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Summary:

San Francisco City & County Airport Commission San Francisco International Airport; Airport; Joint Criteria

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Credit Profile		
US$382.045 mil airport rev rfdg bnds (San Francisco Intl Arpt) ser 2014A due 05/01/2044		
Long Term Rating	A+/Stable	New
US$98.88 mil airport rev rfdg bnds sr lien (San Francisco Intl Arpt) ser 2014B due 05/01/2044		
Long Term Rating	A+/Stable	New

Rationale

Standard & Poor's Ratings Services assigned its 'A+' long-term rating to the San Francisco City & County Airport Commission's $382.05 million series 2014A and $98.88 million series 2014B senior-lien revenue bonds issued for the San Francisco International Airport (SFO). In addition, Standard & Poor's affirmed its 'A+' long-term rating and underlying rating (SPUR) on the commission's $4.2 billion senior-lien revenue bonds outstanding issued for SFO and affirmed its 'AAA' long-term rating on certain commission bonds issued for SFO based on the application of our joint criteria. The outlook is stable.

The ratings reflect our view of SFO's:

- Growing high-yield origin and destination (O&D) market and strong market position, with virtually no competition for international passengers in the Bay Area;
- Large, international hub designation, with historically strong international traffic growth and capacity for expanded service;
- Deep and diverse service area economy consisting of 8.5 million residents, with strong income levels, a diverse employment base, healthy tourism trends, and good job growth in recent years;
- Good liquidity position, with $365 million, or 350 days' cash, on hand as of audited fiscal 2013 and with similar levels estimated for fiscal 2014; and
- Strong management team that we believe has been successful in controlling costs, expanding and diversifying air carrier service, and maintaining strong financial metrics.

Partly offsetting the above strengths, in our view, are:

- The airport's increasing leverage and significant additional capital needs, most of which will be financed by additional bonds;
- The airport's current and projected relatively high cost structure; and
- The weak credit quality of and continued concentration in the airport's primary carrier, United Airlines.

The bonds are secured by the net revenue of the airport. The bond proceeds will finance and refinance (by repaying the commission's $248 million in commercial paper, or CP, notes outstanding) several projects, including the completion of the new air traffic control tower, baggage handling modernization, runway safety area improvement, a new long-term parking garage, and various terminal redevelopment projects for Terminals 1 and 3. Management anticipates that the 2014A and 2014B bonds will be fixed rate and additionally secured by the pooled reserve fund, which management anticipates will be fully cash funded. SFO has $4.2 billion in senior-lien debt outstanding. As of fiscal 2014 (ended June 30), slightly less than 12% of debt outstanding is variable rate; the airport has six swaps outstanding with a total notional value of $482.2 million. SFO's current CP program is backed by three direct-pay letters of credit totaling $400 million. Repayment of CP notes is a subordinate obligation to the bonds.

After recording an impressive 8.0% increase in enplanements in fiscal 2012, enplanements rose 4.0% in fiscal 2013 followed by an estimated 3.2% for fiscal 2014 (preliminary and unaudited) to a record 23 million. Fiscal 2015 enplanements are projected to reach another record of 23.5 million, a 2.0% increase, with international enplanements projected to grow by 3.0% and domestic enplanements by 1.7%. Including preliminary enplanement figures for fiscal 2014, the compound annual growth rate for traffic has been 4.8% during the past five years and 4.1% during the past 10 years. SFO has been the second-fastest-growing large-hub airport in the country during the past seven years, after Charlotte Douglas International Airport (CLT). SFO temporarily closed two runways in the summer of 2014 as part of a four-year project to improve conditions at its runway safety areas. The runways were reopened on August 10, 2014, one month ahead of schedule. Despite this, good passenger growth continued during the closure, with 4.5% growth in May 2014, 4.2% growth in June 2014, and 6.6% growth in July 2014, compared with the prior-year periods.

According to Airports Council International, SFO was the seventh-most-active airport in the U.S. for total passengers served in 2013. Of the 10 largest airports in the U.S., SFO had the highest growth rate in calendar 2012 at more than 8%, outpacing the airport with the second-highest growth rate, Charlotte, at more than 5%, but it ranked seventh for calendar 2013. The airport is a large hub, O&D passengers account for 78% of the total traffic, and SFO has the highest share of O&D traffic of any connecting large hub airport. We believe that the large, wealthy service area (8 million people) has historically provided a robust traffic base, and the area serves as a popular tourist and convention destination.

In fiscal 2014, United and United Express accounted for a concentrated 46.3% of total enplanements (but just 22.0% of airport operating revenue), with Virgin America accounting for 8.5% and Delta Airlines 8.0%. In terms of international enplanements, United represented 36.1% in fiscal 2014, with Air Canada second at 6.7%. Management anticipates that these market share figures will remain relatively stable during the next several years. Domestic traffic has shown impressive growth, in our opinion, particularly in the past five years. Management attributes this growth primarily to the introduction of service in fiscal 2007 by three low-cost carriers (LCCs) -- Southwest Airlines, JetBlue, and Virgin America -- that offered almost 5x the number of average daily passenger seats in 2014 as the airport's LCCs did in 2007. LCCs accounted for 24.2% of domestic enplanements at SFO in fiscal 2014 versus 12.5% in fiscal 2007. According to management, SFO was able to accommodate Virgin America's growth on an accelerated basis more so than the other Bay Area airports. SFO provided nonstop service to 76 domestic and 37 international destinations in fiscal 2014.

In terms of competition from other Bay Area airports, we believe SFO has fared well recently. As the other two main competitors, Oakland International (OAK) and San Jose International (SJC), are primarily domestic O&D airports, a comparison on this basis is most relevant. SFO's share of domestic O&D passengers increased to 66% in fiscal 2012 from 41% in fiscal 2003, but declined slightly to 60% in fiscal 2013. The total market share for the airport was 71% for fiscal 2014, including international traffic, as the airport serves approximately 95% of the Bay Area's international passenger traffic. Total scheduled departing seats at SFO have increased by 27% since fiscal 2007, while OAK and SJC seats have declined by 36% and 21%, respectively.

The airline use and lease agreements between the airport and 44 signatory airlines took effect July 1, 2011. The term is 10 years and the agreements maintain the general terms of the prior agreements, including a residual cost rate-setting methodology, airline review of capital projects, common-use facilities in the international terminal, and annual service payments to the city. The international terminal is joint use, but the domestic terminals are a mixture of preferential, joint, and common use -- not exclusive use -- allowing airport management to optimize gate utilization.

The commission has approved a $2.5 billion five-year capital plan and a $4.4 billion 10-year capital plan for fiscal years 2015 through 2024, up from $2.1 billion and $4.1 billion, respectively, a year ago. The five-year capital plan includes approximately $2.4 billion in projects that will require the issuance of new debt during the forecast period through fiscal 2019. According to management, other sources of funds for the capital plan consist of grants, passenger facility charges (PFCs), and other sources such as FAA Airport Improvement Program (AIP) funds and airport operating funds.

The capital plan includes several large-scale projects, including:

- Runway safety area improvements;
- Modernization of the T3 checked baggage screening system and baggage handling system;
- The new air traffic control tower;
- West field cargo development;
- Construction of a new long-term parking garage;
- Construction of an AirTrain extension;
- T3 east renovation;
- T1 renovation;
- Construction of the new boarding area B; and
- The proposed on-airport hotel.

We consider the significant debt the airport will need to issue to finance the capital plan to be a rating limitation. We will monitor the effects these projects may have on the airport's financial metrics.

Audited 2013 unrestricted cash and investments were $365 million, equal to 350 days' operations, which we consider good. Unaudited cash and investments for fiscal 2014 were $388 million, or 346 days' operations. Debt service coverage (DSC), as calculated in the indenture (including rolling coverage and pledged PFC revenue), was 1.44x in fiscal 2013, down from 1.47x in fiscal 2012. Pledged PFC revenue designated to pay debt service in fiscal 2013 was $45.0 million of the $85.1 million collected. Management projects that DSC will decline over the forecast period to 1.34x in fiscal 2021, calculated in accordance with the indenture, including the current and future additional debt plans. Excluding the transfer from the contingency account, coverage was 1.17x in fiscal 2013, and management anticipates that it will be approximately 1.12x over the forecast period. With the airport's residual rate methodology, however, the level of coverage is not a significant risk, in our view.

The airport has a high cost structure, in our opinion. The cost per enplanement (CPE) in fiscal 2012 was $14.18, and management's projections indicate that CPE will rise to approximately $20.09 in fiscal 2019. Although we consider this rate high, we understand that it is average for all carriers at the airport, and that the rate is higher or lower based on the facility used (e.g., the international terminal or a domestic terminal). This is important when considering the effect of the cost on certain airlines' service decisions. In addition, strong non-airline revenue growth in recent years has helped to contain CPE. Management has implemented a three-part strategy to control costs and make the airport more competitive, including cutting operating costs, increasing concession revenue, and attracting new carriers and service. The debt per enplanement is also high, in our view, at $175 as of fiscal 2013. With the net effect of planned issuance of an additional $2.4 billion and some principal amortization through fiscal 2019, debt per enplanement is forecast at $236, which we consider very high. This assumes 1.8% average annual growth of enplanements to 25.2 million and total debt of $5.95 billion by fiscal 2019, with total debt increasing about 43% from the 2014 level.

The airport, located 14 miles south of downtown San Francisco in an unincorporated area of San Mateo County, occupies approximately 2,383 acres on a 5,171-acre site (the remaining acreage is undeveloped tidelands). The existing domestic passenger terminal complex totals 2.6 million square feet, and the international terminal totals 2.5 million. The airport has 88 operational gates and four runways, and is owned and operated as an enterprise department by the City and County of San Francisco. A five-member airport commission, the members of which are appointed by the mayor to four-year terms, governs the airport. During fiscal 2014, 46 passenger and nine cargo-only airlines served the airport, with domestic air carriers providing nonstop service to 76 U.S. destinations and one-stop service to an additional 28. In addition, 30 airlines provided nonstop passenger service to 37 international airport destinations and one-stop service to an additional 14. The airport has a 5,843-space hourly domestic parking lot connected to the three terminals as well as a 7,322-space covered and uncovered long-term parking lot about 1.5 miles from the terminals.

Bond Provisions

The bonds are secured by the airport's net revenue and are issued under the 1991 resolution. Net revenue includes that earned by the commission from operation of the airport in accordance with generally accepted accounting principles, but explicitly excludes special facility revenue and PFCs, unless specifically pledged. The airport has $4.2 billion in parity debt outstanding.

The 1991 resolution allows for the establishment of a contingency account that can be used for debt service, operations and maintenance, and certain other airport costs. The commission is not obligated to replenish this account in the event that funds are withdrawn. The balance in this account is $93.2 million, or 24% of maximum annual debt service (MADS) on the outstanding bonds issued under the 1991 resolution. Funds in this account are deposited as of the last business day of each fiscal year and are applied to satisfy the coverage requirement under the rate covenant.

The rate covenant requires that net revenue in each year be at least sufficient to pay debt service and all required payments to the city. In addition, together with any transfer from the contingency account, net revenue must be at least 1.25x debt service of the 1991 resolution bonds. This contingency account transfer effectively allows for rolling coverage on the bonds. In years that amounts owed after debt service decrease relative to the size of debt service, actual coverage from current-year rates and charges can fall and be offset by the contingency fund. The size of the transfer is limited to 25% of MADS for purposes of calculating the additional bonds test (ABT). Although the contingency account may be used to meet the rate covenant, we anticipate (and management projects) that generating revenue will equal at least 1x from rates and charges, without the use of the contingency account. If the contingency fund were to be drawn down for any reason, the commission has the authority to set rates and charges to 1.25x and continue to do so until the contingency fund is rebuilt, if ever.

The ABT requires that projected net revenue meet the rate covenant for the proposed debt or that historical revenues with the transfer will outstanding and proposed debt by 1.25x. This test, as with nearly all other tests for airports in the U.S., allows for the use of projected revenue, which, in essence, means some demonstration of compliance of the 1.25x multiple by an airport consultant.

Outlook

The stable outlook reflects our anticipation that United Airlines will continue to operate a major hub at SFO, that passenger demand will remain stable, and that liquidity will remain good. The prudent implementation of a capital plan that maintains management's estimates of additional indebtedness will also be an important rating factor, in our opinion. Given our view of SFO's potential additional debt needs and current debt profile, we do not anticipate raising the ratings during the next two years. Neither do we anticipate lowering the rating in the next two years given SFO's market share, good enplanement trends, and good financial metrics, but a material decline in enplanements could put pressure on the rating.

Related Criteria And Research

Related Criteria

- USPF Criteria: Municipal Applications For Joint Support Criteria, June 25, 2007
- USPF Criteria: Bank Liquidity Facilities, June 22, 2007
- Criteria: Joint Support Criteria Update, April 22, 2009
- Criteria: Airport Revenue Bonds In The U.S. And Canada, Nov. 15, 2013

Ratings Detail (As Of September 3, 2014)		
San Francisco City & Cnty Arpt Comm, California		
San Francisco Intl Arpt, California		
San Francisco City & Cnty Arpt Comm (San Francisco International Airport) (wrap of insured) (FGIC & AGM) (SEC MKT)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
San Francisco City & Cnty Arpt Comm (San Francisco International Airport) (wrap of insured) (MBIA & AGM) (SEC MKT)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
San Francisco City & Cnty Arpt Comm (San Francisco Intl Arpt) arpt rev rfdg bnds rmktd		
Long Term Rating	A+/Stable	Affirmed
San Francisco City & County Airport Commission (San Francisco International Airport)		
Long Term Rating	A+/Stable	Affirmed
San Francisco City & County Airport Commission (San Francisco International Airport) VRDB		

Ratings Detail (As Of September 3, 2014) (cont.)		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
San Francisco City & County Airport Commission (San Francisco International Airport) VRDB		
Long Term Rating	AAA/A-1	Affirmed, Removed from CreditWatch
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
San Francisco City & County Airport Commission (San Francisco International Airport) VRDB		
Long Term Rating	AAA/A-1	Affirmed
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
San Francisco City & County Airport Commission (San Francisco International Airport) VRDB (ASSURED GTY)		
Long Term Rating	AA/NR/Stable	Affirmed
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
San Francisco City & County Airport Commission (San Francisco International Airport) VRDB (ASSURED GTY)		
Long Term Rating	AA/NR/Stable	Affirmed
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
San Francisco City & County Airport Commission (San Francisco International Airport) VRDB 36B		
Long Term Rating	AAA/A-1	Affirmed
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
San Francisco City & County Airport Commission (San Francisco International Airport) VRDB Ser 36C		
Long Term Rating	AAA/A-1	Affirmed
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
San Francisco City & County Airport Commission (San Francisco International Airport) (ASSURED GTY)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
San Francisco City & County Airport Commission (San Francisco International Airport)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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