S&P Global
Ratings

Research

Summary:

Philadelphia
Philadelphia International Airport; Airport

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Long Term Rating	A+/Stable	Upgraded
Philadelphia (Philadelphia Intl Arpt) arpt (AGM)		
Unenhanced Rating	A+(SPUR)/Stable	Upgraded
Philadelphia (Philadelphia Intl Arpt) arpt (AGM)		
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Credit Highlights

- S&P Global Ratings raised its long-term rating and underlying rating (SPUR) on Philadelphia's airport revenue bonds outstanding, issued for Philadelphia International Airport (PHL), to 'A+' from 'A-'.
- The outlook is stable.
- The upgrade reflects a passenger recovery resulting in an improved enterprise risk profile to very strong and financial metrics we expect will be maintained at levels generally consistent with a strong financial risk profile.

Security

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 2020C and 2021 bonds. If needed, the city also has access to a cash-funded debt service reserve account totaling approximately $123 million.

The airport has approximately $1.6 billion of debt outstanding, consisting of $1.5 billion of airport revenue bonds (including about $144 million of direct purchase debt—series 2005C and 2017 bonds-- and $125.3 million of commercial paper [CP] notes outstanding under a $350 million CP program). Most of the airport's debt is fixed rate. Only the airport's $31.2 million series 2005C bonds, which mature in 2025, are floating-rate bonds based on the Securities Industry and Financial Markets Association (SIFMA) index. Such bonds, however, are synthetically fixed.

Credit overview

The rating action reflects growth in enplanements trending at levels above budget expectations as well as higher expected liquidity and return to business-as-usual rate-setting flexibility, contributing to our view of an improved enterprise risk profile to very strong and financial risk profile to strong.

Our very strong enterprise risk profile assessment, consistent with our pre-pandemic view, considered PHL's historically high activity levels (with total enplanements increasing to about 16 million in fiscal 2019 from about 14.8 million in fiscal 2017) from serving a populous service area with limited competition, and its important role within American Airlines Inc. system; and ongoing recovery. Enplanements for fiscal 2023 year to date (10 months ended April 30, 2023) improved to about 84% of pre-pandemic levels, better than the 82% recapture rate assumed in the fiscal 2023 budget. Air travel demand continues to recover, with fiscal 2023 year-to-date enplanements up 17% year over year. Although the airport's recovery enplanement is lagging the broader recovery in air travel demand across large hub airports, we understand that the slower recovery in enplanements at PHL is due to industry capacity constraints caused by a shortage of trained pilots and narrowbody aircraft delivery delays. We expect PHL's enplanements will continue to recover as these issues are resolved. Current estimates for total enplanements for fiscal year ending June 30, 2023, is approximately 13.2 million; and the fiscal 2024 budget assumes enplanements of nearly 14.9 million (93% of fiscal 2019 enplanements).

Our strong financial risk profile assessment considered the airport's historical performance, current financial projections that include additional borrowing plans, and generally steady financial results through different economic conditions. The City of Philadelphia operates PHL and the Northeast Philadelphia Airport (PNE), 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 financial risk profile assessment. Our assessment reflects our expectation that PHL's recovery in air travel demand and return to business-as-usual rate-setting flexibility and new airline use and lease agreements (effective July 1, 2023) will allow the airport to maintain higher levels of unrestricted cash reserves than it has historically, while coverage will be maintained near 1x with PHL continuing to operate on a full cost recovery basis. Cost per enplanement and debt per enplanement are projected to be near $16 and $100, respectively, from fiscal years 2024-2027, while coverage, debt to net revenues, days' cash on hand, and unrestricted reserves to debt are projected to average about 1.1x, 10x, 580 days', and 33%, respectively.

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

- Large-hub classification serving a large origin and destination market with favorable economic fundamentals that spans 11 counties, with limited competition and role as a key component of American Airlines' route system;
- Financial metrics (S&P Global Ratings-calculated) we expect will be maintained at levels consistent with a generally strong financial risk profile for a fully residual airport (with coverage near 1x, debt-to-net revenues between 10x-15x, unrestricted days' cash at least near 400, and unrestricted cash reserves to debt of over 20%); and
- Skilled and very strong management team that is effective and experienced in mitigating financial and operational risks.

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

- Relatively high airline concentration, with American Airlines (B-/Positive/--) and its regional affiliates, accounting for about 65% of fiscal 2022 total enplaned passengers (down from about 70% pre-pandemic); and
- A large airline approved $1.8 billion capital improvement plan, of which $1.2 billion of additional debt is needed to

finance it, tempered somewhat by rapid amortization of the airport's existing debt over the next three years, with approximately half paid off over the next 10 years.

Environmental, social, and governance

We analyzed PHL's risks and opportunities related to environmental, social, and governance risk factors relative to the airport's market position, management and governance, and financial performance, and view them as credit neutral. Although PHL's revenue performance was affected by reduced activity due to the COVID-19 pandemic, which we view as a social factor, this risk has abated and is credit neutral in our credit rating analysis.

Outlook

The stable outlook reflects our expectation that the airport's capital plans and finances will be prudently managed, PHL's enplanements will continue to recover and normalize near pre-pandemic levels, and financial metrics (S&P Global Ratings-calculated) will be maintained at levels consistent with a generally strong financial risk profile.

Downside scenario

We could lower the rating in the next two years if the airport's enplanements drop significantly or if we believe financial metrics will be materially weaker than expected on a sustained basis as a result; for example, the airport issuing significantly more debt than currently planned.

Upside scenario

Although unlikely, we could raise the rating in the two-year outlook period, if the airport experiences a significant increase in demand that we believe is sustainable and consistent with a stronger market position and we believe the airport can continue to maintain financial metrics consistent with a strong financial risk profile.

Credit Opinion

New airline use and lease agreements will take effect on July 1, 2023, after receiving city council approval this month. The new agreements will have a three-year term with two one-year renewal options. We understand that the city and airlines collectively agreed on short-term agreements instead of long-term agreements at this time because Philadelphia has not completed its long-term planning process and its discussions with the airlines regarding additional future airport capital investments. Approximately $935 million in new capital funding to support operations at both PHL and PNE over the term of this agreement was approved by the airlines. State of good repair work, upgrades throughout PHL's terminals, cargo program projects, and initial funding to support aviation-related development within the closed section of the PHL Economy Lot will be funded.

The new agreements will allow the airport to establish and maintain higher cash reserve balances. More specifically, additional funding will be set aside for reserves to increase funding to the airport's operating reserves from $1 million to up to $10 million annually, allowing the airport to increase the balance in its O&M reserve account to 25% from 7% of annual operating expenses over the term of the agreement.

The updated multiyear capital program, approved in connection with the executive of the new airline use and lease agreements, totals $1.8 billion ($985 million in new projects and $878 million carried over from the previous program). The capital program consists of about:

- $980 million in terminal and landside projects;
- $523 million in airfield and apron projects;
- $221 million in security and technology projects; and
- $89 in Philadelphia Northeast Airport airfield and taxiway projects.

Anticipated funding sources are about:

- $292 million of passenger facility charge revenues and grants;
- $200 million of proceeds from previously issued bonds;
- $266 million of proceeds from bonds planned to be issued in fiscal 2025;
- $976 million of proceeds from bonds planned to be issued in the future; and
- $80 million in operating funds.

S&P Global Ratings currently believes that the U.S economy will fall into a shallow recession in 2023, although increased credit tightening stemming from recent events in the banking sector has elevated the likelihood of a hard landing. Supply-chain disruptions continue in certain sectors and, while inflation likely peaked in third-quarter 2022 as prices for goods products moderated, prices for services excluding housing remain elevated. Our U.S. GDP growth forecast is 0.7% for 2023 and a 1.2% for 2024. We also now expect U.S. GDP to decline by 0.3 percentage points from its peak in first-quarter 2023 to its third-quarter trough. If correct, this will beat the 2001 recession as the softest recession since 1960. We expect the unemployment rate, at 3.6% in February 2023 and just above its pre-pandemic level, will rise in 2023 and peak at 5.4% in second-quarter 2024 before falling in late 2025. Our lower GDP and inflation forecasts for 2023 and 2024 reflect the likely outcome of the Federal Reserve's continued aggressive policy stance to keep interest rates higher until inflation exhibits declines toward its 2% target. We believe the federal funds rate will peak at 5.00%-5.15% by May 2023 with the first interest rate cut in mid-2024. See "Economic Outlook U.S. Q2 2023: Still Resilient, Downside Risks Rise," March 27, 2023, on RatingsDirect.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Ratings Detail (As Of June 22, 2023)		
Philadelphia, Pennsylvania		
Philadelphia International Airport, Pennsylvania		
Philadelphia (Philadelphia Intl Arpt) arpt (AGM)		
Unenhanced Rating	A+(SPUR)/Stable	Upgraded
Philadelphia (Philadelphia Intl Arpt) arpt (BAM) (SECMKT)		

Ratings Detail (As Of June 22, 2023) (cont.)		
Unenhanced Rating	A+(SPUR)/Stable	Upgraded
Philadelphia (Philadelphia Intl Arpt) arpt (FGIC)		
Unenhanced Rating	A+(SPUR)/Stable	Upgraded

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.