S&P Global Ratings

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Summary:

Philadelphia International Airport Philadelphia; Airport; Joint Criteria

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Summary:

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Credit Profile		
Philadelphia, Pennsylvania		
Philadelphia International Airport, Pennsylvania		
Philadelphia (Philadelphia International Airport)		
Long Term Rating	A-/Negative	Downgraded, Removed from CreditWatch

Rating Action

S&P Global Ratings lowered its long-term rating and underlying rating (SPUR) to 'A-' from 'A' on Philadelphia's airport revenue bonds outstanding, issued for Philadelphia International Airport (PHL), and removed the rating from CreditWatch, where it had been placed with negative implications on Aug. 7, 2020. The outlook is negative.

At the same time, we lowered to 'AA/A-1' from 'AA+/A-1' our joint rating on the airport's parity variable-rate demand bonds series 2005C, of which approximately $74.1 million is outstanding. The rating reflects the application of joint criteria (assuming low correlation) of S&P Global Ratings' SPUR on PHL and the direct-pay, irrevocable letters of credit from Wells Fargo Bank N.A.

PHL, along with many other U.S. airports, had been placed on CreditWatch to reflect the material negative impact of the COVID-19 pandemic on traffic levels, expected financial performance metrics, and overall credit quality. For more information, see "U.S. Airport Ratings Placed On CreditWatch Negative On Severe Passenger Declines And Weakening Credit Metrics," published Aug. 7, 2020.

The city of Philadelphia operates PHL and the Northeast Philadelphia Airport, a small general aviation airport that operates at a loss. Together, they constitute the airport system. We consider PHL's consolidated financial results in our assessment. Net project revenues; amounts payable to the city under a qualified swap; and all amounts on deposit in, or credited to, some aviation funds secure the bonds. Project revenues include all revenues from system occupants and users. Net project revenues do not include interdepartmental charges, which we view as additional operating and maintenance expenses. As a result, we include them in our adjusted debt service coverage (DSC) calculations although they are subordinate to debt service under the general airport revenue bond ordinance. A portion of passenger facility charges is pledged to pay debt service for the airport's series 2010D, 2011A, and proposed 2020C bonds. If needed, the city also has access to a cash-funded debt service reserve account totaling $147.3 million as of June 30, 2020.

As of Aug. 31, 2020, the airport had approximately $1.6 billion in debt outstanding, consisting of $1.3 billion of airport revenue bonds, $180.3 million of commercial paper notes, and $118 million of taxable notes (direct purchase debt). It is our understanding that the city is issuing approximately $370 million of airport revenue and refunding bonds in the near term.

Credit overview

The rating action and negative outlook reflect our expectation that activity levels at PHL will be materially depressed, and also reflect our expectation of unpredictable or demonstrate anemic growth due to the COVID-19 pandemic and associated effects outside of management's control. In our view, the severe drop in demand has diminished PHL's overall credit quality and will likely pressure financial metrics relative to historical levels. We view this precipitous decline not as a temporary disruption with a relative rapid recovery, but as a backdrop for what we believe will be a period of sluggish air travel demand that could extend beyond our rating outlook horizon.

PHL entered the pandemic with generally favorable enplanement trends and steady financial results, with total enplaned passengers reaching an all-time peak (16.1 million), adequate DSC levels, and strong overall liquidity. However, enplanements for the first seven months of 2020 were 61% lower year over year; for July they were 72.5% lower year over year; and a high degree of uncertainty exists regarding the trajectory of a recovery in aviation activity, complicating financial planning and increasing operational challenges. For additional information, see "This Time Is Different: An Anemic And Uncertain Passenger Recovery Will Challenge U.S. Airports' Credit Quality, " published Aug. 7, 2020, and "Activity Estimates For U.S Transportation Infrastructure Show Public Transit And Airports Most Vulnerable To Near-Term Rating Pressure," published June 4, 2020, on RatingsDirect.

The SPUR reflects PHL's strong enterprise risk profile, adequate financial risk profile, and a positive holistic analysis adjustment to reflect the airport's relatively high activity levels historically, steady financial results through different economic conditions, limited competition, and importance to the American Airlines, Inc. system.

Our forward-looking view resulted from a weakening of PHL's market position assessment, which in turn lowered our enterprise risk profile assessment to strong from very strong. Under our criteria, market position is a primary credit factor that incorporates activity level trends, passenger volatility, rate-setting flexibility, and additional considerations outside of the operator's control including health scares. Within our overall enterprise risk profile, market position assessment is the highest weighted factor (60%), followed by industry risk (20%), economic fundamentals (10%), and management and governance (10%). Within our overall financial risk profile, we consider such factors as financial performance (55% weight), debt and liabilities capacity (35%), and liquidity and financial flexibility (10%). For additional information, see "U.S. And Canadian Not-For-Profit Transportation Infrastructure Enterprises: Methodologies And Assumptions," published March 12, 2018.

Our overall financial risk profile is unchanged at adequate, as we evaluate management's strategy and the shape of the traffic recovery along with the anticipated impact on financial metrics. Our financial risk profile assessment incorporates PHL's:

- Historically adequate financial performance, with 1.13x DSC in 2019 (S&P Global Ratings-calculated; 3.1x and 2.1x as calculated under the airport's general revenue bond ordinance, exceeding 1.0x and 1.5x [excluding interdepartmental charges] rate covenants);
- Comparatively higher airline cost structure and moderate debt burden ($14.34 cost per enplanement; $104 debt per enplanement--all for 2019);
- Strong debt capacity, with a debt-to-net revenue ratio of 12x and the need to debt-finance a portion of $738 million

in airline-approved capital improvement projects through fiscal 2026, of which a portion is financed with $246.8 million of existing debt and $283.4 million with additional debt; and

- Strong liquidity and financial flexibility (313 days' cash on hand and 14.5% of debt outstanding as of fiscal year ended June 30, 2019).

However, we anticipate the airport's financial performance (DSC), in fiscal years 2020 and 2021 will be lower than in recent years. Existing liquidity in concert with mitigation measures taken thus far to reduce outlays, and approximately $116 million in Coronavirus Aid, Recovery, and Economic Security (CARES) Act funding will allow PHL to weather the near-term activity decline. Management used $78.9 million of CARES Act money to pay debt service in fiscal 2020 and may use $18.2 million to pay a portion of operating expenses in fiscal 2021 and the remaining $19.4 million to pay a portion of operating expenses in fiscal 2022, depending on the rate of recovery.

PHL's experienced and skilled management team has taken a variety of actions to mitigate the collapse of passenger activity across the system that has negatively affected volume-based revenues, including those derived from concession as well as aeronautical revenues such as landing and international arrival fees. Such actions include reducing the scope of various contractual services; implementing a hiring freeze on noncritical positions; significantly limiting overtime work; suspending contractual labor rate increases; suspending all nonessential employee travel and other reimbursables; significantly reducing and limiting vehicle allowances; reducing salaries for non-civil service employees; and temporarily closing nonsecure portions of terminal facilities and continually evaluating temporary closures of other terminal facilities and reductions in personnel based on evolving operational demands. Management has also suspended minimum annual guarantees for all concessionaires, allowing agreed-upon percentages of gross revenues to be paid until airline traffic levels return to 70% of pre-COVID levels. In addition, management offered rate relief to concessionaires and airlines (for landing fees and terminal rental rates) for up to three months between February and July 2020 with repayment of such deferrals occurring from Sept. 1, 2020 through Dec. 31, 2020. Management has also deferred approximately $702 million of certain capital development projects, while advancing $738 million of others through fiscal 2026, unless traffic levels trend lower than forecast.

A recent airport consultant's report estimates fiscal 2020 enplanements totaling 11.8 million (26.4% lower than in fiscal 2019) and includes a baseline forecast that assumes enplanements dropping to 7.3 million in fiscal 2021 (54.6% lower than in fiscal 2019) before rebounding to 13.4 million in fiscal 2022 and to 16.8 million in fiscal 2023, slightly higher than 2019's traffic level. The report also included a low scenario, which assumes lower enplanements levels for fiscal years 2021-2026, with enplanements falling to about 5.3 million in fiscal 2021 before rebounding to almost 10 million in fiscal 2022 and reaching no higher than 15.3 million by fiscal 2026. Under the baseline forecast, DSC (S&P Global Ratings-calculated) for fiscal 2021 is weaker than historical levels before improving to levels comparable to levels maintained pre-COVID-19. Although the estimated financial effects appear to be manageable, projected impacts on key financial metrics are, in our view, subject to considerable uncertainty. We could weaken our assessment of the financial risk profile if enplanements remain depressed for an extended period, further pressuring financial metrics including DSC (S&P Global Ratings-calculated) and debt-to-net revenue.

Key credit strengths, in our opinion, include PHL's:

- Large-hub classification serving a large origin and destination market with favorable economic fundamentals that span 11 counties with limited competition and role as a key component of American Airlines' route system;

- Skilled and very strong management team that is effective and experienced in mitigating financial and operational risks;
- Historically steady financial performance; and
- Strong liquidity position, with $242.5 million for fiscal year ended June 30, 2019, providing above 300 days of operating costs and an unaudited unrestricted cash balance (excluding CARES Act money) totaling approximately $277 million as of June 30, 2020.

Key credit weaknesses, in our view, are PHL's:

- Exposure to potentially prolonged weak or unpredictable enplanement levels as a result of the ongoing COVID-19 pandemic and lingering ancillary effects (such as the pandemic-induced recession; shifting travel restrictions; stay-at-home and social distancing restrictions; or behavioral changes with respect to air travel, particularly business travel), which complicate budgeting and planning;
- Hampered cash flow generation ability, particularly derived from activity-based concession revenue sources and a weakened rate-setting environment;
- Relatively high airline concentration, with financially stressed American Airlines (B-/Negative/--), its largest carrier, accounting for 67% of fiscal 2020 total enplaned passengers; and
- Rising airline cost structure and debt metrics.

The airport is located partly in the southwestern section of the city of Philadephia and partly in the northeastern section of Delaware County, about 7.2 miles from Center City, Philadelphia. It has two parallel runways (one 12,000 feet long and one 9,500 feet long), a 6,501 crosswind runway, and a 5,000-foot commuter runway. PHL's passenger terminal complex provides a total of 3.3 million square feet of space and 126 aircraft gates. The airport has 18,940 public parking spaces, which will become part of the airport system in October 2020 as a result of the city exercising its option to purchase the airport parking facilities from the Philadelpia Parking Authority in August 2020. According to Airports Council International-North America data, in 2018, PHL ranked 20th in terms of total passengers in the U.S. For calendar 2019, the airport ranked as American Airlines' fifth busiest hub and largest transatlantic gateway.

Environmental, social, and governance factors

Our rating action reflects health and safety risks posed by the COVID-19 pandemic and its impact on passenger activity due to mobility restrictions and behavioral changes related to travel, which we view as a social factor within our environmental, social, governance factors, resulting in significant operating and financial pressures for PHL. We analyzed the airport's risks related to environmental and governance factors, and consider them to be in line with our view of the standard for the airport sector. We will continue to evaluate these risks as the situation evolves.

Negative Outlook

Downside scenario

We could lower the rating if we come to believe that PHL's enplanements will remain materially depressed for longer than we currently expect, negatively affecting financial metrics for an extended period.

Return to stable scenario

We could revise the outlook to stable in the next two years with improved clarity on the trajectory of PHL's enplanement recovery and stabilization of activity levels. When making this assessment, we will evaluate if management's ability to maintain financial metrics is achievable, sustainable, and consistent with the rating.

Credit Opinion

S&P Global Ratings acknowledges a high degree of uncertainty about the evolution of the pandemic and its effect on the economy and air travel. S&P Global Economics' current forecasts anticipate a slower recovery beginning in third-quarter 2020, ending at a negative 5.0% real GDP growth rate in 2020 and rebounding to 5.2% growth in 2021, a full percentage point weaker than its previous 2021 estimate of 6.2%. With this summer's national virus transmission rates rising to new peaks, uncertainty is elevated again. Several states had shut down parts of their economies and instituted new quarantine restrictions, which could possibly erode the bounceback in third-quarter 2020 real GDP growth of 22.2% (annualized). The recovery remains fragile--in particular, because of uncertainty about the timing of an effective vaccine being readily available, fears of another wave of COVID-19, and the reluctance of surviving businesses to quickly rehire workers. Our economic forecasts and macro credit implications associated with the pandemic assume a vaccine or effective treatment is widely available in the second half of 2021. (See "U.S. Economic Update: A Recovery At Risk As COVID-19 Surges," published July 22, 2020, and "Economic Research: U.S. Real-Time Economic Data Continues To Paint A Mixed Picture," published Aug. 14, 2020.)

PHL has one floating-to-fixed-rate swap with JPMorgan Chase Bank N.A., which terminates on June 15, 2025, if not previously terminated by the counterparty. The swap synthetically fixes 100% of the airport's 2005C bonds, resulting in a net variable-rate percentage of 0%. The 2005C bonds, with a total principal of $74.1 million, represent the only variable-rate debt PHL has outstanding. As of July 31, 2020, the mark-to-market value for the swap was approximately $5.3 million, not in the airport's favor. We consider the contingent liquidity risk low for the swap, given the rating differential between the rating on the swap insurer and rating triggers that would require PHL to post a material amount of collateral or make a termination payment. In April 2017, the airport entered a direct-purchase agreement with PNC Bank on a $125.0 million taxable airport revenue note, of which $118 million remains outstanding as of Aug. 31, 2020. Proceeds funded certain land acquisition costs. After our review of the direct-purchase agreement and the city's bond ordinance, we believe the contingent liquidity risk from this direct purchase is low because it would be unlikely that the direct-purchase bonds could be accelerated in less than 180 days.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of September 18, 2020)
Philadelphia, Pennsylvania
Philadelphia International Airport, Pennsylvania
Philadelphia (Philadelphia International Airport) arpt rev rfdg bnds (Philadelphia Arpt) ser 2005C dtd 06/02/2005 RMKT dtd 12/23/2008 due 06/15/2025

Ratings Detail (As Of September 18, 2020) (cont.)		
Long Term Rating	AA/A-1	Downgraded, Removed from CreditWatch
Unenhanced Rating	A-(SPUR)/Negative	Downgraded, Removed from CreditWatch
Philadelphia (Philadelphia International Airport) arpt rev rfdg bnds (Philadelphia Arpt) ser 2005C dtd 06/02/2005 RMKT dtd 12/23/2008 due 06/15/2025		
Long Term Rating	AA/A-1	Downgraded, Removed from CreditWatch
Unenhanced Rating	A-(SPUR)/Negative	Downgraded, Removed from CreditWatch
Philadelphia (Philadelphia International Airport) arpt (AGM)		
Unenhanced Rating	A-(SPUR)/Negative	Downgraded, Removed from CreditWatch
Philadelphia (Philadelphia International Airport) arpt (AGM)		
Unenhanced Rating	A-(SPUR)/Negative	Downgraded, Removed from CreditWatch
Philadelphia (Philadelphia International Airport) arpt (BAM)		
Unenhanced Rating	A-(SPUR)/Negative	Downgraded, Removed from CreditWatch
Philadelphia (Philadelphia International Airport) (AGM)		
Unenhanced Rating	A-(SPUR)/Negative	Downgraded, Removed from CreditWatch
Philadelphia (Philadelphia International Airport) (FGIC)		
Unenhanced Rating	A-(SPUR)/Negative	Downgraded, Removed from CreditWatch
Philadelphia Industrial Development Authority, Pennsylvania		
Philadelphia International Airport, Pennsylvania		
Philadelphia Auth for Indl Dev (Philadelphia Intl Arpt) (FGIC) (National)		
Unenhanced Rating	A-(SPUR)/Negative	Downgraded, Removed from CreditWatch

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.