Fitch Affirms Indianapolis Int'l Airport, IN Local Public Improvement Bond Bank Revs at 'A'

Fitch Ratings-Chicago-11 August 2017: Fitch Ratings has affirmed the 'A' rating on the Indianapolis Local Public Improvement Bond Bank's (the bond bank) approximately $502.2 million and the Indianapolis Airport Authority's (IAA, or the authority) approximately $21.5 million outstanding airport revenue bonds. In addition, the airport has approximately $354.2 million of outstanding bonds not rated by Fitch. The Rating Outlook is Stable.

KEY RATING DRIVERS

Summary: The ratings reflect the air trade service area which is well-anchored and supported by origination & destination (O&D) traffic. The rating considers the airport's relatively high leverage, healthy liquidity, and strong cost recovery framework under a fully residual use and lease agreement (AUL) through FY2018 which continues to protect the authority's liquidity and coverage ratios in the event of negative financial impacts to the forecast.

Diverse carrier base serving a stable local market [Revenue Risk - Volume: Midrange]
Indianapolis International Airport serves a stable and diverse region with an enplanement base of 4.2 million of primarily (96%) O&D enplaned passengers. Further, the diverse carrier mix, with only one single carrier representing more than 30% of enplanements, protects the airport from concentrated airline counterparty risk. In addition, Federal Express Corp. (FedEx) operates its second-largest global sorting facility at the airport and has demonstrated its commitment to Indianapolis with continued significant capital improvements.

Strong recovery framework [Revenue Risk-Price: Stronger]
IAA's strong AUL is fully residual and was renewed through FYE2018. The AUL enables the airport to pass all costs to air carriers if non-airline revenues

are insufficient. Additionally, the diverse revenue stream, with passenger airline carriers representing only 28% of operating revenues, allows the airport to maintain a competitive cost per enplanement (CPE) in the $9-$11 range. A large amount of air cargo activity provides some diversity to the airport's revenue base (historically constant at approximately 7%) and helps maintain a stable cost environment by distributing airfield expenses across a broader customer base.

Modest capital needs, no medium-term additional debt issuance [Infrastructure Renewal & Development: Stronger]
IAA recently completed its seven-year, $1 billion new terminal and airport improvements program. Going forward, the authority's capital improvement needs are modest and are expected to be funded without issuing additional debt. The authority's 5-year (FY2017-FY2021) capital improvement program totals $213 million, approximately 28% grant-funded, 55% authority-funded, and the remainder funded from other external sources.

Variable-rate debt offset with swaps [Debt Structure: Midrange]
All debt ranks senior and is fully amortizing with a final maturity of 2037, but IAA has more variable-rate debt exposure compared to peers at 35% of total outstanding principal which is mitigated by swaps with adequately rated bank counterparties. IAA also has a fully funded cash debt service reserve fund at $54.8 million as of FYE2016 and satisfactory 1.25x rate covenants for all debt.

Debt levels partially mitigated by sizable reserves
Fitch expects near-term leverage, calculated as net debt-to-cash flow available for debt service (CFADS), to moderate to the 6x range reflecting reductions in annual debt service requirements. Additionally, significant balance sheet liquidity and reserves serve to mitigate some of this risk and provide additional financial flexibility. At FYE2016, the authority's liquidity was healthy at $62.8 million of unrestricted cash and investments and $11.4 million in the operations and maintenance (O&M) reserve, equivalent to 403 days cash on hand (DCOH). IAA-calculated debt service coverage ratio (DSCR) was stable at 2.07x, while Fitch-calculated coverage, which considers PFC and CFC as revenues rather than an offset to debt service and excludes the rolling coverage account, was lower at 1.55x.

Peer Analysis: Fitch-rated airports with similar credit profiles and large cargo hubs include Cincinnati ('A+'/Stable Outlook) and Alaska ('A+'/Stable Outlook). IAA's 2016 CPE of $10.50 is comparable to that of Alaska's at $10.73 and Cincinnati's at $9.17. IAA's 2016 enplanement count of 4.2 million was stronger than both peers (both 3.2 million) while its market share is more diversified. At 33%, Southwest, IAA's largest carrier by market share, was far smaller than Alaska (60%) and Cincinnati (56%).

RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action:

-- Material decrease in traffic and/or increase in costs leading to an unsustainably higher CPE.

-- Significant deterioration of the Indianapolis Airport Authority's strong cash position resulting in a leverage position above 7.0x on a sustained basis.

Future Developments That May Lead to Positive Rating Action:

-- Given current leverage metrics, the rating is likely constrained to its current level in the near term; however, reduction in leverage to 5.0x on a sustained basis may result in consideration for a higher rating.

CREDIT UPDATE

Following two years of declines, IAA has experienced three years of strong enplanement growth (2.3% in 2014, 8.7% in 2015, and 5.7% in 2016). YTD 2017 (through June) enplanements total 2.1 million, a 1.25% increase over 2016 levels for the same time period. The growth is primarily attributable to increased airline service and passenger travel. Southwest Airlines Co. (Southwest) carried the largest share of enplanements (33.2%) followed by American Airlines, Inc. (American, 23.2%), Delta Air Lines (21.7%) and United Airlines, Inc. (United, 13.5%) during fiscal 2016. The traffic base is now primarily O&D at 96% of fiscal 2016 enplanements, compared with 87% in fiscal 2005.

Airline revenues grew 16.4% in 2016 due to increases in rates and charges, and as airlines increased services and airport usage. Parking and concession revenues both increased by 7.5% reflecting the growth in passenger traffic.

Overall, total operating revenues increased 7% in 2016, and six-month YTD revenues are comparably favorable. The airport's operating expenses grew 7.8% in 2016 due to increased airport activity. IAA has managed expense growth well, maintaining low cost growth in previous years of traffic expansion.

Given the increase in traffic and airport activity, Fitch-calculated 2016 DSCR (with PFC and CFC as revenue) grew to 1.76x compared to 1.61x in 2015. Leverage continued to moderate, stepping down to 6.97x compared to 7.86x in 2015. Additionally, the airport maintained adequate financial flexibility, with 403 DCOH.

IAA's five-year capital program is manageable and totals $213 million through 2021. Major capital investment focuses on apron/airfield construction and rehabilitation, parking improvements, and safety/security upgrades. The airport has no plans to issue additional debt for its capital program.

Performance Update

Fitch Cases

Fitch's base case applied an annual enplanement growth assumption of 1.2% through fiscal 2021. Given a significant reduction in annual debt service expenses, Fitch's base case airline revenue assumptions experience a 15% decline in 2019. Non-airline revenues and cargo landing fee projections increase annually by 1% and 0.5%, respectively, throughout the forecast. Total operations and maintenance expenses were increased by 3% annually through fiscal 2021. Under these assumptions, net revenues are expected to produce Fitch-calculated coverage averaging 1.85x through 2021 and a net debt/cash flow available for debt service figure of 6.64x in fiscal 2021.

In Fitch's rating case, enplanements experienced a -5% shock in 2018, followed by a gradual recovery. Similar to the base case, due to a significant reduction in debt service costs, airline revenue assumptions experience a 15% decline in 2019. Non-airline revenues are modelled with a 0.3% reduction annually, while cargo landing fees are held flat throughout the forecast. Total operations and maintenance expenses were increased by 4%

annually through fiscal 2021. Under these assumptions, net revenues are expected to produce Fitch-calculated coverage averaging 1.78x through 2021 and a net debt/cash flow available for debt service figure of 7.35x in fiscal 2021.

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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. 08 Jul 2016)
(https://www.fitchratings.com/site/re/882594)

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