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RATING ACTION COMMENTARY

Fitch Rates Philadelphia (PA) Series 2021 GARBs at 'A'; Outlook Revised to Stable

Wed 16 Jun, 2021 - 12:01 PM ET

Fitch Ratings - New York - 16 Jun 2021: Fitch Ratings has assigned an 'A' rating to Philadelphia (PA)'s $318 million series 2021 general airport revenue bonds (GARBs) issued on behalf of Philadelphia International Airport (PHL, or the airport). In addition, Fitch has affirmed the 'A' rating on the airport's approximately $1.5 billion airport revenue bonds. The Rating Outlook for all instruments has been revised to Stable from Negative.

RATING RATIONALE

The 'A' rating reflects PHL's role as the main air service provider to a large and stable service area that generates a solid base of origination and destination (O&D) traffic, offset by a high degree of concentration in American Airlines ('B'/Rating Watch Negative) and some connecting traffic exposure. PHL's strong residual airline agreement provides for full recovery of operating expenses and debt service costs but also results in narrow coverage and adequate liquidity levels. Rising airline costs and elevated leverage are expected to continue in the near term as a result of enplanement declines from the coronavirus pandemic and as additional capital-related borrowings are passed through to airlines.

The Rating Outlook revision to Stable reflects the YTD passenger recovery at PHL and the airport's importance as a primary hub for American Airlines, providing financial stability that is further supported by federal and state grants through the trough of the pandemic. While enplanement recovery in the Northeast lags the national average, the Stable Rating Outlook reflects Fitch's expectation that a continuation of the current recovery trajectory,

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KEY RATING DRIVERS

Sizable, Stable American Airlines Hub: Revenue Risk - Volume: Midrange

PHL's service area is the large and stable Philadelphia MSA, which provided around 7.8 million O&D enplanements in fiscal 2020 and typically provided approximately 10 million-11 million O&D enplanements prior to the onset of the pandemic. PHL is a leading connecting hub for American Airlines, which lends to sizable carrier concentration of 67% and connecting traffic exposure of around 33% of total enplanements (4 million enplanements in fiscal 2020). Service reduction risk is partially mitigated by American Airlines' longstanding presence at the airport.

Strong Cost-Recovery Framework: Revenue Risk - Price: Stronger

The airport benefits from a fully residual airline use and lease agreement (AUL), which was extended through fiscal 2022, effectively providing for a 100% recovery of operating expenses and debt service costs. PHL's cost per enplaned passenger (CPE) level, which spiked initially as a result of the novel coronavirus, is expected to settle back down into the $13-$14 range by fiscal 2026 under Fitch's rating case. Rising costs over the next few years are expected to be mitigated in part by the airport's franchise strength and airline support for the capital program.

Largely Debt-Funded Capital Plan - Infrastructure Development and Renewal: Midrange

The airport's remaining capital development program (CDP), extending through 2026, is approximately $1.2 billion and focuses primarily on state of good repair projects at the airfield and terminal. The CDP has significant flexibility, and PHL has currently deferred approximately $344 million of projects due to the pandemic. Around 62% of the current CDP will be funded with proceeds from existing bonds or additional long-term debt, with the remainder from passenger facility charges (PFCs), grants and a small amount of operating cash. Notably, the CDP projects and funding sources are subject to change based on the airport's operational needs, and deferred projects may commence after the projection period or may resume if the airport's traffic recovers sooner than currently anticipated.

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fixed-rate, in addition to a $350 million CP program. Structural features are considered adequate, with fully cash-funded debt reserves at maximum annual debt service (MADS) balanced with permissive rate covenants. Although the 2021 refunding bonds will provide debt service relief in fiscal years 2022 and 2023, debt service obligations remain elevated over the intermediate term due to additional debt borrowings for the CDP.

Financial Profile

The airport has historically managed to narrow debt service coverage (DSC) levels of around 1.0x (excluding fund balances), and it has improved its liquidity position to around 250 days-300 days in recent years; however, expected increases in unrestricted cash levels are expected to increase days' cash on hand (DCOH) to the 400-days range in Fitch's coronavirus rating case. DSC ratio metrics are considered narrow relative to large hub peers yet adequate for airports with residual AULs, as the agreements limit bottom line cash flow volatility. These narrow levels also limit PHL's ability to fund its capital plan without affecting the airline rate base. Fitch's conservative coronavirus downside case expects leverage to decline from the current 9.0x level to around 6.6x by fiscal 2026, reflecting both debt paydown and improved cash balances in reserve funds and unrestricted cash compared to historical levels.

PEER GROUP

Philadelphia is compared with the airports of Miami (A/Negative) and Charlotte (AA-/Stable), both of which serve as American Airlines hubs and exhibit carrier concentration and connecting traffic exposure. Charlotte's higher rating reflects significantly lower CPE and leverage and stronger liquidity and DSC despite higher exposure to American Airlines' hubbing operations. Miami has a stronger traffic base as a leading international gateway hub despite slightly higher leverage and CPE. PHL is also compared with Detroit-Wayne County Airport Authority (A/Stable), which serves as a secondary hub in the Delta network. Both Philadelphia and Detroit have similar enplanement and leverage levels, although Detroit has lower CPE and higher exposure to connecting traffic, overall resulting in similar ratings.

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--A positive rating action is not expected in the near future given uncertainty regarding the recovery from the pandemic.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A material reduction in or the elimination of American's hubbing activity, which reduces financial flexibility.

--An inability to maintain leverage at or below 10.0x-11.0x on a sustained basis.

--An inability to maintain a minimum of 1.0x net revenue DSC.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

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TRANSACTION SUMMARY

The City of Philadelphia Airport Division is issuing approximately $318 million of series 2021 revenue bonds. The series 2021 bonds will be used to finance certain capital projects, finance capitalized interest on a portion of the series 2021 bonds, fund a deposit to the parity sinking fund reserve account, refund the outstanding series 2011 bonds and pay issuance costs. The bonds will be on parity with the existing GARBs. Debt service savings from the refunding bonds will be mostly taken in fiscal years 2022 and 2023.

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Performance Update

Enplanements fell by 26.4% to 11.8 million in fiscal 2020 as a result of the pandemic. Specifically, American enplanements fell by 28.9% to 8 million, representing a 67% market share. O&D traffic at the airport remained stable at around 66% of overall enplanements, or approximately 7.8 million. International enplanements decreased in fiscal 2020 to 1.5 million, representing 12.5% of total enplanements. For the first eight months of fiscal 2020 through February (prior to the start of the pandemic), enplanements were up 4.5% over the same period in fiscal 2019. Additionally, PHL has seen strong growth in cargo activity, with total cargo increasing 6.5% in fiscal 2020.

YTD 2021 enplanements through April are down 60% over the prior period yet are showing signs of recovery, with April 2021 enplanements down 50% compared to April 2019 (with April 2020 reflecting the pandemic trough). Transportation Security Administration (TSA) throughput at PHL is generally tracking in line with the U.S. recovery as a whole, with total U.S. throughput down 41% and PHL down 44% through April. The Northeast has generally seen a slower recovery than the rest of the U.S.

As a result of the pandemic, the CDP has been modified to defer major projects comprising approximately $344 million, including the construction of an air traffic control tower ($197 million), widebody aircraft gate design ($30 million) and support facilities ($57 million). The CDP is primarily debt-funded, with 33.1% of the funding coming from future debt financings and 28.9% originating from existing bonds that include the series 2021 bonds. Other funding sources include PFCs/grants (37.6%) and operating cash flow (0.3%). For the purposes of this review, Fitch has assumed additional issuances of $266.4 million in 2025 for the CDP, some of which may be funded through the airport's CP program and refinanced into long-term debt at later dates.

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The city's efforts to assume control over the Philadelphia Parking Authority are continuing and may require additional debt to commence acquisition. Although Fitch continues to monitor the situation, it does not currently expect the acquisition to have a material impact on cashflows and leverage.

FINANCIAL ANALYSIS

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76% in 2022, 85% in 2023 and 95% in 2024 (relative to 2019). Fitch also modeled an additional coronavirus downside case to reflect deeper traffic declines.

For both cases, non-airline revenues move broadly in relation to passenger traffic trends and airline revenues are adjusted to comply with the rate covenant and to provide for a minimum Fitch-calculated coverage of 1.0x. Operating expenses continue to fall slightly in fiscal 2021 as a result of cost-cutting measures by management but are projected to grow at an inflationary average of around 3%-4% during fiscal years 2022-2026. Coronavirus Aid, Relief and Economic Security (CARES) Act funds are assumed to be used through fiscal 2024. The result is coronavirus rating case coverages that average 1.1x, while leverage peaks at 8.5x in fiscal 2021 before devolving to 6.6x by fiscal 2026. CPE averages $15.92 over the forecast, although it peaks at $26.28 in fiscal 2021.

Fitch also ran a coronavirus downside case that shows a maximum traffic reduction of 45% in 2021 and delays the recovery in the following fiscal periods. Under this scenario, the DSC ratio averages 1.0x and leverage declines to 6.7x by fiscal 2026, although airport system CPE levels would average over $18 during the same timeframe.

SECURITY

The bonds are secured by net revenues generated through airport operations. In addition, the airport may pledge certain PFC revenues for eligible projects.

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Asset Description

Philadelphia's airport system consists of PHL, the principal commercial airport serving the Philadelphia MSA, as well as Northeast Philadelphia Airport, a general aviation reliever facility. The City of Philadelphia owns the airport system, and the city's division of aviation operates the airport.

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Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Philadelphia International Airport (PA)				
• Philadelphia (PA) /Airport Revenues/1 LT	LT	A Rating Outlook Stable	Affirmed	A Rating Outlook Negative

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Infrastructure and Project Finance Rating Criteria (pub. 24 Mar 2020) (including rating assumption sensitivity)

Airports Rating Criteria (pub. 22 Oct 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

GIG AST Model, v1.3.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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