STANDARD & POOR'S

Global Credit Portal
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Summary:
Pensacola, Florida
Pensacola Regional Airport; Airport

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Pensacola (Pensacola Regl Arpt) arpt rev bnds ser 2008-A		
Long Term Rating	BBB/Stable	Downgraded
Pensacola		
Unenhanced Rating	BBB(SPUR)/Stable	Downgraded

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services has lowered its long-term and underlying ratings on Pensacola, Fla.'s airport revenue bonds outstanding, issued for Pensacola Regional Airport (PNS), to 'BBB' from 'BBB+'. The downgrade reflects our view of eroded financial margins, lower traffic levels, increased competition from recently opened Panama City Airport, and a high debt load. The outlook is stable.

The 'BBB' rating reflects what we consider to be the following credit weaknesses:

- An erosion in financial margins as evidenced by debt service coverage (DSC; Standard & Poor's-calculated) that declined to approximately 0.8x in fiscal 2009 and an estimated 1.2x in fiscal 2010, down from about 1.9x in fiscal 2008. We do not expect the airport's financial margins to return to those achieved before fiscal 2009 because of increased competition from low-cost carrier service at the new Panama City Airport;
- A high debt burden, at $106 per enplanement based on fiscal 2010 enplanements of 720,000;
- High exposure to Delta Air Lines Inc. and its affiliates (including Northwest Airlines Inc.), which together accounted for approximately 47% of estimated enplanements for fiscal 2010; and
- Enplanements that fell 2.4% in fiscal 2008 and 13.9% in fiscal 2009, and could face further pressure due to increased competition from the new Panama City Airport.

In our view, offsetting credit strengths include:

- A good origin-destination market, which we believe provides PNS with a good base level of air travel demand;
- Good revenue diversity, with airline revenues representing approximately 29% of total operating revenues in both fiscals 2009 and 2010; and
- Limited additional debt needs.

The airport's net revenues secure the series 2005A and 2008A and B airport revenue bonds, as well as the 2010 Bank of America N.A. bank bonds that are on par. It also has outstanding a 2008 revenue note for which it has committed customer facility charge revenue. In addition to net revenues, a portion of passenger facilities charges (PFCs) are committed to pay part of the debt service on the 2008B airport revenue bonds. The airport has approximately $76.13 million in debt outstanding.

Much like many airports, PNS experienced a drop in air travel demand in fiscals 2008 and 2009 because of record high fuel prices in the summer of 2008, the recession, and most airlines' reduction in domestic capacity. The airport's enplanement trends, however, fared worse than national trends for scheduled domestic enplanements, with 13.9% fewer passengers for fiscal year-end 2009 (Sept. 30), while domestic scheduled enplanements on U.S. airlines experienced a 7.2% drop. Air travel demand may have stabilized. Enplanements estimated for fiscal year-end 2010 are approximately 720,000, up 2.7% from fiscal 2009.

Before fiscal 2008, the airport benefited from six consecutive years of enplanement growth from fiscals 2002-2007 due to low-cost service provided by AirTran Airways, which initiated service in fiscal 2002. Enplanements increased 59.4% to a record 835,121 in fiscal 2007 from 523,991 in fiscal 2001, or an annual compound growth rate of 11.9% from fiscals 2004-2008. For fiscal 2010, AirTran accounted for approximately 15% of enplaned passengers and has made up 15%-18% of enplanements since fiscal 2007. Delta, including Northwest airlines, composed an estimated 47% of traffic in fiscal 2010, followed by AirTran, and Continental Airlines Inc. at 13%. Although PNS benefits from its proximity to the city's military bases, providing it with a good base of air travel demand, we believe that Panama City Airport (103 miles away), which offers Southwest Airlines Co. service, will limit the airport's ability to recover to its historical activity levels. Smaller airports in Fort Walton Beach, Fla. (40 miles away) and Mobile, Ala. (58 miles) are less of a credit concern.

PNS maintained good financial margins before fiscal 2009. Since then however, its financial margins have eroded due to weaker revenue performance from lower traffic levels and higher operating expenses. More specifically, DSC (Standard & Poor's-calculated), which excludes previous-year transfers and includes committed PFCs in the numerator, was what we view as a weak 0.84x in fiscal 2009, down from a good 1.98x in 2008 and 2.3x in fiscal 2007. A 14.5% decrease in pledged revenues and a 12.3% increase in expenses were key factors that led to the significant erosion. Estimated fiscal 2010 coverage is 1.22x (Standard & Poor's-calculated). PNS' indenture coverage, which includes transfers from the previous period, exceeded the 1.25x requirement. In fiscal 2009, indenture coverage was 2.50x as a result of the airport including $5.3 million in transfers, up from the $2.2 million-$2.5 million that it has carried forward historically. Estimated fiscal 2010 indenture coverage is 2.16x and includes $2.4 million in transfers. Management budgets indenture coverage for fiscal 2011 at 1.9x. Although PNS has the legal flexibility to satisfy its rate covenant with unlimited use of previous-year transfers, we expect management will operate the airport such that annual debt service coverage consistently exceeds 1x (Standard & Poor's-calculated), which excludes transfers and includes committed PFCs as part of revenues rather than as an offset to debt service.

The airport has approximately $76.1 million of airport revenue bonds outstanding, or what we consider a high $106 per enplanement based on fiscal 2010 enplanements. Currently, it does not have any additional debt needs except for a potential refinancing of its 2008 $19 million interest-only loan from Bank of America, for which $14 million is outstanding. PNS' unrestricted cash position improved to $7.7 million for fiscal 2010, providing 224 unrestricted days' cash on hand, which we consider adequate for the rating level, up from 93 in fiscal 2009. The airport has maintained a moderate cost structure, ranging from $5.99-$6.30 per enplaned passenger from fiscals 2007-2009; however, management has budgeted it to rise to $7.42 in fiscal 2010.

We consider the airport's capital needs manageable. The city's rolling multiyear capital improvement program (CIP) for PNS for fiscals 2011-2015 totals $67.9 million and includes $18.7 million in airfield rehabilitation and renovation costs, $10 million in land acquisition costs, and $30 million for a parking structure that management will finance through cash, PFC pay-as-you-go money, or internally generated funds. Expected CIP funding sources include PFCs ($33.4 million), federal and Florida Department of Transportation grants ($29.7 million), and the airport's funds ($4.7 million).

Outlook

The stable outlook reflects our expectation that PNS will maintain adequate financial margins and liquidity levels, while limiting its debt needs. A decrease in the airport's liquidity, a material increase to its debt burden, or consistently slim DSC (Standard & Poor's-calculated) could lead to a negative outlook or downgrade. We do not expect to raise the ratings during the next two years because we believe PNS' lower activity levels and high debt burden will likely pressure financial margins.

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