FitchRatings

FITCH RATES SAN FRANCISCO INTERNATIONAL AIRPORT (CA) REVS 'A+'; OUTLOOK STABLE

Fitch Ratings-Chicago-03 October 2017: Fitch Ratings has assigned an 'A+' rating to the Airport Commission's, City and County of San Francisco, San Francisco International Airport (SFO) approximately $346 million series 2017A second series revenue bonds, $235 million series 2017B second series revenue bonds, $46 million series 2017C second series revenue bonds, $151 million series 2017D second series revenue bonds, and $126 million series 2018A second series revenue refunding bonds. Fitch has also affirmed the 'A+' rating on approximately $4.8 billion of parity SFO second series revenue bonds.

The Rating Outlook for all of the bonds is Stable.

KEY RATING DRIVERS

Summary: The rating reflects SFO's strong operational and financial performance within the healthy, yet competitive air trade market in the San Francisco Bay Area. The airport's fully residual airline agreement and proven management team provide a solid framework for stable and competitive results; however, its elevated leverage profile and additional borrowing needs create some pressures on the rating. Leverage is forecast to peak around 13x, but moderate to less than 10x by 2022, while CPE will increase to around $24. These results are reasonable for an international gateway airport and should remain competitive relative to peers and the 'A+' rating level.

STRONG OPERATING PROFILE AND POSITIVE TRAFFIC TRENDS (Revenue Risk-Volume: Stronger): SFO serves as a major international gateway airport with a consistently strong 69% market share of passenger traffic within the San Francisco bay region. The airport has a well-balanced traffic profile, with 80% origination & destination (O&D) traffic and the remainder being a mix of domestic and international connecting traffic. United Airlines Inc. (United; 'BB'/Outlook Stable) maintains a sizable presence at SFO, with a 44% share of the passenger market. United's share has fallen in recent years despite its increased seat capacity as growth at SFO has been largely driven by the increasing presence of low-cost carriers (21% in FY2017) and service expansion by foreign-flag airlines.

FAVORABLE RATE-SETTING FRAMEWORK (Revenue Risk-Price: Stronger): The current airline use agreement (AUL), in place through 2021, is fully residual and provides for strong cost recovery with respect to all operating and debt service requirements. Airline charges were $16.46 per enplanement in FY2017 and have been relatively stable in recent years, although they are expected to rise in the medium term due to additional projected costs associated with the airport's capital improvement program (CIP).

LARGE, DEBT-FUNDED CAPITAL PLAN (Infrastructure Development/Renewal: Midrange): Airport capital needs are well managed, but substantial infrastructure improvement is planned for the near-to-medium term. Recently completed terminal improvements together with planned development projects are considered necessary to allow the airport to adequately serve its growing user base. The new 10-year CIP totals $6.2 billion and is expected to be predominantly funded through revenue bonds. The program has been accelerated with more projects occurring in the five-year horizon such that approximately $5.8 billion in new money issuance was factored into the forecast period through fiscal 2022.

STABLE DEBT PROFILE (Debt Structure: Stronger): SFO has a predominantly fixed rate, fully amortizing debt structure with sufficient covenants and reserves. Management is proactive in seeking opportunities to defease debt, lower interest rate costs through refundings, and fix out variable rate debt, eliminating the need for associated swaps. However, annual debt service obligations and leverage will rise with the additional borrowings.

FINANCIAL METRICS: SFO's debt level is high at $4.8 billion ($178 per enplanement in FY2017) and contributes to the airport's high fixed-cost structure. The airport's current net debt-to-cashflow available for debt service (CFADS) ratio is similar to that of peer large-hub airports at 8.3x. Additional borrowings to support capital spending will cause debt metrics to rise, but they should remain reasonable for an international gateway with stronger assessments for both revenue risks (volume and price). Nevertheless, the airport has a good liquidity position (293 days cash on hand [DCOH] for FY2017; 319 DCOH including prefunded debt service for 2018) and stable coverage levels, demonstrating it can adequately meet its debt service obligations. Fitch forecasts the debt service coverage ratio (DSCR) to remain in the 1.34x - 1.38x range through FY2022 including permitted transfers (1.09x - 1.14x without).

PEER GROUP
SFO's peers include Los Angeles International Airport (LAX, 'AA/AA-'), Miami International Airport ('A'), and Atlanta International Airport ('AA-/A+') given their similar prominence as large-hub, international gateway airports. All also have elevated leverage related to large capital needs in support of their on-going operations. SFO benefits from the most positive enplanement trends over the last five years while LAX benefits from the highest DSCR given its hybrid AUL. Cost per enplanement (CPE) is expected in the $20 range for all but Atlanta, although SFO's CPE is projected to rise above $20 after FY2020.

RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action:
--A larger capital program size or additional borrowings above current forecast parameters;
--Changes in the airport's traffic profile given the sizable presence of United and the presence of competing airports in San Jose and Oakland.

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action:
--Upward rating migration is unlikely at this time given SFO's elevated leverage and large additional borrowing needs over the next 10 years.

TRANSACTION SUMMARY

SFO is expected to issue a total of $612 million new money Series 2017ABC to take out $300 million in commercial paper (CP), fund $293 million in new projects, and fund the DSRF, capitalized interest, and the contingency account. Another $166 million of Series 2017CD bonds will fix out (refund) Issue 36ABC variable rate bonds with fixed rate bonds and pay the associated swap termination payment. Series 2018A bonds in the amount of $126 million will forward refund Issue 34E (Feb 1 approximate delivery) for debt service savings. NPV savings are estimated at $3.9 million through 2024 (or $15.6 million total), approximately 11% of refunded par. Following the transaction, 94% of debt will be fixed-rate with the remaining 6% synthetically fixed.

Performance Update

SFO's traffic has continued to perform extremely well in recent years (4.6% CAGR between FY2012 - FY2017), with strong enplanement growth every year. Most recently, enplanements grew by 4.9% in FY2017 (continuing the trend of outperforming the airport consultant's forecasts) to a record 26.9 million enplanements, and are up another 6.7% for the first month of FY2018.

SFO is benefiting from international passenger traffic growth in addition to strong domestic performance driven by low-cost carrier expansion and United's increased service. United remains the dominant carrier with 44% of enplanements, though the share of low-cost carriers increased to 21% in FY2017 from 6% in FY2007. Since the recent economic downturn, SFO's passenger traffic market share has increased relative to competing Oakland and San Jose airports, now comprising approximately 69% of the Bay Area.

Estimated debt service coverage in FY2017 was 1.37x, taking into account permitted contingency fund transfers of approximately $95 million as well as the use of designated passenger facility charge (PFCs) as revenues. On a stand-alone basis, excluding contingency rollover funds, coverage was 1.14x. This coverage level is in line with performance in recent years and is not unusual given SFO's residual rate-setting methodology.

The airport commission utilized $23 million of PFC revenue to cover debt service in FY2017, down from FY2016, and down notably from the $73 million and $87 million used in FY2012 and FY2011, respectively. However, PFC utilization is forecast to return to historic levels ($95 million) by 2020 and grow to as much as $239 million by 2022 as the commission uses this revenue stream to offset new debt service attributable to the CIP and as a tool to manage costs passed on to airlines.

SFO's airline CPE held steady at $16.46 in FY2017, down slightly from $16.52 in 2016, remaining in line with expectations and reasonable for an international gateway. Continued growth in enplaned passengers as well as large increases in non-airline revenue sources and usage of PFC receipts as offsets to debt service payments together contribute to the recent stabilization of airline costs. Even with a quintupling of PFCs designated as revenues, CPE is forecast to exceed $23 by 2022 under a scenario of modest traffic growth. This level is reasonable for an international gateway and should remain competitive relative to peers.

SFO is implementing a sizeable, 10-year CIP of around $6.2 billion, with a main focus on modernizing terminals 1 and 3, increasing safety and security, and enhancing passenger experience. The program is demand-driven and has been accelerated due to the consistent outperformance in enplanement growth over the last few years. While projects have been moved forward to meet current and projected demand, should enplanements fall, a portion of the program could be deferred. The program will be nearly all bond-funded.

SFO's leverage, in terms of net debt-to-CFADS, is moderate for a large-hub airport at approximately 8.3x for FY2017. This will, however, increase as a result of the magnitude of the CIP despite the rapid amortization of existing debt. Through the forecast period, leverage will peak at approximately 13x, but fall to less than 10x by 2022 as new principal begins to amortize and the additional debt service enters the rate base charged to carriers. This elevated leverage level is mitigated by SFO's strong franchise strength and cost recovery framework demonstrated by its stronger assessment for revenue risk in terms of both volume and price.

The commission is still completing its airport development plan (ADP), elements of which may be integrated into the current capital plan (subject to environmental approval and demand). It is demand-driven and would be additive to the current CIP. To the extent additional borrowings for either the current CIP or forthcoming ADP materially weaken the airport's financial profile, the rating may be pressured at its current level.

Fitch Cases

Fitch's base case assumes 1.9% average enplanement growth through 2022, in-line with the airport consultant and notably lower than that observed in recent years. Total revenues are expected to grow at 9.8% driven by airline revenue growth of 9.9% and a massive increase to PFCs designated as revenues. Operating expenses are forecast to grow at an average of 6.0% annually over the same period, which is above historical levels. Under this scenario, CPE is likely to reach $$24 by FY2022. Net debt-to-cashflow averages 11x but falls to below 10x by 2022. Under this base case, DSCR is expected to remain stable at around 1.34x - 1.38x (including permitted transfers) given the fully residual AUL.

Fitch's rating case assumes a weaker -0.2% average enplanement growth through 2022, taking into account an 8.2% loss in 2019 with recovery in future years. Total revenues are expected to grow at 9.8% driven by airline revenue growth of 10.8% while operating expenses are forecast to grow at the same 6.0% average annually as the base case through 2022 despite the lower enplanement volume. PFCs designated as revenues remain unchanged from the base case. Under this scenario, CPE is likely to reach the $28 range; however, net debt-to-cashflow and DSCR levels are expected to remain comparable to the base case given the AUL framework.

Even with continued growth in the airport's enplanement base, Fitch expects the average CPE to increase over the next few years to service rising annual DS payments resulting from additional borrowings. Fitch believes that rising airline costs will affect SFO's overall financial flexibility, although it notes that such higher airline costs are supported by a relatively large component of high-yielding international and long-haul domestic travel. In addition, these costs facilitate necessary improvements to support the continued growth experienced at SFO and should remain in-line with and comparable to peer airports with similarly sized capital needs.

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Applicable Criteria
Rating Criteria for Airports (pub. 14 Dec 2016)
https://www.fitchratings.com/site/re/891804
Rating Criteria for Infrastructure and Project Finance (pub. 24 Aug 2017)
https://www.fitchratings.com/site/re/902689