S&P Global
Ratings

RatingsDirect®

Summary:

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

Primary Credit Analyst:
Mary Ellen E Wriedt, San Francisco (1) 415-371-5027; maryellen.wriedt@spglobal.com

Secondary Contact:
Paul J Dyson, San Francisco (1) 415-371-5079; paul.dyson@spglobal.com

Table Of Contents

Summary:

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

Credit Profile		
US$581.775 mil 2nd series rev bnds (San Francisco Intl Arpt) (Amt) ser 2016B due 05/01/2046		
Long Term Rating	A+/Stable	New
US$168.64 mil 2nd series rev bnds (San Francisco Intl Arpt) (Non-amt Govt Purp) ser 2016C due 05/01/2046		
Long Term Rating	A+/Stable	New
US$129.2 mil 2nd series rev rfdg bnds (San Francisco Intl Arpt) (Non-amt) ser 2016D due 05/01/2031		
Long Term Rating	A+/Stable	New

Rationale

S&P Global Ratings assigned its 'A+' long-term rating to San Francisco City and County Airport Commission's $581.8 million series 2016B, $168.6 million series 2016C, and $129.2 million series 2016D senior-lien revenue refunding bonds. In addition, S&P Global Ratings affirmed its 'A+' long-term rating and underlying rating (SPUR) on the commission's $4.2 billion bonds outstanding. All bonds were issued for the San Francisco International Airport (SFO). The outlook is stable.

The series 2016B and 2016C bond proceeds will be used to fund a portion of the capital plan to expand capacity at the airport; the series 2016D bond proceeds will be used to refund certain bonds outstanding.

The ratings reflect our view of the following credit strengths:

- A growing high-yield origin and destination (O&D) market and strong market position, with virtually no competition for international passengers in the Bay Area;
- A large, international hub designation, with historically strong international traffic growth and capacity for expanded service;
- A 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 $404 million, or 344 days of operational cash, on hand as of audited fiscal 2015; and
- A 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 bond proceeds;

- The current and projected high cost structure; and
- The continued high though declining concentration in the airport's primary carrier, United Airlines.

The bonds are secured by the net revenue of the airport. Of debt outstanding, 11.3% is variable rate; the airport has six swaps. The swaps, in our view, pose low contingent liquidity risk to the airport, given the rating differential between the underlying rating on airport's revenue bonds and the rating triggers that would prompt the airport to make a swap termination payment if the swap valuation at the time of the termination is not in the airport's favor. The swaps had a mark-to-market value of approximately $96 million as of July 30, 2016; the valuation is not in the airport's favor.

SFO's commercial paper (CP) program is backed by three direct-pay letters of credit totaling $400 million; the CP capacity will be $400 million after the 2016 bond issuance. Repayment of CP notes is a subordinate obligation to the bonds.

Recent enplanement growth at the airport has been very strong, in our opinion. After recording an impressive 8.0% increase in fiscal 2012, enplanements rose an additional 4.0% in fiscal 2013, followed by 3.2% for fiscal 2014 and 4.5% in fiscal 2015 to a record 24 million. In fiscal 2016, enplanements grew by an impressive 6.7% to 25.6 million. The compound annual growth rate for traffic has been 5.3% during the past five years. Airport management is projecting continued growth in enplanements, with a compound annual growth rate of 2.2% for 2016 through 2022. In our opinion, this growth rate is achievable, as is the financial forecast based on the enplanement forecast.

According to Airports Council International, SFO was the seventh-most-active airport in the U.S. for total passengers served in 2015. The airport is also one of the principal gateways for the Pacific traffic in the U.S. The airport is a large hub: O&D passengers accounted for 79% of the total traffic in fiscal 2015, and SFO has the highest share of O&D traffic of any connecting large hub airport. We consider this large percentage of O&D traffic to be stable. We believe that, historically, the large, wealthy service area (almost 9 million people) has provided a robust traffic base, and the area serves as a popular tourist and convention destination.

In fiscal 2016, 53 passenger and eight cargo-only airlines served the airport. United and United Express accounted for what we consider a concentrated 44% of total enplanements, with American Airlines (including US Airways) and Virgin America each accounting for 9%. In terms of international enplanements, United represented 32.3% in fiscal 2016, with Air Canada second, at 7.5%. Management expects these market share figures to remain relatively stable over 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 grew from 6% of the market in fiscal 2007 to 20% in fiscal 2016. According to management, SFO was able to accommodate Virgin America's growth on an accelerated basis more so than the other Bay Area airports could. SFO provided nonstop service to 78 domestic and 44 international destinations in fiscal 2016.

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 more relevant. SFO's share of Bay Area domestic O&D passengers increased to 66% in fiscal 2015 from 41% in fiscal 2003. The total market share for the airport was 70% for fiscal 2016 when including international traffic (the airport serves approximately 93% of the Bay Area's international passenger traffic), up from

58% in fiscal 2007. SFO's 10-year CAGR (compound annual growth rate) was 4.5% versus OAK's at -2.1% and SJC's at -0.6%.

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. We consider the use-and-lease agreements to be credit neutral.

The capital plan is very sizable and is a credit concern, but we recognize the need to add gates and expand terminal space to meet the growing demand. In fiscal 2017, the commission has approved a $5.7 billion five-year capital plan and a $6.1 billion 10-year capital plan. This is up from the $2.8 billion five-year capital plan for fiscal 2016 and a $4.5 billion 10-year capital plan for fiscal years 2016 through 2025. Of the increases, $1.6 billion is due to primarily to terminal work (including the acceleration of the Terminal 1 project, added scope for the Terminal 3 west project, and gate enhancements); $575 million is due to the consolidated rental car facility, long-term parking garage added scope, and AirTrain extension cost escalation; $361 million is due to security improvements, hangar renovation, and technology improvements; and $321 million is due to utilities and airfield projects. The five-year capital plan includes approximately $6.5 billion in new debt during the forecast period through fall 2020. According to management, other sources of funds for the capital plan include grants, passenger facility charges (PFCs), FAA Airport Improvement Program funds, and airport operating funds. The capital plan includes several large-scale projects, including Terminal 1 renovation, Terminal 3 West renovation, and a new airport hotel. We consider the significant debt that 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. We do consider the airport's proven record of delivering large capital projects on time and on budget to be a mitigating factor.

Audited 2015 unrestricted cash and investments totaled $404 million, equal to 344 days' operations, which we consider good. Unaudited cash for fiscal 2016 is estimated at 332 days. Debt service coverage as calculated in the indenture (including rolling coverage and pledged PFC revenue) was 1.36x in fiscal 2015, down from 1.47x in fiscal 2012, but not a credit risk given the residual airline agreement. Pledged PFC revenue designed to pay debt service in fiscal 2015 totaled $47.6 million. Excluding the transfer from the contingency account, coverage was 1.12x in fiscal 2015 and unaudited fiscal 2016, and is forecast to decline to 1.09x in fiscal 2022. 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) was $16.00 in fiscal 2015, and is estimated at $16.53 in fiscal 2016. Management's projections indicate the CPE will rise to $24.40 in fiscal 2022.While we consider this rate to be high, we understand that this is an average rate for all carriers at the airport and that, based on the facility used (e.g., the international terminal or a domestic terminal), the rate is higher or lower. This is important when considering the effect of the cost on certain airlines' service decisions. In addition, strong nonairline 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 $189 as of fiscal 2015. With the net effect of the planned issuance of an additional $6.5 billion and some principal amortization, debt per enplanement for fiscal 2022 is forecast at $330, which we consider very high.

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 2.7 million square feet, and the international terminal totals 2.5 million. The airport has 91 operational gates and four runways. The airport 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.

Bond Provisions

The bonds are secured by the airport's net revenue and are issued under the 1991 resolution. We consider the bond provisions to be credit neutral. Net revenue includes that which the commission earns from operating the airport in accordance with generally accepted accounting principles, but, explicitly excludes special facility revenue and PFCs, unless specifically pledged. The airport has $4.5 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 funds are withdrawn. The balance in this account as of Dec. 1, 2015 was $94 million, or 23% 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 net revenue in each year to 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 in which 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). While the contingency account may be used to meet the rate covenant, we expect (and management projects) that generating revenue will equal at least 1x debt service 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 debt service and continue to do so until the contingency fund is rebuilt, if ever.

The ABT requires that projected net revenue will meet the rate covenant for the proposed debt or that historical revenue with the transfer will cover 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, passenger demand will remain stable, and liquidity will remain good. The prudent implementation of a capital plan that maintains management's estimates of additional debt will also be an important rating factor, in our opinion.

Upside scenario

Given our view of SFO's potential additional debt needs and current debt profile, we do not expect to raise the ratings during the next two years.

Downside scenario

We could lower the rating if enplanements decline materially, reducing the airport's ability to manage rising debt levels.

Ratings Detail (As Of September 13, 2016)		
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 Intl Arpt) arpt rev rfdg bnds rmktd		
Long Term Rating	A+/Stable	Affirmed
San Francisco City & Cnty Arpt Comm (San Francisco Intl Arpt) AIRPORTS		
Long Term Rating	A+/Stable	Affirmed
San Francisco City & Cnty Arpt Comm (San Francisco Intl Arpt) JOINTCRIT		
Long Term Rating	AA+/A-1	Affirmed
Unenhanced Rating	A+(SPUR)/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		
Long Term Rating	AA+/A-1+	Affirmed
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
San Francisco City & County Airport Commission (San Francisco International Airport) VRDB		
Long Term Rating	AA+/A-1	Affirmed
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
San Francisco City & County Airport Commission (San Francisco International Airport) VRDB		
Long Term Rating	AA+/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	Current
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	Current
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
San Francisco City & County Airport Commission (San Francisco International Airport) VRDB 36B		

Ratings Detail (As Of September 13, 2016) (cont.)		
Long Term Rating	AA+/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.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.