FitchRatings

Fitch Affirms Pensacola, Florida's Airport Revs at 'BBB-'; Outlook Revised to Positive

Fitch Ratings-New York-10 October 2017: Fitch Ratings has affirmed Pensacola, Florida's (the city) 'BBB-' rating on $30.6 million of outstanding series 2008 airport capital improvement revenue bonds issued on behalf of Pensacola International Airport (PNS, or the airport). The Rating Outlook has been revised to Positive from Stable.

In addition to the 2008 bonds, PNS has approximately $18.2 million of parity obligations that Fitch does not rate.

The Positive Outlook reflects the airports improved financial metrics as demonstrated by declining leverage, increased liquidity, and higher coverage levels. The airport's performance is expected to continue to improve under the newly implemented residual airline agreement, which benefits from strong cost recovery mechanisms, and thereby mitigating the volatility associated with traffic performance.

KEY RATING DRIVERS

Summary: The 'BBB-' rating reflects the airport's small traffic base of about 802,000 enplanements with recent years of stable operational performance despite regional competition from surrounding airports and observed historical volatility. Additionally, the rating is also reflective of the airports implementation of a long-term residual airline agreement with adequate cost recovery provisions, modestly sized capital improvement plan (CIP) without the need for future borrowing, and improved financial metrics.

Small, Competitive Regional Market (Revenue Risk - Volume: Weaker): PNS serves a small 100% O&D passenger market in and around the western portion of the Florida Panhandle. The airport has exhibited three years of consecutive positive enplanement growth up 4% since 2014. PNS benefits from a well-diversified mix of business, tourism and military travellers. However, future performance is susceptible to a significant degree of competition from three other regional airports. In addition, the airport serves a limited number of direct markets and has a moderately high level of carrier concentration, with Delta Airlines (Issuer Default Rating [IDR] 'BBB-'; Outlook Stable) accounting for about 44% of total enplanements.

Strengthened Cost Recovery Framework: (Revenue Risk- Price: Midrange) (Revised from Weaker): Fitch views favourably the airports ability to transition to a long-term residual airline use and lease agreement (AUL) through 2022 replacing a month-to-month hybrid AUL which had been in place since 2008. The new agreement effective FY2018 (October 1st) provides the airport with assurance that costs for airline facility and services are recovered from rents and fees through ratemaking in costs centers. Management expects to maintain CPE below $8.50 going forward under the new agreement.

Limited Capital Needs (Infrastructure Development & Renewal: Stronger): The airport's updated five-year capital improvement program (FY2019 - FY2023) of approximately $64 million is manageable. Projects mainly include improvements to the hanger and taxiway rehabilitation/extension related projects. The vast majority of CIP is expected to be funded with grants from the Florida Department of Transportation and the Federal Aviation Administration. Management expects no additional borrowing to fund future projects.

Solid Overall Debt Structure & Covenants (Debt Structure: Stronger): The airport's outstanding debt is predominantly fixed rate (78% by par outstanding) or synthetically fixed (11%) and fully amortizes. Covenants are consistent with those of other U.S. municipal airports and includes a cash-funded debt service reserve fund sized the maximum allowed by the IRS. The debt service profile escalates slightly through 2019 before dropping off thereafter, which should provide airline cost relief in the medium term.

Financial Metrics: PNS financial metrics are expected to stabilize with the adoption of the residual AUL agreement that targets debt service coverage of 1.6x for the bond resolution, which includes all transfers effective FY2018. Fitch's rating case debt service coverage averages 1.64x throughout the projected period (FY2017 - FY2022) and leverage averages 2.4x.

PEER GROUP

Fitch views Burlington, Vermont ('BBB-'/ Outlook Positive) and Fresno, California ('BBB'/Outlook Positive) as comparable peers due to similarly small size enplanement bases (Burlington 600,000 and Fresno 740,000) and financial metrics. Fresno's higher rating is driven by stronger financial metrics with debt service coverage at 2.4x, and similar leverage and cash on hand as compared with PNS. Burlington credit profile reflects a lower amount of cash on hand and similar coverage level within the 1.5x to 1.6x range.

RATING SENSITIVITIES

Future Developments that May, Individually or Collectively, Lead to Positive Rating Action:
--Continued improvement in PNS financial performance supported by both the recently effected airline agreement and demonstrated traffic stability.
--Leverage evolving below 4x and coverage levels maintaining at the 1.6x level could support a positive rating action on a sustained basis.

Future Developments that May, Individually or Collectively, Lead to Negative Rating Action:
--Sustained declines or uneven trends in passenger traffic levels leading to fluctuating or unsustainable CPE levels.
--Leverage increasing materially above 4x and/or debt service coverage remaining below 1.6x, on an ongoing basis.

CREDIT UPDATE

Performance Update

The airport experienced minor enplanement growth of 0.5% to 802k in fiscal 2016, exhibiting a continuation of positive performance over the past two-years, which grew by 3% in FY2015 and 2% in FY2014. The airport's recent growth is primarily driven by increasing mainline passenger traffic from Delta Airlines and Southwest Airlines, whereas regional traffic performance has been more volatile. Management expects continued growth in passenger traffic to be driven by service expansions, trends towards larger aircrafts, and general economic growth at the airport.

PNS continues to maintain its carrier concentration with Delta Airlines leading the market share at 44%, followed by American Airlines (formerly U.S. Airways) at about 24%, Southwest Airlines about 15%, and United Express 10%. Other carriers represent smaller portions of market share relative to total. The airport also serves United Parcel Service (UPS) modest cargo operations representing 9.5% of total landed weight.

Fitch views the updated five-year capital improvement program manageable at about $64 million and will primarily be funded from Federal Aviation Administration (FAA) entitlements and Federal grants. Passenger Facility Charge funds will also fund parts of the CIP, but represents a small percentage relative total. Management expects no additional debt to fund future projects.

Supported by the airports stable operational performance, total revenues grew by 4.6% to about $22 million in FY2016 primarily supported by growth in non-airline revenues mainly from parking and airport automobile rentals, along with a general increase in other terminal area revenues. Similarly, airline revenues exhibited robust growth at 9.7% to $7.2 million in FY2016 due to increases in terminal building rents and passenger airline landing fees. Operating expenses rose by 8.4% to $12.5 million up from $11.6 million in FY2015 mainly driven by increased spending on services & supplies, and salaries & benefits, which grew by 11% and 8% respectively.

The airports debt service coverage rose to 2.00x (2.42x with transfer funds) in FY2016 from 1.84x and 2.07x the prior year. PNS liquidity increased to 531 days cash on hand (DCOH) benefiting from a stronger unrestricted cash position in FY2016, and leverage fell below 3x. CPE increased to $8.82 in FY2016 up from $8.02 in FY2015, driven by higher airline revenues. Fiscal year 2018 CPE is expected to fall to about $7 benefiting from baggage handling service (BHS) use fee coupled with growth in enplanements.

Fitch Cases

Due to the residual nature of the AUL, Fitch's assumes stable annual debt service coverage (DSC) targeting about 1.6x. Fitch's base case assumes flat enplanement growth of 0.5% reflecting recent performance in fiscal 2016 and is held constant throughout the FY2017 - FY2022 projected period. Fitch generally adopted the sponsor's financial performance for revenues and expenses for FY2017 and FY2018, with expenses increasing 2.5% each year and unrestricted cash held flat. Cost per enplanement (CPE) averages $7.88 and day's cash on hand reflects 504 days on average.

Fitch's rating case was similar but applied a 5% and 1% to traffic stress in 2018 and 2019 based on a reasonable estimate of historical volatility, followed by 1% annual recovery thereafter. Operating expenses were increased by 0.5% above base case levels. With the residual AUL, coverage is still maintained at about 1.6x, but CPE is inflated to nearly $8.49 by fiscal 2022 on average. Leverage (Net Debt/CFADS) averages 2.4x and days cash on hand is 510 days.

Security

The bonds are payable from net revenues generated by the airport and a cash-funded DSRF sized to the maximum level allowed by the IRS.

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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)

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