FitchRatings

RATING ACTION COMMENTARY

Fitch Rates San Francisco International Airport (CA) Revs 'A+'; Outlook Stable

Fri 13 Oct, 2023 - 3:11 PM ET

Fitch Ratings - Austin - 13 Oct 2023: Fitch Ratings has assigned an 'A+' rating to the Airport Commission's, City and County of San Francisco, CA, San Francisco International Airport (SFO) approximately $794 million series 2023C and D second series revenue refunding bonds. The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
San Francisco (City & County) Airport Commission (CA) [Airport]				
San Francisco (City & County) Airport Commission (CA) /Airport Revenues/1 LT	LT	A+ Rating Outlook Stable	Affirmed	A+ Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

RATING RATIONALE

The rating reflects SFO's strong operational and financial performance within the normally 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. Fitch rating case leverage (including capitalized interest as a revenue) peaks above 11x, but falls below 10x by 2030 while cost per enplanement (CPE) steadily rises above $40 by fiscal 2030. These results are reasonable for an international gateway airport and should remain competitive relative to peers and the 'A+' rating level.

KEY RATING DRIVERS

Strong Operations, Some Concentration - Revenue Risk (Volume): High Stronger

SFO serves as a major international gateway airport with a consistently strong greater than 60% market share of passenger traffic within the San Francisco region under normal operating conditions. The airport has a well-balanced traffic profile, with mostly origination and destination (O&D) traffic and the remainder being a mix of domestic and international connecting traffic. Though recovery has lagged the nation, pre-pandemic enplanement growth was among the strongest reaching a peak of more than 28.8 million enplanements in fiscal 2018 and a full recovery is expected over the next few years as international travel from Asia and business travel ramp back up.

United Airlines Inc. (United; B+/Stable) maintains a sizable presence at SFO, with a steady passenger market share of almost 50%. This is despite United's increased seat capacity as low-cost carriers have also grown at SFO and foreign-flag airlines have expanded service prior to the pandemic. CPE will increase significantly but remain consistent with peers and reasonable for the product offered.

Favorable Rate-Setting Framework - Revenue Risk (Price): Stronger

SFO's new fully residual airline use agreement (AUL), extends 10 years through fiscal 2033, providing for continued strong cost recovery with respect to all operating and debt service requirements and stable financial performance. Airline charges have been steadily increasing as the capital plan progresses and will continue to do so under the new agreement given full cost recovery. Positively, this successor agreement includes the build-up of a discretionary cash fund for use by the airport, funded through the airline rate base, which will enhance available liquidity and provide a potential additional funding source for capital projects.

Large, Debt-Funded Capital Plan - Infrastructure Development/Renewal: Midrange

The updated capital improvement plan (CIP) totals approximately $11 billion through 2033. This reflects a combination of the Ascent Program Phase 1.5 ($8 billion) and Infrastructure Projects Plan ($3 billion). The CIP includes $4.9 billion of carry forward budget, $2.7 billion of increased scope on existing projects and $3.5 billion of new projects. SFO considers the recently completed and planned projects necessary to adequately serve the airport's growth. SFO's capital needs are well managed, including project reserves totaling $1 billion, several project level contingencies, and various other approaches to anticipate and mitigate construction cost escalation. The CIP continues to be predominantly bond funded, though $2.2 billion has already been funded leaving $7.6 billion in future bonds through 2033 following the series 2023CD issuance.

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 will approximately triple historical levels and leverage will remain relatively flat given the expected new money issuances.

Financial Profile

SFO's debt level is high at more than $8 billion and contributes to the airport's high fixed-cost structure. Additional borrowings beyond the 2023 issuance to support capital spending cause debt metrics to remain relatively flat, but they should remain reasonable for an international gateway with SFO's franchise strength and consistent with peers and the current rating. The airport has a strong liquidity position (Fitch calculated days cash on hand [DCOH] above 600 for estimated fiscal year end 2023) and stable coverage levels, demonstrating it can adequately meet its debt service obligations. The debt service coverage ratio (DSCR) remains around 1.4x through fiscal 2030, including permitted transfers (1.2x without) in Fitch's case.

PEER GROUP

SFO's peers include Los Angeles International Airport (LAX; AA/AA-/Stable) and Chicago O'Hare International Airport (ORD; A+/Stable) given their similar prominence as large-hub, international gateway airports with elevated leverage, sizeable capital plans to support on-going operations, and material borrowing needs. LAX's higher rating is supported by its lower net debt-to-CFADS and higher DSCR given its hybrid AUL. SFO's fully residual airline

agreement will provide for comparable airline costs and leverage to ORD over the medium term, albeit with a smaller enplanement base.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--Material increases to the capital program size or additional borrowings leading to sustained leverage above 12x;

--Unfavorable changes in the airport's traffic profile given the sizable presence of United at SFO and the competing airports in San Jose and Oakland.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--Though unlikely in the near term given SFO's elevated debt burden and sizeable additional borrowing needs, sustained leverage near or below 10x.

TRANSACTION SUMMARY

SFO is expected to issue approximately $794 million of series 2023C and D bonds to repay approximately $498 million of outstanding CP, refund approximately $242 million of outstanding series 2013A bonds for debt service savings (subject to market conditions), fund capitalized interest and reserve funds, and pay cost of issuance. SFO expects to achieve around $11.5 million of NPV savings (4.8% of refunded par) on the refunding, subject to market conditions.

CREDIT UPDATE

SFO continues to lag national traffic recovery, ending fiscal 2023 (FYE 6/30) at nearly 82% of fiscal 2019 levels. International traffic continues to rebound at a faster pace, with all traffic restrictions lifted, and reached 85% of 2019 levels for fiscal 2023. Domestic traffic has recovered slightly less to around 81%. However, these levels are consistent with those of several other large hub and international gateway peers as well as West Coast airports.

Despite its slower recovery, Fitch views SFO as an airport with an important role in the national aviation system and a favorable coastal geographic location to support its standing as a prominent international gateway. A pre-pandemic five-year CAGR for 2014-2019 of 4.5% highlights the strength and desirability of the underlying air service area and the approximately 82% O&D traffic levels add stability to volume levels. SFO also continues to enjoy a dominant market share in the Bay Area.

SFO remains especially important to its dominant carrier, United (47%). SFO is United's fifth busiest hub based on scheduled departing seats and plays an important role in United's system as a domestic connecting hub and international gateway. Over the last five years, United has launched service to more international destinations from SFO than from any other hub and has repositioned international equipment from LAX to SFO. United has invested significant capital in SFO and continues to partner with SFO on future capital improvements.

SFO executed a new 10-year AUL effective July 1, 2023 through fiscal 2033 with 37 signatory carriers as of Sept. 1, 2023. It maintains the strong cost recovery provisions under a fully residual rates and charges methodology and the same negative majority-in-interest (MII) provisions, but it includes the build-up of a discretionary cash fund for use by the commission, funded through the airline rate base.

The additional liquidity will be held within the airport revenue fund and designated as the Operating Revenue and Capital Improvement Fund (ORCIF), which can be used for any lawful airport purpose. The ORCIF will initially be funded with $250 million in fiscal 2024 and be subject to minimal annual additions as well as additional annual deposits. However, no deposit will be made in any fiscal year in which the starting unencumbered and unallocated ORCIF balance exceeds $650 million before inflationary adjustments.

SFO's recently approved CIP totals $11 billion through fiscal 2033 between Ascent 1.5 and Infrastructure CIP (formerly Rolling CIP). Ascent Phase 1.5 encompasses projects that address existing infrastructure, as well as anticipated passenger and airline growth-related needs. Infrastructure Projects Plan includes spending on support systems, miscellaneous airfield improvements, terminal improvements, energy and efficiency improvements, and equipment projects.

Ascent 1.5 will build upon Ascent Phase 1, which was first included in the fiscal 2017 capital plan and included projects supporting terminals, groundside, airport support, utilities, and airfield, with a majority of the budget focused on terminals. The single largest project was the renovation of Terminal 1 ($2.6 billion). The largest terminal project spending in the current CIP is for the modernization of Terminal 3 West ($2.2 billion) and the renovation of Terminal 1 Center ($1.6 billion). The reconfiguration and renovation of the western side of Terminal 3 is intended to increase gate flexibility (domestic and international as well as various aircraft types), improve seismic stability, upgrade building and baggage handling systems, improve passenger flow, add a sterile connector to the international terminal complex, and enhance passenger amenities.

Following the expected series 2023C and D issuance, SFO is projecting CIP spending of $8.3 billion from fiscals 2024-2033. Approximately $7.6 billion of additional bonds are anticipated through fiscal 2029 as well as $763 million of other funding to complete the program. Positively, the program includes various contingencies at the project and program level as well as other mitigation factors should costs rise and/or volumes decline and SFO continues to take a modular and phased approach.

Estimated fiscal 2023 debt service coverage, taking into account permitted contingency fund transfers of approximately $168 million and reduced debt service obligations (relative to historical levels), remained slightly above pre-pandemic levels at 1.7x. On a standalone basis, excluding contingency rollover funds, estimated coverage was 1.3x. Looking forward, management forecasts DSCR to remain around 1.4x. CPE tempered further to less than $24, but will rise to around $40 by 2030 in the airport consultant's forecast as new debt comes online. Still, CPE should remain competitive for an international gateway airport with sizeable capital needs.

The airport closely monitors liquidity and was able to maintain its DCOH (Fitch-calculated) at more than 600 days for fiscal 2023. When also including cash-funded debt service reserve funds, leverage in terms of net debt-to-cash flow available for debt service, fell to 13x and would be lower if not for the reduced debt service obligations together with lower operating expenses reducing the revenue needs under the residual agreement.

FINANCIAL ANALYSIS

Fitch Cases

Fitch received and reviewed the report of the airport consultant as an input to developing its own base and rating cases. Both cases assume an additional $7.6 billion of future bonds in addition to the anticipated $498 million of series 2023CD bonds.

Fitch's base case takes a more conservative view of enplanement recovery in light of the airport's stage of pre-pandemic recovery, as well as Fitch's view of the current and future macroeconomic landscape. The result is a 3.6% CAGR over fiscals 2023-2030. Operating expenses are informed by SFO's own scenario analysis and grow at a 7.0% CAGR for 2023-2030. Annual PFC utilization is also informed by management and ranges from $130 to $200 million annually. Non-airline, passenger driven revenues move largely with enplanement fluctuations and airline revenues are calculated to ensure compliance with rate covenants under the residual AUL framework.

Results indicate a stable DSCR profile of around 1.4x (including permitted transfers) in line with historical performance, while cost per enplanement rises above $40 by 2029 given the additional debt and growing expenses. Leverage remains relatively flat between 9x-11x, falling below 10x by 2030 despite additional borrowing needs, when accounting for capitalized interest and assuming additional liquidity from the new AUL.

The rating case follows a similar methodology to the base case, but models in a hypothetical recession in 2025 such that enplanements fall 5% followed by a two-year recovery and 3% growth thereafter for a 2023-2030 CAGR of 2.2%. Given the fully residual AUL, coverage and leverage metrics are consistent with the rating case, but airline CPE is $4-$5 higher each year assuming that SFO takes no actions to curtail costs or reduce capex given the enplanement loss and slower growth, which is unlikely. Leverage remains consistent with the current rating in the rating case and CPE would remain consistent with international gateway peers with sizeable capital plans and reasonable for the SFO product.

DATE OF RELEVANT COMMITTEE

11 January 2023

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

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FITCH RATINGS ANALYSTS

Jeffrey Lack
Senior Director
Primary Rating Analyst
+1 312 368 3171

jeffrey.lack@fitchratings.com
Fitch Ratings, Inc.
2600 Via Fortuna, Suite 330 Austin, TX 78746

Seth Lehman
Senior Director
Secondary Rating Analyst
+1 212 908 0755
seth.lehman@fitchratings.com

Scott Monroe, CFA
Senior Director
Committee Chairperson
+1 415 732 5618
scott.monroe@fitchratings.com

MEDIA CONTACTS

Sandro Scenga
New York
+1 212 908 0278
sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

Transportation Infrastructure Rating Criteria (pub. 16 May 2022) (including rating assumption sensitivity)

Infrastructure & Project Finance Rating Criteria -- Effective July 20, 2022–May 17, 2023 (pub. 20 Jul 2022) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

GIG AST Model, v1.3.1 (1)

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