FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Philadelphia Airport GARBs at 'A'; Outlook Stable

Fri 17 Jun, 2022 - 3:56 PM ET

Fitch Ratings - New York - 17 Jun 2022: Fitch Ratings has affirmed the 'A' rating on Philadelphia International Airport's (PHL) approximately $1.45 billion of airport revenue bonds. The Rating Outlook is Stable. In addition to the aforementioned bonds, there is an additional $115.5 million of outstanding parity debt which is a direct loan and Fitch does not rate.

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-/Stable) 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 resulting in medium term leverage of nearly 9x. Overall, the strong residual agreement in conjunction with the importance of American Airlines' market share supports the current rating level.

KEY RATING DRIVERS

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

(Revised from Midrange following publication of the new Transportation Infrastructure criteria, which assesses volume risk on a five-point scale)

PHL's service area is the large and stable Philadelphia MSA, which has typically provided approximately 10-11 million O&D enplanements prior to the coronavirus pandemic, though the airport has connecting traffic exposure of around 33% of total enplanements. PHL is also a leading connecting hub for American Airlines, which lends to sizable carrier concentration of 67%. Service reduction risk is partially mitigated by American's long-standing presence at the airport. Traffic has been steadily increasing throughout fiscal 2021 and into 2022 but still lagging behind national average, due to airport's reliance on international traffic.

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 year 2022, which effectively provides for 100% recovery of operating expenses and debt service costs. Should the AUL expire without a new agreement in place, PHL will continue operations largely consistent with current rates and charges structure until a new contract is in place. 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 $12-$13 range by FY2026 in Fitch's conservative rating case. The

rising costs over the next few years are 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) is approximately $1.2 billion and focuses primarily on state of good repair projects on the airfield and terminal. The majority of the current CDP will be funded with proceeds from existing bonds or additional long-term debt, with the remainder from PFC's and grants as well as a small amount of operating cash. Notably, the CDP projects and funding sources are subject to change based on the operational needs of the airport, and any deferred projects may commence after the projection period.

Sound Structural Protections - Debt Structure: Stronger

PHL benefits from all senior, fully amortizing debt issued as fixed-rate and synthetically fixed-rate, in addition to a $350 million commercial paper (CP) program. Structural features are considered adequate, with fully cash-funded debt reserves at maximum annual debt service (MADS) balanced with permissive rate covenants. Debt service obligations are expected to be elevated over historical levels over the intermediate term, and may increase as additional borrowings for the CPE come online.

Financial Profile

The airport has historically managed to narrow debt service coverage levels of around 1x (excluding fund balances) and has managed an improved liquidity position of around 300-400 days range in recent years. DSCR 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 rating case expects leverage to decline from the current levels of nearly 9x to approximately 7x by fiscal 2026.

PEER GROUP

Peer airports for PHL include Miami (A/Stable) 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 debt service coverage, 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.

RATING SENSITIVITIES

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

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

--Inability to maintain leverage levels at or below 10x to 11x on a sustained basis;

--Inability to maintain a minimum of 1x net revenue debt service coverage.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

-- Full pre-pandemic traffic recovery together with leverage declining to below 7x, inclusive of any additional borrowings for the capital plan.

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.

CREDIT UPDATE

Performance Update

Enplanements fell by 44.8% to 6.5 million in FY 2021 compared to prior year, as a result of the COVID-19 pandemic. Specifically, American enplanements fell by 67.3% to 2.6 million. Origin and destination (O&D) traffic at the airport remained stable at around 69% of overall enplanements, or approximately 4.5 million. While enplanements fell significantly in FY2021, PHL has seen strong growth in cargo activity, with total cargo increasing 5.1% in FY 2021. With travel restrictions being lifted, the traffic is steadily increasing though is lagging behind the national average due to the continued pressures on international traffic. The airport continues to serve as a major hub for American Airlines, which is the principal airline serving PHL.

Total airline revenues for FY 2021 increased by approximately 32.5%, while total non-airline revenues declined by 45.9% over FY2020. Overall, total operating revenues only declined 2.4% to $288.4 million though CPE spiked to $25.50 due to the declined passenger traffic. Expenses fell by 12.7% in FY2021 over 2020, reflecting decreased costs due to the coronavirus pandemic. PHL has continued to implement cost-saving measures to mitigate the impact of reduced traffic on airport revenues. Overall, leverage declined to 6.3x due to a stronger cash position at the airport in conjunction with the use of federal funding to offset revenue declines. Debt service coverage as calculated by Fitch (including interdepartmental charges, excluding fund balance) came in higher than historical levels at 1.6x in FY2021 due to the use of federal funding.

Under the Airline Agreement, the Signatory Airlines have approved approximately $1.3 billion in capital development projects to date, of which approximately $300 million has been spent to date. The CDP is primarily debt funded, with approximately 33% of the funding coming from future debt financings and 29% coming from existing bonds. Other sources of funding 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.

Additionally, the Airport recently defeased the outstanding Philadelphia Parking Authority's ("PPA") airport parking bonds in the aggregate principal amount of $53.8 million, assumed ownership of airport parking garages from the PPA, and terminated the PPA's leasehold interest in airport land.

FINANCIAL ANALYSIS

Fitch Cases

Fitch developed two scenarios, the Fitch rating case and Fitch downside case, that serve as the basis for this review. For the purposes of this review, Fitch's rating case also acts as the Fitch base case. Fitch's rating case assumes, relative to fiscal 2019, a 30% decline in enplanements in 2022 followed by recoveries reverting the losses to 10% in 2023, 5% in 2024 and full recovery to 2019 levels by fiscal 2025.

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 increase slightly in FY 2022 as a result of traffic recovery and grow at an inflationary average of around 3%-4% for FY 2022- 2026. CARES Act funds are assumed to be used through Fiscal 2024. Under the Fitch rating case, Fitch-calculated DSCR (excluding fund

balances) averages 1.1x and leverage declines to 6.9x by Fiscal 2026. CPE remains elevated relative to historical levels as traffic recovers, though declines to the $12-$13 range by the end of the forecast period.

Fitch also ran a downside case, which contemplates a slower traffic recovery, such that 2019 enplanement levels are not achieved until fiscal 2026. As in the rating case, airline revenues are adjusted to meet 1x coverage and non-airline revenues move in line with enplanements. Expenses are the same as in the rating case. Under this scenario, DSCR averages 1.1x and leverage declines to 7.4x by fiscal 2026. CPE is higher than the base case, averaging $16.66.

While the airport's enplanement recovery lags behind the national average, Fitch expects that a continuation of the current recovery trajectory, together with the PHL's residual airline lease and prudent expense management throughout the pandemic, will provide sound financial performance in the near term.

SECURITY

The bonds are secured by the net revenues generated through the operations of the airport. In addition, the airport may pledge certain passenger facility charge (PFC) revenues for eligible projects.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable 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 Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Infrastructure and Project Finance Rating Criteria (pub. 23 Aug 2021) (including rating assumption sensitivity)

Transportation Infrastructure Rating Criteria (pub. 16 May 2022) (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, v1.3.1 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Philadelphia (PA)	EU Endorsed, UK Endorsed

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