New Issue: San Francisco Airport Commission, CA

MOODY’S ASSIGN A1 TO SAN FRANCISCO AIRPORT’S SECOND SERIES REVENUE BONDS, SERIES 2010A; THE OUTLOOK IS STABLE

SAN FRANCISCO HAS A TOTAL OF $4.4 BILLION OF AIRPORT REVENUE DEBT

Airport
CA

Moody’s Rating

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Opinion

NEW YORK, Jan 27, 2010 -- Moody's Investors Service has assigned an A1 long-term rating to San Francisco Airport Commission's Second Series Refunding Revenue Notes, Series 2010A in the amount of $216.0 million. The offering is comprised of variable rate bonds in three sub-series: A-1 will have a par amount of $86.375 million, A-2 will have a par amount of $57.595 million and A-3 will have a par amount of $72.0 million., The rating outlook is stable. The rating and the outlook are based on the airports strong position for air travel in the Bay Area, diversifying carrier base, and strong liquidity position that offsets substantial financial risks. The commission operates the San Francisco International Airport (SFO).

USE OF PROCEEDS: The Series 2010A bonds will refund all or a portion of the airport's currently outstanding fixed rate Issue 23A, Issue 24A, Issue 25 and Issue 26A bonds. The refunding is being pursued primarily to provide a hedge to the airport's forward starting swap scheduled to activate on February 1, 2010 and no substantial cost savings is expected.

LEGAL SECURITY: Net revenues of the airport will secure the bonds on parity with all outstanding second series senior lien obligations. The bonds will initially be supported by a direct-pay letter of credit from J.P. Morgan Chase Bank, N.A. (Long Term bank deposits rated Aa1, short term rating P-1, Negative outlook), which will expire three years after bond closing.

The 2010A bonds will not be supported by a debt service reserve fund. As a result, the funding requirement for the Issue 1 or pooled reserve account, will be reduced. To offset concerns about the value of some surety policies supporting debt service reserve requirements, the airport does not intend to withdraw any funds upon the refunding.

At closing the total pooled reserve requirement is expected to be $284.3 million and will contain $240.7 million in cash, $9.0 million in surety policies from providers rated Aa3 or above, and $136.0 million in surety policies from providers rated below Aa3.

INTEREST RATE DERIVATIVES:
In July 2007 the airport entered into four forward-starting swaps with the expectation of issuing variable rate debt as part of Bond Issue 32 and 33 in 2008 and Bond Issue 35 expected in 2010. The airport elected to change the structure of some bond issues and as a result the swaps that were planned to match the Issue 32 and 33 bonds now hedge Issue 37B and Issue 37C. The starting date for these swaps was extended from February 1 to May 15th, 2008 at an approximate cost of $800,000 to the commission. The swap that was matched to the Issue 37B bonds will now hedge the Series 2009A and B bonds since the Issue 37B bonds are now held in trust. This swap pays the airport 61.85% of LIBOR plus 0.34% and the airport pays a fixed rate of 3.898% to the counterparty Merrill Lynch Capital Services. The swap matched to the Issue 37C bonds pays the airport 61.85% of LIBOR plus 0.34% and the airport pays a fixed rate of 3.898% to the counterparty Bear Stearns Capital Markets Inc./JP Morgan Chase Bank, NA on a notional amount of $89.9 million. A portion of the Issue 37D bonds, the 2008A notes and a small portion of several other series remain unhedged, exposing the commission to some interest rate risk.

The airport has two swaps associated with Issue 36A/B for a total notional amount of $139.9 million. J.P. Morgan Chase Bank, N.A. is the counterparty for these swaps in which the airport receives a variable rate of 63.5% of LIBOR plus 0.29% and pays a fixed interest rate of 3.445%.

The variable interest rate for Issue 36 C/D bonds is hedged by two floating-to-fixed rate swap agreements that the commission has entered into with Bear Stearns Capital Markets L.P./J.P. Morgan Chase Bank, N.A. as the counterparty to originally hedge the Issue 32 bonds in the notional amount of $60.0 million. These transactions, which mature in 2026 require the airport to pay a fixed rate of 3.444% and 3.445% to the counterparty and receive 63.5% of LIBOR plus 0.29%.

The Series 2010 bonds are being issued to match the airport’s forward-starting swap transaction that was originally expected to be hedged by the Issue 35 bonds. Swap payments to the airport will be 61.85% of LIBOR plus 0.34% and the airport will pay a fixed rate of 3.925% to two counterparties: Goldman Sachs Capital Markets L.P. on a notional amount of $143.95 million and Depfa Bank plc. New York Branch, on a notional amount of $71.973 million. The airport has renegotiated the collateral provisions such that it has no requirement to post collateral as long as the airport’s underlying rating remains at or above Baa1.

SFO’s strong internal liquidity provides a significant offset to the additional financial risks such as basis risk, amortization mismatch, and market access risk associated with the airport’s extensive $585.4 million swap portfolio. Termination risk is more acute where the counterparty risk is higher due to lower counterparty ratings such as the swap with Depfa (long term bank deposits rated A3, short term rating P-1, negative outlook). The current marked-to-market value of this swap is $7.8 million in favor of Depfa and the airport would be required to make that payment in the event a failure of Depfa causes the swap to terminate. The swap now contains an independent amount of $4.25 million held by a third party institution that provides some protection to the airport if Depfa fails. The independent amount covers any reasonable cost the airport might incur from interest rate fluctuations in the replacement of Depfa as the counterparty.

The current marked-to-market value of all the commission’s swaps is $53.3 million in favor of the counterparties.

STRENGTHS

* Large, affluent service area provides strong demand for origin and destination (O&D) traffic
* Recent enplanement growth has been resilient due to three new, low-cost carriers increasing domestic competition

CHALLENGES

* Revenues remain highly reliant on United Airlines (UAL, enhanced equipment trust rated Ba3, negative outlook) accounting for 41% of enplanements in FY 2009
* Debt levels ($233 debt per O&D enplaned passenger) and cost structure (average airline cost per enplanement of $13.74) are well above Moody’s U.S. airport medians
* Use of variable rate debt has increased the commission’s exposure to variable interest rate risk and bond put risk relative to its liquidity position
* Competition from other Bay Area airports and capacity constraints at SFO may limit future passenger growth

RECENT DEVELOPMENTS:

Airport enplanements continue to outperform national trends as enplanements increased 3.9% in December and were 0.4% in calendar year 2009 compared to 2008. Domestic enplanements grew at 10.1% in
November and 6.8% in December. The economic downturn has seemed to have had little impact on growth as the three new carriers continue to add service. Moody's believes a portion of this growth is being artificially generated by the competition, but some portion springs from demand that has gone unserved since airlines reduced capacity at the airport following the events of September 11th, 2001. In addition, SFO is currently enjoying an improving position relative to the other Bay Area airports (Oakland International Airport, Port of Oakland rated A2; San Jose International Airport rated A2) due to service lost at those airports. The end effect likely means that some portion of this growth is natural and sustainable, but a significant portion could be lost quickly from changes to airline operating strategies.

Financial statements for 2009 indicate a generally stable financial picture. Cost per enplanement only increased to $13.74 from $13.20 in FY 2008 benefiting from strong cost controls, increased concession revenues, and decreased capital expenditures. The airport's unrestricted cash balance improved to $307.7 million in FY 2009 from $299.2 million in FY 2008, though it is expected to fluctuate between $280 million and $300 million throughout the year.

Internal liquidity remains a key aspect of the airport's credit rating and it is under considerable strain from a number of financial and operational risks. Operationally the liquidity helps to offset the airport's concentration in United Airlines and large component of connecting enplanements (24%). Financial risks include the commission's debt portfolio that includes a large amount of swap contracts with a total market value that currently favors the counterparties by approximately $53.3 million, put risk that will require reasonable market access on various dates for the $429.7 million of bonds with mandatory tender dates, and exposure to interest rate, counterparty and other risks associated with the commission's $535 million of variable rate debt outstanding after this transaction. Moody's believes the current liquidity level, which stood at approximately $307 million in available cash at the end of FY 2009 is essential to the stability of the current rating and any significant change could potentially have rating implications.

Capital plans remain limited beyond the current re-development of Terminal 2. The airport believes it has the funds on hand to complete that construction, which remains on schedule for late January 2011. Upon completion, the airport plans to invest approximately $22.5 million to update HVAC and finishings in Boarding Area E of Terminal 3.

SFO does not expect to issue any new money debt during 2010, but plans to access the market several times to manage its considerable portfolio of short term debt. The airport faces mandatory tenders in May and September that will need to be refinanced. The airport currently expects to issue fixed rate bonds to take out the $100 million of debt that will be tendered in May. The airport also expects to issue bonds to take out its commercial paper currently outstanding in the amount of $128 million. The airline use and lease agreement expires in June 2011 and Moody's notes that management has been proactive in negotiations for a new lease.

Outlook

The rating outlook is stable and reflects our expectation that enplanement levels will stay at or above the current level and that the airport will manage costs and maintain financial liquidity near current levels as it implements its on-going capital improvement program.

What Could Change the Rating - UP

Continued expansion by carriers other than United that diversify the airport's revenue base, reduce its reliance on United for passenger traffic, and improve airline cost per enplanement and internal financial liquidity could have a positive impact in the rating.

What Could Change the Rating - DOWN

Unexpected cost escalations that increase the airline cost per enplanement above projections and reduce the airport's competitive position for local traffic compared to nearby airports or for international traffic compared to other West Coast gateway airports could pressure the rating downward. Changes in the airport's financial liquidity below the current level which reduces its ability to offset existing finance-related risks could also place negative pressure on the rating.

KEY INDICATORS

Type of Airport:O&D

Rate-making methodology:Residual

FY 2009 Enplanements: 18.225 million

5-Year Enplanement CAGR 2004-2009:3.4%
FY 2009 vs. FY 2008 Enplanement growth:-0.8%

FY 2010 vs. FY 2009 YTD Enplanement growth:4.1%

% O&D vs. Connecting, FY 2009 (5 YR AVG):76% (74%)

Largest Carrier by Enplanements, FY 2009 (share):United (41%)


Debt per O&D Enplaned Passenger, FY 2009 (5 YR AVG):$233 ($292)

Bond Ordinance Debt Service Coverage, FY 2009 (5 YR AVG):1.48x (1.43x)

Utilization Factor, FY 2009:2.3

Days Cash on Hand, FY 2009: 356

RATED DEBT

Second Series Revenue Bonds, $4.38 billion outstanding, A1

Fixed rate: $3.84 billion

Variable rate: $535 million

Commercial Paper Notes, $400 million, $128 million outstanding, P-1

CONTACTS

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The last rating action was on October 5, 2009 when the ratings on the Series 2009D, E & F bonds were assigned and the parity bond ratings were affirmed.

The San Francisco Airport Commission bond ratings were assigned by evaluating factors believed to be relevant to the credit profile of the issuer such as i) the business risk and competitive position of the issuer versus others within its industry or sector, ii) the capital structure and financial risk of the issuer, iii) the projected performance of the issuer over the near to intermediate term, iv) the issuer's history of achieving consistent operating performance and meeting budget or financial plan goals, v) the nature of the dedicated revenue stream pledged to the bonds, vi) the debt service coverage provided by such revenue stream, vii) the legal structure that documents the revenue stream and the source of payment, and viii) and the issuer's management and governance structure related to payment.

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