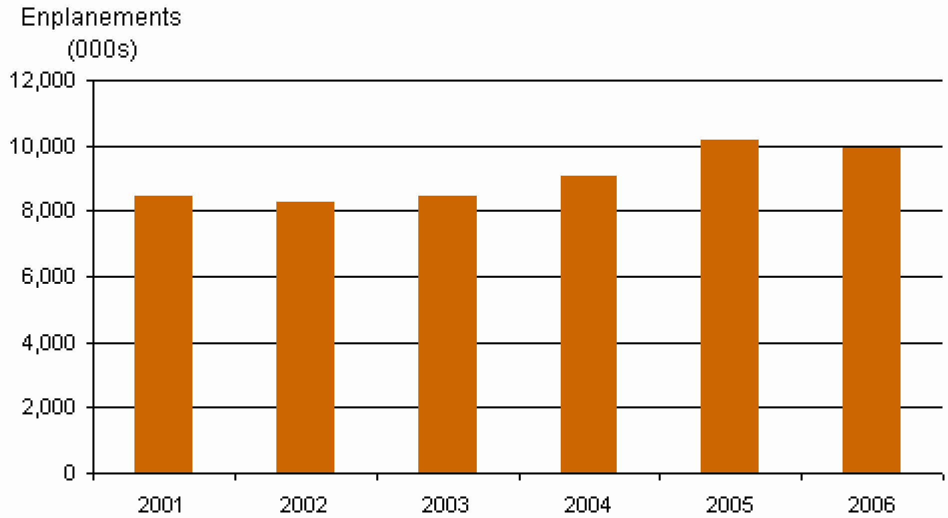
US Airways

US Airways, along with US Airways Express, still remains the airport's dominant passenger carrier, despite Southwest Airlines' expansion into the Philadelphia market. From fiscals 2003-2006, US Airways and US Airways Express' share of total enplaned passengers has gradually declined to 64% from about 70%. In fiscal 2006, US Airways enplaned 9.9 million passengers, of which 4.4 million were originating (45% of the airport's total originating passengers) and 5.5 million were connecting (96% of the airport's total connecting passengers). Despite US Airways' financial challenges over the past few years, it has demonstrated a strong commitment to the airport by maintaining its hub operations. Philadelphia serves as US Airways' primary northeast connecting hub and the airline's international gateway airport. In fiscal 2006, US Airways and US Airways Express accounted for about 79% of the airport's two million international enplanements and 61% of the airport's 13.6 million domestic enplanements.

US Airways' merger with America West Airlines became effective upon US Airways Group's emergence from bankruptcy on Sept. 27, 2005. Following the merger, America West Holdings continued as a wholly owned subsidiary of US Airways Group. Before the merger, America West operated its route system through a hub-and-spoke network centered on its Phoenix and Las Vegas hubs. US Airways' major connecting hubs before the merger were at airports in Charlotte and Philadelphia. US Airways also had substantial operations at Logan International Airport in Boston, New York's LaGuardia Airport, Pittsburgh International Airport, and Ronald Reagan Washington National Airport. Following the merger, Charlotte, Philadelphia, and Phoenix remained primary hubs of the combined company. The combined company also retained secondary hubs/focus cities in Pittsburgh; Las Vegas; New York; Washington, D.C.; and Boston. The combined company offers approximately 4,000 flights daily to 240 communities in the U.S., Canada, the Caribbean, Latin America, and Europe. US Airways also has an established East Coast route network, including the US Airways shuttle service at New York's LaGuardia Airport and the Washington, D.C., area's Ronald Reagan Washington National Airport (see Chart 2).

Chart 2

Historical US Airways Enplanement Trends At Philadelphia International Airport*



*Fiscal year ending June 30.

Southwest Airlines

Since 2004, when Southwest began service at Philadelphia, fare competition at the airport has resulted in reduced average airfares and increased air travel, both by passengers who otherwise would have used competing airports and by those who would not have traveled by air. In fiscal 2001, average airfares at the airport were 51% higher than those at Baltimore; in fiscal 2006, they were 17% higher. Since fiscal 2005, the number of originating passengers at Philadelphia has exceeded the number of originating passengers at Baltimore.

In fiscal 2006, Southwest Airlines flights handled approximately 9% of the airport's total enplanements and 12% of the airport's total originating passengers. Southwest has the second largest share of the market, behind US Airways and US Airways Express.

Air Service Area Economy

The airport serves a broad geographic area that spans four states, including Pennsylvania, New Jersey, Delaware, and Maryland. The primary service region of the airport is made up of 11 counties, consisting primarily of the Philadelphia-Camden-Wilmington, Pa.-N.J.-Del.-Md. MSA. The 11 counties include Bucks, Chester, Delaware, Montgomery, and Philadelphia counties in Pennsylvania; Burlington, Camden, Gloucester, and Salem counties in New Jersey; Cecil County in Maryland; and New Castle County in Delaware.

The airport's 11-county service region had an estimated population of approximately 5.8 million in 2006. Since 1980, the rate of population increase in the region has been lower than that of the nation as a whole. Although population growth has been relatively flat, the airport system benefits from serving a region with a per capita personal income that has been historically higher than the national average.

The Philadelphia regional economy is highly diversified, with an emphasis on health care services, pharmaceutical manufacturing, aerospace manufacturing, education services, and transportation services. This diversity buffers the region during economic downturns. Education and health services represent 18% of metropolitan area jobs. Growth prospects are good for the metropolitan area's core of knowledge-based industries (which include health services, pharmaceuticals, education, and biotechnology), chiefly due to a highly educated workforce drawn from suburban areas. With 45 hospitals and seven medical schools, the area is one of the largest health care centers in the world and is home to more than 80 degree-granting institutions of higher education. Hospitals employ more than 110,000 workers, while private colleges and universities employ roughly 56,000. Leading private employers in the metropolitan area include the Jefferson Health System (27,200 employees), the Philadelphia school district (26,800), the University of Pennsylvania (21,000), Merck and Company (12,000), the University of Pennsylvania Health System (11,200), and United Parcel Service (10,300).

Competitive Position

The airport benefits from the lack of nearby competing facilities--no major airport exists within a one-hour drive of the airport. Baltimore/Washington International Airport (102 miles to the southwest) and Newark Liberty International Airport (106 miles to the northeast) are Philadelphia International Airport's primary competing airports. These two airports define the boundaries of the airport's primary service region. Both airports offer comparable levels of service. Baltimore, a Southwest Airlines hub, is particularly competitive. Competing connecting hub airports located near Philadelphia include Newark Liberty (Continental Airlines) and Washington Dulles (United Airlines). Airports in Allentown, Pa.; Harrisburg, Pa.; Atlantic City, N.J.; and Trenton, N.J. do not pose any significant threat to Philadelphia, since each has limited capacity.

Airline Use Agreement

As of July 1, 2007, a new airline agreement has been executed by Philadelphia International Airport's airlines, which account for more than 80% of the passengers at the airport. The new airline agreement provides discretionary cash flow and reserves; a streamlined majority-in-interest (MII) approval process; conversion of all exclusive-use gates to common or preferential use; and consolidation of 10 cost centers to seven.

Changes under the new airline lease agreement will allow the airport to accumulate funds available for debt service, which are forecasted to grow to $63.2 million in fiscal 2012 from $48.8 million in fiscal 2008. These funds alone are projected to cover estimated annual debt 0.47x-0.58x over the forecast period.

Under the airline agreement, capital expenditures are approved by the signatory airlines unless they are specifically disapproved by an MII. For projects affecting terminal area rentals, fees, and charges, MII is defined as more than 50% of the passengers enplaned at the airport during the preceding calendar year. For projects affecting airfield area fees and charges, MII is defined as more than 50% of landed weight at the airport during the preceding calendar year. In each case, the number of signatory airlines must be no less than two, which together account for more than 50% of enplaned passengers or landed weight, depending on whether the capital project is related to the landside or airside. MII approval obligates the signatory airlines to pay rentals, fees, and charges as required to enable the city to comply with the rate covenant.

Under the previous airline agreement, most of the gates at the airport were leased to airlines for their exclusive use. Under the new airline agreement, to improve the use of gates, airport management has prudently decided to lease all gates on a preferential-use basis or common-use basis. The airport can accommodate the proposed operations of an airline by using another airline's preferential-use premises if it cannot accommodate the proposed operations on a common-use basis and if the use by the requesting airline does not disrupt other airline's operations. Furthermore, the airport may reallocate a portion of any signatory airline's leased premises if such signatory airline does not maintain a minimum use requirement, which ranges between 4.25 departures per gate per day for a signatory airline leasing only one gate to 5.00 departures per gate per day for signatory airlines leasing four or more gates.

Like the previous agreement, this new airline agreement, which extends through fiscal 2011, employs a fully residual rate-setting methodology.

Legal Provisions

Although the definition of the project revenues has changed to include revenues and expenses related to the airport's outside terminal area and overseas terminal, effective July 1, 2007 (fiscal 2008), the legal provisions are still considered relatively weak. They include a rate covenant and projected additional bonds test that incorporate unlimited rolling tests, allowing the airport flexibility to achieve rate covenant compliance or incur additional debt, despite producing low coverage based on pledged operating revenues net of all fixed charges.

Net project revenues of the airport system secure the bonds. The airport system consists of the Philadelphia International Airport (the airport) and the Northeast Philadelphia Airport; the system is owned by the city and operated by the Division of Aviation of the city's Department of Commerce. Project revenues are revenues derived from the airport systems, net of net operating and maintenance expenses. Revenue derived from the outside terminal area (which is mostly automobile parking revenues) and from the overseas terminal will become part of project revenues effective July 1, 2007, pursuant to amendments made to the seventh supplemental ordinance to the amended and restated general airport revenue bond ordinance. This enhancement to pledged project revenues is viewed favorably by Standard & Poor's because it increases the diversity of revenues that secure the airport's bonds. A portion of PFCs is also pledged to pay debt service related to the airport's series 2001A and 1998B bonds. Net operating and maintenance expenses are net of interdepartmental charges, which are subordinate to debt service.

The bonds are also secured by a sinking fund reserve account with a reserve requirement equal to the lesser of MADS or the maximum amount permitted by the Internal Revenue Code of 1986.

The rate covenant allows unlimited rolling coverage by which rates and charges can be set so that any amounts remaining from the previous year can be carried forward and counted together with amounts available for debt service (which includes net project revenues, pledged PFCs, carryover amounts, and other available funds) in the current fiscal year. This coverage must at least equal the greater of one of the two summed amounts:

- Net operating expenses plus 1.50x senior lien debt service plus any amounts required to be paid into the reserve account plus any amounts required to be paid into the renewal fund, or
- All operating expenses plus all debt service requirements (exclusive of GO bonds and not self-sustaining GO bonds issued for improvements to the outside terminal area and the overseas terminal, unless revenues from these areas are pledged in a supplemental ordinance) plus any amounts paid into the reserve account plus any amounts paid into the renewal fund plus all amounts required to be paid under exchange agreements.

Since the rate covenant imposes no limit on carryover amounts and fund balance amounts that can be used to satisfy the rate covenant, it allows the airport the flexibility to achieve rate covenant compliance, while producing low coverage based on pledged operating revenues net of all fixed charges.

The airport may issue additional parity debt as long as historical and projected tests are met. The historical test requires that pledged amounts available for debt service (including carryover amounts, pledged PFCs, and other available funds) from either the immediately preceding fiscal year of the city or any period of 12 full consecutive months during the 18-month period preceding the delivery of the consultants' reports is sufficient to satisfy the rate covenant. The projected test requires that the amount available for debt service for each of the five fiscal years immediately following the issuance of the bonds is sufficient to comply with the rate covenant. In the event that the consultant is professionally unable to provide an opinion for a period in excess of three fiscal years, the projected test requires the amount available for debt service for each of the three fiscal years immediately following the issuance of the bonds to be sufficient to comply with the rate covenant. Since the additional bonds test imposes no limit on how much carryover funds or fund balances can be used to satisfy the rate covenant, it allows the airport the flexibility to incur additional debt while producing low coverage based on pledged operating revenues net of all fixed charges.

The priorities for applying project revenues and other amounts on deposit in the aviation operating fund are as follows:

- Payment of operating expenses net of interdepartmental charges,
- Deposit to the sinking fund to pay the debt service for the airport's revenue bonds,
- Restoration of any deficiency in the debt service reserve account,
- Restoration of any deficiency in the renewal fund and payment of any amounts due under exchange agreements,
- Payment of any swap termination amounts,
- Payment of debt service on any subordinate obligations,
- Payment of debt service on GO bonds,
- Payment of interdepartmental charges, and
- Payment of debt service on non-self-sustaining GO bonds.

Under the general ordinance, any remaining balance may be used by the city for any airport system purpose. Under the airline agreement, beginning in fiscal 2008, any remaining balance is to be applied as follows:

- The amount required to maintain a balance in the bond redemption and improvement account, which is equal to at least 15% of debt service requirements in fiscal 2009, 20% in fiscal 2010, and 25% thereafter (the bond redemption and improvement account balance, as of July 1, 2007, was $16.8 million);
- The amount required to maintain a balance in the operations and maintenance account, which is equal to 10% of operating expenses (the operations and maintenance account balance, as of July 1, 2007, was $15.0 million); and
- Fifty percent of net revenues from the OTA cost center in excess of $7.0 million, to be credited in the annual calculation of signatory airline landing fees, which is identified as the airline revenue allocation.

Any remaining funds are to be deposited to the airport discretionary account and may be used by the city for any airport system purpose.

The changes airport management has made to the general airport revenue bond ordinance and new airline agreement are viewed favorably by Standard & Poor's since they provide improved coverage and additional funds available for debt service. Revisions made to subsequent airline agreements that would retract from these enhancements would be viewed negatively by Standard & Poor's.

Finances

As a result of steadily increasing air travel demand, the airport has produced stable financial results on a consistent basis. From fiscals 2003-2006, total fixed charge coverage (as calculated by Standard & Poor's) has been maintained close to 1x and is estimated to remain close to 1x for fiscal 2007. If interdepartmental charges (which are subordinate to debt service) are excluded from the calculation, coverage ranges from 1.5x-1.7x for fiscals 2003-2006 and is estimated to be 1.8x. The airport's cost structure has also maintained moderate cost structure and manageable debt load for a large hub. From fiscals 2003-2006, the airport's cost per enplanement averaged less than $8. For fiscal 2007, the airport's cost structure is expected to remain a moderate $7.45. Based on an estimated 15.8 million enplanements for fiscal 2007, the airport's debt per enplanement is a manageable $73. The airport has maintained an unrestricted cash position that has provided almost 200 days' cash on hand, on average, for fiscals 2003-2006.

As a result of the airport deciding to include revenues generated by the OTA and overseas terminal as part of project revenues and taking steps to ensure higher levels of liquidity over time, the airport's financial profile is expected to improve from fiscals 2008-2012 (the forecast period). These changes will become effective July 1, 2007 (the beginning of fiscal 2008). Net OTA revenues are forecasted to gradually increase to about $17.8 million in fiscal 2012 from about $12.1 million in fiscal 2008. The combination of including revenues and costs allocated to the airport's OTA and changes under the new airline lease agreement will allow the airport to accumulate funds available for debt service, which are forecasted to grow to $63.2 million in fiscal 2012 from $48.8 million in fiscal 2008. These funds alone are projected to cover estimated annual debt 0.47x-0.58x over the forecast period. Based on reasonable forecasts, total fixed charge coverage (as calculated by Standard & Poor's) is expected to range from 1.12x-1.15x over the forecast period; if the estimated combined balance of funds available for debt service is included, coverage is no lower than 1.6x. If interdepartmental charges (which are subordinate to debt service) are excluded from the calculation, coverage ranges from 1.8x-2.0x over the forecast period; if the estimated combined balance of funds available for debt service is included, coverage is no lower than 2.3x over the forecast period.

The cost structure is forecasted to steadily increase to $11.55 in 2012 from about $8.20 in 2008. The airport's debt structure is also expected to increase, but remain manageable, as a result of the 2007 bond issue and a $331 million 2009 bond issue. Based on an estimated 15.8 million enplanements for fiscal 2007, debt per enplanement is approximately $84 after this bond issue and a still-manageable $102 if the airport was to issue the 2009 bond issue now (see tables 1 and 2).

Table 1

Historical Financial And Operational Statistics For Philadelphia International Airport

	--Fiscal year ending June 30--				
	2003	**2004**	**2005**	**2006**	**2007e**
Demand and market ratios					
Fiscal year enplanements (000s)	12,137	13,089	15,491	15,575	15,800
Year-over-year change (%)	1.1	7.8	18.4	0.5	1.4
O&D enplanements (%)	60.0	60.4	63.1	63.5	63.9
US Airways enplanements market share (%)	69.6	69.2	65.8	63.5	N.A.
Cost per enplaned passenger ($)	7.53	9.09	7.44	6.64	7.45
Passenger airline revenue to total operating revenue (%)*	49.9	59.5	53.2	44.6	51.9
Debt service coverage					
Project revenues ($000s)	168,324	183,307	185,127	200,787	214,813
PFCs pledged to GARB debt service ($000s)	31,234	32,777	32,908	32,592	32,921
Funds available for indenture debt service coverage ($000s)	199,558	216,084	218,035	233,379	247,734
Standard & Poor's adjustment: Deduct excess revenue carried forward from previous year ($000s)	28,341	17,768	18,688	22,876	9,621
Standard & Poor's adjustment: Add back excess revenue carried forward to subsequent year ($000s)	17,768	18,688	22,876	9,621	N/A
Funds available for debt service coverage per S&P adjustments ($000s)	188,985	217,004	222,223	220,124	238,113
Operating expenses net of interdepartmental charges ($000s)	66,977	71,863	71,348	77,152	84,552
Interdepartmental charges ($000s)	46,147	52,218	57,555	57,860	67,317
All operating expenses ($000s)	113,124	124,081	128,903	135,012	151,869
Net available for Standard & Poor's debt service coverage	122,008	145,141	150,875	142,972	153,561

($000s)-1.50x test ¶					
Net available for Standard & Poor's debt service coverage ($000s)-1.00x test §	75,861	92,923	93,320	85,112	86,244
Annual GARB debt service ($000s)	83,175	89,653	88,081	88,126	84,533
Annual GO debt service ($000s)	1,436	1,051	1,051	N/A	N/A
Indenture debt service coverage (x)-1.50x test	1.59	1.61	1.67	1.77	1.93
S&P debt service GARB coverage (x)-1.50x test	1.47	1.62	1.71	1.62	1.82
Indenture debt service coverage (x)-1.00x test	1.02	1.01	1.00	1.12	1.13
Standard & Poor's debt service GARB coverage (x)-1.00x test	0.90	1.02	1.05	0.97	1.02
Debt ratios					
GARB debt outstanding ($000s)	1,129,202	1,092,888	1,101,720	1,191,210	1,161,410
GARB debt per enplaned passenger ($)	93.04	83.50	71.12	76.48	73.51
GARB debt per O&D enplaned passenger ($)	155.06	138.24	112.71	120.44	115.03
Liquidity ratios					
Unrestricted cash and investments from audit ($000s)	57,882	71,171	89,937	94,912	N.A.
Days' unrestricted cash on hand	161.73	187.14	219.18	219.20	N.A.
Unrestricted cash and investments to GARB debt (%)	5.1	6.5	8.2	8.0	N.A.

e-estimate. N.A.-not available. N/A-not applicable. *Passenger airline revenue to total operating revenue is slightly overstated because total operating revenues include net automobile parking revenues. ¶1.50x test excludes interdepartmental charges. §1.00x test includes interdepartmental charges.

Table 2

Projected Financial And Operational Statistics For Philadelphia International Airport

	--Fiscal year ending June 30--					
	2007e	**2008f**	**2009f**	**2010f**	**2011f**	**2012f**
Demand and market ratios						
Fiscal year enplanements (000s)	15,800	16,500	17,200	17,600	18,000	18,400
Year-over-year change (%)	1.4	4.4	4.2	2.3	2.3	2.2
O&D enplanements (%)	63.9	63.6	63.4	63.6	63.9	64.1
Cost per enplaned passenger ($)	7.45	8.20	8.58	8.89	9.76	11.55
Debt service coverage						
Project revenues	204,813	249,632	270,351	285,935	310,009	353,326
PFCs pledged to GARB debt service ($000s)	32,921	32,926	33,027	33,096	33,043	33,047
Other amounts available for debt service ($000s)	10,000	48,815	50,262	52,291	55,015	63,178
Funds available for indenture debt service coverage ($000s)	247,734	331,373	353,640	371,322	398,067	449,551
Standard & Poor's adjustment: Deduct excess revenue carried forward from previous year ($000s)	9,862	-401	2,455	3,200	4,335	4,493
Standard & Poor's adjustment: Deduct other amounts available for debt service ($000s)	10,000	48,815	50,262	52,291	55,015	63,178
Funds available for debt service coverage per Standard & Poor's adjustments ($000s)	227,872	282,959	300,923	315,831	338,717	381,880
Operating expenses net of interdepartmental charges ($000s)	84,552	114,018	113,474	120,657	128,657	134,786
Interdepartmental charges ($000s)	67,317	71,630	80,647	84,871	88,839	92,993
All operating expenses ($000s)	151,869	185,648	194,121	205,528	217,496	227,779
Net available for Standard & Poor's debt service coverage ($000s)-1.50x test *	143,320	168,941	187,449	195,174	210,060	247,094
Net available for Standard & Poor's debt service coverage ($000s)-1.00x test ¶	76,003	97,311	106,802	110,303	121,221	154,101
Annual GARB debt service ($000s) §	84,533	84,001	94,858	96,834	107,920	134,647
Indenture debt service coverage (x)-1.50x test	1.93	2.59	2.53	2.59	2.50	2.34
Standard & Poor's debt service GARB coverage (x)-1.50x test	1.70	2.01	1.98	2.02	1.95	1.84
Indenture debt service coverage (x)-1.00x test	1.13	1.73	1.68	1.71	1.67	1.65

Standard & Poor's debt service GARB coverage (x)-1.00x test	0.90	1.16	1.13	1.14	1.12	1.14

e-estimate. f-forecasted. *1.50x test excludes interdepartmental charges. ¶1.00x test includes interdepartmental charges. §Includes debt service for planned 2009 bond issue.

Capital Improvement Program

The Division of Aviation maintains an ongoing six-year CIP for the airport system. The 2007 project represents the next phase of an ongoing process of expanding and modernizing airport facilities to keep pace with increasing traffic demand and changes in the air transportation system. Elements of the 2007 project--expected to be funded with a portion of the proceeds of the 2007A bonds--include the reconfiguration of aircraft gates at Terminal A-West, design for the expansion and renovation of Terminal F, design for upgraded baggage system for terminals B and C, an infrastructure improvement program, terminal upgrades, operational upgrades, and a land acquisition program (see Table 3).

Table 3

The 2007 Project

Project elements ($000s)	Total project costs	Series 2007A bonds	% funded from 2007A bonds
Projects related to Terminals A-West, B-C design, and F design	44,200	44,200	100
Infrastructure improvement program	83,000	79,000	95
Terminal facility and operational upgrades	25,000	17,500	70
Land acquisition	30,000	7,500	25
Total 2007 project	182,200	148,200	81

After the series 2007 bond issue, airport management plans to issue approximately $331 million in additional debt in 2009, assuming the airport receives airline approval. If approved, the majority of the series 2009 bond proceeds will be used to finance the expansion of Terminal F and a baggage system for terminals B and C (see Table 4).

Table 4

The 2009 Project

Project elements ($000s)	Total project costs	Series 2009 bonds	% funded from 2009 bonds
Terminal F expansion and Terminal B-C baggage system	248,900	198,900	80
Taxiways	60,000	15,000	25
Runway 9L-27R resurfacing and navigational aids	23,000	8,500	37
Airport maintenance facility	10,000	10,000	100
Central utility plant	8,000	8,000	100
Total 2009 project	349,900	240,400	69

Beyond the 2009 bond issue is the airport's multibillion-dollar airfield capacity enhancement program (CEP), which will reduce delays and accommodate future growth. Commencement of the CEP is tied to conclusion of the Environmental Impact Statement (EIS) process that would be done following receipt of a Federal Aviation Administration (FAA) record of decision (ROD), which the airport currently expects to receive in late 2009. All debt service related to this project would begin after the current forecast period, which ends in 2012. Estimated funding sources for the airport's CEP currently include AIP entitlement grants, AIP discretionary grants, PennDOT grants, PFC revenues used on a pay-as-you-go basis, PFC-backed bonds, internally generated funds, third party financing, and revenue bond financing. Other than debt service on the 1998B and 2001A bonds, PFC revenues at the airport are largely unencumbered after fiscal 2011. The period over which these projects are to be financed has not been determined until AIP and PFC reauthorization has been decided. The city will likely present a more detailed plan of finance at the time of the 2009 bond issue.

Debt Derivative Profile: '1'

The airport has been assigned a Standard & Poor's DDP score of '1' on a scale of '1' to '4', with '1' representing the lowest risk and '4' the highest. The overall DDP score of '1' indicates that the swaps are a minimal risk. The current overall DDP score of '1' reflects strong collateralization requirements; the high economic viability of the swaps; very good management practices and procedures that are supported with formal swap management policies; and a moderate degree of termination risk and collateral risk due to relatively wide rating trigger spreads, despite the long maturity of the swaps. The DDP score incorporates one floating-to-fixed-rate swaption that was exercised on June 15, 2005.

The airport's floating-to-fixed-rate swaption currently relates to $182.7 million of the airport's series 1995A first-lien general airport revenue bonds (GARBs), which the airport entered into with JPMorgan Chase Bank N.A. (AA/Stable/A-1+). The airport received an option premium of about $6.5 million from JPMorgan in April 2002, when the airport entered into the swaption with JPMorgan. JPMorgan exercised its option to put the airport into a swap for the 1995A GARBs, which became callable on or around June 15, 2005.

Under the terms of the swap, the airport pays multiple synthetic fixed rates (starting at 6.466% and decreasing over the life of the swap to 1.654%), while JPMorgan pays a floating rate equal to the BMA Municipal Swap Index. On or after June 15, 2007, JPMorgan has the option to terminate the swap if the daily weighted average of the BMA Municipal Swap Index exceeds 7.0% for 180 days before the exercise date. JPMorgan exercising its termination option, however, has limited downside risk due to its high interest-rate barrier. Net swap payments and termination payments are each on parity with the airport's first-lien GARBs.

If market conditions are favorable, the airport will issue the series 2007B bonds as auction-rate securities and synthetically fix 100% of the series 2007B bonds with a BMA swap. If the airport were to enter into this proposed BMA swap, the resulting overall DDP score would remain at '1', based on Standard & Poor's review of draft terms of the proposed swap.

The airport's net variable-rate percentage is below 4%, which is considered manageable.

Contacts

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Ratings Detail (As Of 08-Aug-2007)

Philadelphia, Pennsylvania		
Philadelphia International Airport, Pennsylvania		
Philadelphia (Philadelphia Arpt) (MBIA)		
Unenhanced Rating	A+(SPUR)/Stable	Upgraded
Philadelphia (Philadelphia Arpt) VRDB ser 2005B (MBIA)		
Long Term Rating	AAA/A-1+/Stable	Affirmed
Unenhanced Rating	A+(SPUR)/Stable	Upgraded
Philadelphia (Philadelphia Arpt) VRDB ser 2005C (MBIA)		
Long Term Rating	AAA/A-1+/Stable	Affirmed
Unenhanced Rating	A+(SPUR)/Stable	Upgraded
Philadelphia (Philadelphia Arpt) (AMBAC)		
Unenhanced Rating	A+(SPUR)/Stable	Upgraded
Philadelphia Auth for Indl Dev, Pennsylvania		
Philadelphia International Airport, Pennsylvania		
Philadelphia Auth for Indl Dev (Philadelphia Arpt Sys) (FGIC)		
Unenhanced Rating	A+(SPUR)/Stable	Upgraded
Philadelphia Auth for Indl Dev (Philadelphia Arpt Sys) (MIRROR BONDS) (FGIC)		
Unenhanced Rating	A+(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

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