Revenue
New Issue

Airport Commission, City and County of San Francisco, California

San Francisco International Airport

Ratings

New Issues[a]

Second Series Variable-Rate Revenue Refunding Bonds, Issue 34A, 34B, 34C, 34F, 34G	A
Second Series Revenue Refunding Bonds, Issue 34D, 34E	A

Outstanding Debt

Second Series Revenue Bonds	A

[a]Issue 34 and all subseries are expected to be insured by a bond insurer whose insurer financial strength is rated 'AAA' by Fitch Ratings.

Rating Outlook

Positive

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New Issue Details

Sale Information: Approximately $535,640,000 Second Series Revenue Refunding Bonds, consisting of: $6,800,000, Issue 34A, variable-rate revenue refunding bonds (AMT); $50,870,000, Issue 34B, variable-rate revenue refunding bonds (AMT); $50,870,000, Issue 34C, variable-rate revenue refunding bonds (AMT); $230,800,000, Issue 34D, revenue refunding bonds (AMT), $25,700,000, Issue 34E, revenue refunding bonds (Non-AMT); $50,000,000, Issue 34F, variable-rate revenue refunding bonds (AMT); and $59,600,000, Issue 34G, variable-rate revenue refunding bonds (AMT). Issue 34A, B, and C bonds to sell on or about Jan. 31; issue 34D and E bonds to sell on or about Jan. 28; and issue 34F and G bonds to sell the week of March 24.
Purpose: Refund portions of the outstanding debt for a net present value of approximately $50 million in debt service savings.
Final Maturity: 2030

Rating Rationale

- San Francisco International Airport (SFO, or the airport) provides almost all international and most long-haul domestic service in the region.
- Passenger traffic at SFO is supported by the strong demand and wealthy service area of the San Francisco Bay area, which is capable of supporting a high (73%) origination and destination (O&D) traffic levels.
- The airport's debt level totals a sizable $3.8 billion, which results in a high fixed-cost structure.
- SFO is well-positioned geographically, serving as the West Coast's second largest international gateway to the Pacific Rim countries.
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Key Rating Drivers

- Continued strong debt management practices.
- Healthy growth in non-airline revenues and continued development of these revenue streams.
- Airport management's ability to implement a sound and prudent capital program that does not negatively affect airport financials.

Credit Summary

The 'A' rating reflects SFO's importance as a regional transportation provider for long-range domestic and international air service, as well as the San Francisco Bay Area's significant population base (in excess of seven million), high wealth levels, and diverse economy, which support the strong passenger demand for service. Additional strengths include the airport's stable and strong balance sheet and healthy financial operating ratio (43% in fiscal 2007). Offsetting credit factors include the airport's high cost structure and, to some extent, air service market share concentration (48.6%) in United (UAL Corp; long-term Fitch Issuer Default Rating of 'B–', with a Positive Rating Outlook). This concentration is partially mitigated by the high level of O&D enplanements, which represent 73% of total volume. Airport revenues derived from United are also somewhat concentrated, representing 26% of SFO's total operating revenues. This concentration is partially mitigated by the strong non-airline revenues at the airport. However, moderate competition exists between the Norman Y. Mineta San Jose International Airport (SJC) and Oakland International Airport (OAK) and SFO, which provide short- to medium-haul low-cost air service alternatives in the south and east bay.

The airport's $919 million capital plan includes the potential for additional debt of approximately $648 million and the use of $166 million in PFC funds, $16 million in construction fund cash, $15 million in operating funds, and $4 million in excess reserve fund cash. While the addition of new debt is expected to place upward pressure on the airport's cost structure, management intends to take a phased-in demand-driven approach, which should moderate and prevent any spikes in the cost structure. Management continues to encourage growth in long-haul, low-cost, and international service.

Capital Structure and Legal Provisions

SFO reported more than $3.8 billion in parity revenue bonds outstanding. The airport's overall debt portfolio will remain primarily long term, fixed rate, nearing its synthetically fixed-rate capacity of 20%, with a total unhedged variable-rate exposure of approximately 10%. According to SFO's audited financial statements, cash and investments equaled $263 million in fiscal 2007, and management retains some additional flexibility with the ability to issue up to $400 million in commercial paper.

Security: The issue 34 series A–G bonds are secured by a pledge of net revenues from the airport and are on parity with the outstanding airport revenue bonds. Additionally, the airport commission currently transfers available funds from the contingency account to the revenue account; these transferred funds are available for payment of up to 25% of debt service, but this source is not pledged and may not always be available.

Rate Covenant: The airport commission covenants to establish rates, fees, and charges for the use of the airport, as well as for services rendered by the commission, which will produce net revenues in each fiscal year at least sufficient to make all required debt obligation payments and the annual service payment to the city. Net revenue, together with the transfer, in each fiscal year must be equal to at least 125% of aggregate annual debt service for the bonds.

Additional Bonds Tests: Additional parity bonds must be approved by the board of supervisors of the city and county of San Francisco and may be issued provided that, among other things:

- According to a certificate from an airport consultant, during the entire period that interest (including on the additional bonds) is to be paid from bond proceeds, net revenue (together with the transfer) will equal at least 1.25 times (x) annual debt service in each fiscal year.
- For the period in which no interest is to be paid from proceeds on the additional bonds (including the later of the fifth full fiscal year following the new issuance or the third full fiscal year during which no interest is to be paid from the proceeds of the new issuance), projected net revenue, together with the transfer, will be at least sufficient to satisfy the rate covenant; or according to a certificate of an independent auditor, net revenue (together with the transfer) in the most recent fiscal year equaled at least 125% of the sum of annual debt service on the bonds in such fiscal year and maximum annual debt service (MADS) on the proposed bonds.

Reserve Account: A debt service reserve fund will be established in an amount equal to MADS. Credit facilities, including surety bonds, may be used to satisfy the debt service reserve fund requirement.

Economic Model

San Francisco International Airport

The city and county of San Francisco own and operate SFO under the jurisdiction of the airport commission. The commission, which consists of five members appointed by the mayor for four-year overlapping terms, operates the airport as a separate enterprise department of the city.

Related Research

- *Airport Commission, City and County of San Francisco, CA (San Francisco International Airport), Oct. 31, 2006*
- *Airport Commission, City and County of San Francisco, CA (San Francisco International Airport), Feb. 7, 2006*

Rating History

Rating	Action	Outlook/ Watch	Date
A	Affirmed	Positive	1/18/08
A	Affirmed	Stable	10/26/06
A	Affirmed	Stable	1/26/06
A	Affirmed	Stable	1/25/05
A	Affirmed	Negative	6/29/04
A	Downgraded	Negative/ Watch	5/23/03
A+	Affirmed	Negative/ Watch	12/13/02
A+	Downgraded	Stable	2/22/02
AA–	Affirmed	Negative	10/15/01
AA–	Assigned	Stable	1/15/98

The airport, which opened for service on June 7, 1927, is the principal commercial service airport for the Bay Area. SFO is located on a 5,171-acre site (about 2,788 acres are undeveloped tidelands) in San Mateo County, about 14 miles south of downtown San Francisco. SFO offers flights to most major U.S. cities and international destinations. Moreover, the airport's passenger traffic is approximately 73% O&D, a significant and positive concentration for a large-hub airport.

The current passenger terminal complex consists of three domestic terminals — terminals 1, 2, and 3 — spanning about 2.6 million square feet. Together, they provide a total of 78 gate positions. The international terminal includes 2.5 million square feet of terminal and boarding area space and 24 gate positions. SFO also has numerous cargo facilities and 11,529 public parking spaces. The airport opened the AirTrain system in early 2003. AirTrain connects the various airport terminals to the rental car facility, the parking lots, and the San Francisco Bay Area Rapid Transit system. Additionally, United operates one of the world's largest maintenance centers at the airport. Airfield facilities include four runways — 28R-10L (11,870 feet), 28L-10R (10,600), 1R-19L (8,900), and 1L-19R (7,000). Airfield configuration permits simultaneous landings during favorable weather conditions. SFO operates in a moderately competitive environment, particularly for short-haul domestic flights, for which the two other Bay Area airports, SJC and OAK, compete.

Debt Service Coverage

($000, Fiscal Years Ended June 30)

	2003	2004	2005	2006	2007
Net Revenues	297,676	311,105	304,729	297,165	302,069
Transfer from Contingency Account	92,658	92,658	92,658	92,584	92,609
Total Available for Debt Service	390,334	403,763	397,387	389,749	394,678
Total Debt Service	276,624	291,838	285,984	278,544	266,919
DSCR per Indenture (x)	1.41	1.38	1.39	1.40	1.48

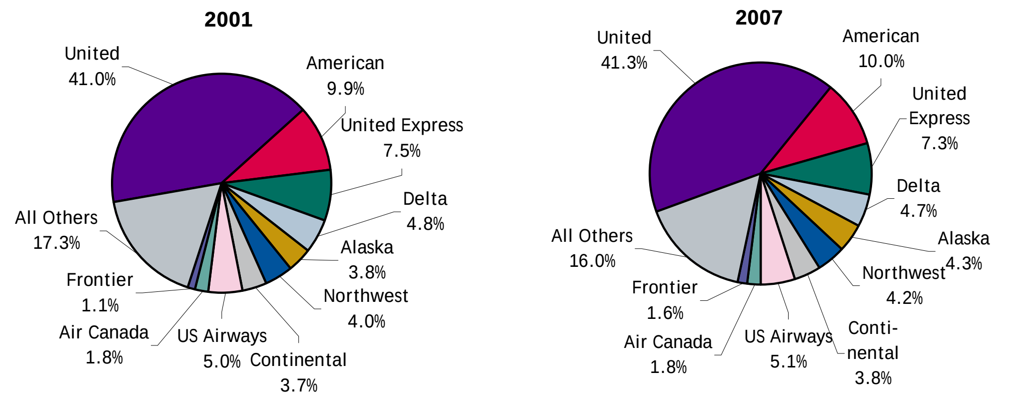
Use and Lease Agreement

The city, acting through the commission, entered into a long-term use and lease agreement with all the domestic airlines and several of the foreign flag carriers that service SFO. Most of the airline agreements expire on June 30, 2011.

The use and lease agreement allows annual adjustment of landing fees and terminal rental rates. According to the residual rate-setting methodology, overall airline payments are established by determining total costs (including debt service) and subtracting non-airline revenue; the remainder is the airline component. If net revenue and the transfer are estimated to be insufficient to meet the rate covenant, the signatory airlines are required under the agreement to provide the minimum amount necessary to comply with the covenant. The agreement also includes a majority-in-interest provision that requires airline approval of large capital expenditures.

Airline-related fees at SFO are high compared with those of airports with similar characteristics. Since fiscal 2001, these fees have escalated significantly as costs associated with the international terminal complex were incorporated into the rate base. However, the CPE, based on the airline rates and charges formula, decreased to $15.06 in fiscal 2007 from a peak of $19.62 in fiscal 2003. This reflected a decrease in airline revenues, as well as an increase in non-airline revenues, including PFCs, that was used to directly offset debt service payments.

Market Share
(Fiscal Years Ended June 30)



Note: Numbers may nor add to 100% due to rounding. Source: San Francisco International Ariport.

Air Service

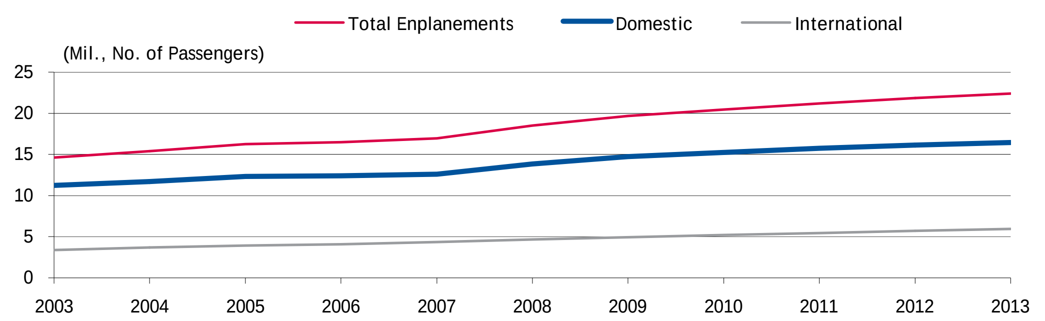
Airlines and Market Share

SFO is served by a total of 43 passenger carriers, 20 of which are domestic carriers and 23 foreign flag carriers. Although the combined airline market share of United (41.3%) and United Express (7.3%) is somewhat high at 48.6%, this is mitigated by the airport's relatively high O&D traffic level (73%). No airline other than United maintains a considerable airline market share, as no other carrier accounted for more than 15% of enplanements in fiscal 2007. Specifically, American Airlines had 10% of overall enplanements, followed by Delta Air Lines (4.7%), Alaska Airlines (4.3%), and Northwest Airlines (4.2%).

Enplanement Trends

After three consecutive fiscal years of total enplanement declines (2001–2003), enplaned passengers increased in each of the past four fiscal years. Enplanements grew by 5.3% in fiscal 2004, mainly due to rising international enplanements, while expanded domestic and international passenger traffic in fiscal 2005 helped propel total enplanements by a further 5.5%, reaching 16.3 million. As management had expected, enplanements in fiscal 2006 grew at a slower pace of 1.5% as lower domestic capacity across the nation had an impact on SFO. Despite the decrease in domestic capacity,

Enplanement Trends
(Fiscal Years Ending June 30)



Source: San Francisco International Ariport.

international traffic continued to grow at 4.3% in fiscal 2006. Fitch views continued growth in enplanements as proof of the market's resiliency, especially since enplanement growth surpassed prior projections by the feasibility consultant.
During fiscal 2007, three new (or returning) low-cost carrier entrants began service: JetBlue Airways, Virgin America, and Southwest Airlines. While SFO had already been served by low-cost carriers (LCCs), the total number of scheduled seats provided by LCCs reached 20.2% in September 2007, up from 9.0% for September 2003. The growth in LCC service at SFO has helped it compete with area airports and foster greater fare competition. While the recent entrant airlines are supporting growth on the domestic side, new international service is being added by both domestic and foreign-flag carriers. United recently announced new direct service to Guangzhou, China in Spring 2008, Cathay Pacific added a second daily nonstop flight to Hong Kong; and Aer Lingus commenced four times weekly service to Dublin, Ireland. In addition, new service to India will also begin in March and April 2008 offered by Kingfisher Air, Jet Airways, and Air India.

Enplanement forecasts appear to be aggressive, forecast at 9.1%, 6.4%, and 3.9% in fiscal years 2008, 2009, and 2010, respectively. However, when actuals for the first four months of fiscal 2008 are compared with that same period in fiscal 2007, total passenger traffic is up 8.3%. While traffic growth should continue to grow at a steady pace, Fitch will closely monitor passenger service at SFO.

Capital Improvement Program

SFO's draft five-year capital improvement plan (CIP) for fiscal years 2009–2011 totals approximately $919 million and includes approximately $504 million in terminal improvements; $187 million in airfield improvements; $108 million in utilities (e.g. central plant improvements, waste water system improvements, industrial treatment); $75 million in airport support (wetland restoration and other projects); $50 million in groundside improvements; and $4 million for the Lomita Canal Drainage. These capital projects are in the planning stages and will be presented to the board of supervisors in 2008. As such, projects have not been committed to and are expected to be structured as demand-responsive, only being initiated after meeting a defined threshold.

Airport management expects to utilize CP to provide some initial funding for the CIP. Management plans to begin issuing CP during 2008, with the expectation of paying off the CP with the issuance of additional long-term bonds. Under the draft capital plan, management expects to issue approximately $648 million in revenue bonds. Fitch believes that airport management has prudently managed its debt profile and expects the new capital plan to be congruent with past practices.

Financial Operations

The airport's overall financial position is strong, largely reflecting SFO's residual use and lease agreement that drives its healthy financial relationship with the airlines utilizing the facility. Over the past five fiscal years, SFO maintained a strong liquidity position, with its unrestricted cash balance ending at $263 million in fiscal 2007, down slightly from its peak in this period of $272 million in fiscal 2003. The airport's cash position resulted in 223 days cash on hand in fiscal 2007. While there has been some fluctuation in the airport's balance sheet, Fitch believes that management effectively weathered the events of Sept. 11, 2001, the outbreak of SARS, and the United bankruptcy while implementing a scaled down capital program. Total debt outstanding continued to decrease as a result of amortization, to $3.8 billion in fiscal 2007 from a high of $4.2 billion in fiscal 2003. It is important to note that SFO retains additional capacity of $400 million in its CP program, which it intends to use to fund capital projects during fiscal 2008.

Balance Sheet

($000, Fiscal Years Ended June 30)

	2003	2004	2005	2006	2007
Assets					
Unrestricted Cash and Investments	271,646	271,219	264,061	240,281	263,176
Unrestricted Current Assets	310,615	306,141	296,230	282,493	306,897
Total Current Assets	314,623	369,734	355,602	336,942	362,827
Restricted Cash and Investments	253,975	174,519	165,992	151,778	125,114
Grants Receivable (FAA-AIP Grants)	8,822	7,156	20,210	38,426	17,986
PFC Receivable	8,550	9,722	7,262	15,210	13,321
Total Restricted Assets	546,002	358,521	366,877	359,399	318,170
Net, Property, Plant, and Equipment	3,971,339	3,900,905	3,760,023	3,676,771	3,640,941
Total Assets	4,877,944	4,708,333	4,534,629	4,426,637	4,371,100
Liabilities					
Accounts Payable (Unrestricted)	13,566	11,254	20,064	27,794	37,769
Accounts Payable (Restricted)	25,045	15,480	9,340	8,919	7,758
Total Current Liabilities	126,441	138,040	137,331	151,833	176,163
Revenue Bond Debt Outstanding	4,154,320	4,040,096	3,974,474	3,901,714	3,819,592
CP Outstanding[a]	—	—	—	—	—
Total Noncurrent Liabilities	4,164,424	4,050,089	3,983,849	3,911,220	3,829,355
Total Liabilities and Equity	4,877,944	4,708,333	4,534,629	4,426,637	4,371,100

[a]$400 million authorized.

From fiscal years 2003–2007, operating revenues were adequate to produce operating ratios that ranged from 41%–52%. By the end of fiscal 2007, SFO's operating ratio was 43%, with operating revenues and operating expenses at $504 million and $288 million, respectively. Although the airport's operating ratio remained stable, total operating revenues were relatively flat while operating expenses, excluding depreciation, grew on an average annual basis at 4.6%. While management successfully controlled growth in personnel, contractual services, and city service expenses, the growth driving the total O&M figure from fiscal years 2003–2007 was the increase in repairs and maintenance expenses. Management continues to benefit from the growth in PFC revenues, which rose on average annually at 5.5% from fiscal years 2003–2007. PFCs contribute additional revenues to assist in reducing the debt service costs to help maintain healthy coverage levels of 1.38x–1.48x during the period. In addition, PFC revenues help reduce airline rates and charges and, thus, assist in reducing the CPE to a budgeted $13.60 in fiscal 2008 from a high of $19.62 in fiscal 2003. Fitch considers

Operating and Financial Statistics

(Fiscal Years Ended June 30)

	2003	2004	2005	2006	2007
Airline Cost Per Enplanement ($)	19.62	17.27	15.42	14.69	15.06
Days Cash On Hand	222	247	230	203	223
Unrestricted Cash Per Enplanement (%)	19	18	16	15	16
Cash to Long-Term Debt (%)	0.07	0.07	0.07	0.06	0.07
Long-Term Debt to Net Fixed Assets (%)	1.05	1.04	1.06	1.06	1.05
Long-Term Debt Per Enplanement ($)	284	262	241	236	225
Operating Ratio (%)	52	52	49	41	43
As % of Operating Revenue					
Signatory Airline Revenues	70	67	63	58	59
Total Concession Revenue	13	14	16	18	18
Total Non-Airline Revenue	30	33	37	42	41
Operating and Maintenance Expense	48	48	51	59	57

Income Statement

($000, Fiscal Years Ended June 30)

	2003	2004	2005	2006	2007
Aviation	347,998	325,256	303,015	263,422	296,368
Concessions	62,790	69,329	74,496	81,865	88,225
Parking And Transportation	49,367	51,742	56,686	61,186	67,428
Net Sales and Services	39,961	39,805	43,117	48,869	51,893
Total Operating Revenue	500,116	486,132	477,314	455,342	503,914
Personnel	152,586	141,249	141,092	153,777	163,945
Contractual Services	54,713	44,789	48,661	52,863	53,148
Services Provided by Other City Departments	10,837	12,314	12,335	11,136	12,425
Repairs and Maintenance	7,823	9,647	23,809	18,810	14,481
Environmental Cleanup Expenses (Reimbursement)	1,188	315	414	1,790	2,499
Other	219,859	192,282	192,682	194,435	184,561
Total O&M Expenses	447,006	400,596	418,993	432,811	431,059
Total O&M Expenses (Excluded Depreciation)	240,927	231,797	244,390	270,811	288,252
Operating Income	53,110	85,536	58,321	22,531	72,855
Operating Income (Excluding Depreciation)	259,189	254,335	232,924	184,531	215,662
Investment Income	33,137	7,550	19,171	25,331	36,272
Interest Expense	(194,030)	(217,705)	(209,452)	(200,291)	(193,773)
PFC Classified As Revenue	51,797	57,498	60,925	62,067	64,277
Loss On Disposal of Equipment	(278)	(56)	(243)	(1,437)	(538)
Environmental Cost Recoveries	—	—	6,033	4,907	—
Other	2,541	2,941	(3,555)	17,189	(828)
Total Non-Operating (Revenue/Expenses)	(106,833)	(149,772)	(127,121)	(92,234)	(94,590)
Loss Before Capital Contributions	(53,723)	(64,236)	(68,800)	(69,703)	(21,735)
Change In Net Assets	(49,868)	(54,993)	(99,016)	(42,672)	1,819
Total Net Assets – Beginning of Year	561,472	511,604	456,611	357,595	314,923
Total Net Assets – End of Year	511,604	456,611	357,595	314,923	316,742

designating a portion of PFCs as revenue to offset debt service as a decent way of reducing airline rates and charges. However, in an airport stress scenario where passenger levels decline, this revenue source will decline proportionally.