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Contacts

David Kamran	+1.212.553.2109
Analyst	
david.kamran@moodys.com	
Marcelle Meyer	+1.212.553.4128
Associate Analyst	
marcelle.meyer@moodys.com	
Kurt Krummenacker	+1.212.553.7207
Senior Vice President/Manager	
kurt.krummenacker@moodys.com	

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Portland (City of) ME Airport Enterprise

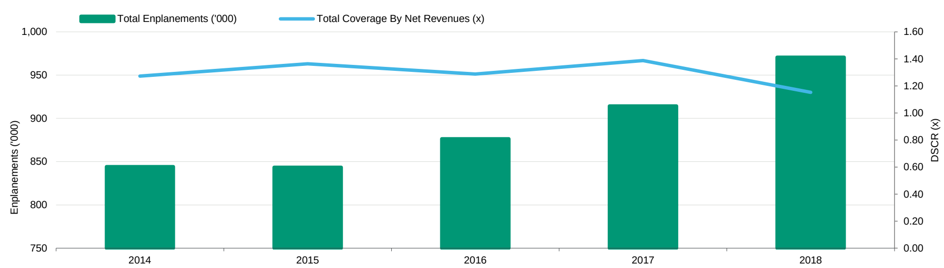
Update to credit analysis

Summary

Portland Airport Enterprise's ("the jetport"; Baa1 stable) credit profile reflects the stable economic profile of the jetport's service area and the strong airline diversity including multiple low-cost carriers, with the largest carrier accounting for only 28.5% of enplanements. The credit profile further incorporates the jetport's competition with nearby Boston-Logan International, and high leverage as measured by debt per origin & destination (O&D) enplanement and narrow debt service coverage ratios (DSCRs), reflecting costs incurred for the recently completed terminal expansion program. Going forward, the jetport has limited capital requirements as a result of the recent terminal expansion, which will enable the jetport to gradually delever.

Exhibit 1

Steady enplanement growth is supporting stable debt service coverage for the jetport



*Enplanements correspond to the left axis and DSCR corresponds to the right axis
Source: Moody's Investors Service

Credit Strengths

» Stable service area that is the primary economic driver for the state

» Strong airline diversity that includes legacy and low-cost carriers, with the primary carrier accounting for only 28.5% of enplanements

» Higher enplanement stability than other small hub airports in the region due to the jetport's role as primary airport for central and northern Maine, which is subject to less competition from Boston-Logan International

» Terminal expansion project was completed early and on-budget, allowing the jetport to benefit from increased efficiencies

» Five-year capital plan remains limited in scope, with relatively small airport contributions expected

Credit Challenges

- » Competition from nearby Boston-Logan International Airport, which has historically absorbed the majority of the region's enplanement growth
- » High leverage as a result of the 2011 expansion and renovation of the jetport's terminal
- » DSCR is narrow as a result of the high debt level
- » Small enplanement base, although some growth is expected

Rating Outlook

The stable outlook reflects the expectation of continued strong enplanement growth, sustained by recent capacity additions and additional service, which will support stability in airline cost per enplanement, liquidity and coverage ratios near current levels.

Factors that Could Lead to an Upgrade

- » Continued and sustainable period of enplanement growth stemming from a greater demand for local air service
- » Substantial revenue growth resulting in sustained DSCR by net revenue above 1.75x and liquidity above 600 days cash on hand

Factors that Could Lead to a Downgrade

- » Sustained decline or lower-than-projected growth in enplanements that negatively impacts revenues and PFC collection
- » DSCR by net revenues consistently lower than 1.20x
- » Deteriorating competitive position coupled with loss of airline diversity

Key Indicators

Key Indicators for Portland (City of) ME Airport Enterprise

PORTLAND (CITY OF) ME AIRPORT ENTERPRISE

	2014	2015	2016	2017	2018
Enplanements ('000)	844	844	876	914	971
Enplanement Annual Growth (%)	3.0	-0.1	3.9	4.3	6.2
Debt Outstanding ($'000)	121,600	119,985	118,320	114,760	112,060
Debt + ANPL Per O&D Enplaned Passenger ($)	$ 144.04	$ 149.83	$ 142.42	$ 135.99	$ 125.19
Days Cash on Hand	350	462	518	474	394
Debt Service Coverage by Net Revenues (x)	1.27	1.36	1.29	1.39	1.15
Debt Service Coverage by Bond Ordinance (x)	1.47	1.62	1.41	1.55	1.34

Source: Moody's Investors Service, Portland Airport Enterprise Audited Financial Statements

Profile

Portland International Jetport is Maine's largest airport by number of passengers serving most of the major domestic airlines and over 1,100,000 enplanements a year (estimated fiscal 2019). The jetport is located in Cumberland County, approximately five miles west of downtown Portland with direct access to US Interstate 95. The jetport facilities include two runways, one 7,200 feet long and a 6,100 foot crosswind runway, both 150 feet wide; a 294,000 square-foot passenger terminal building with three levels; 12 loading gates; 9,000 square yards of air cargo apron and two cargo sort buildings; 3 baggage claim carousels; 2,162 space parking garage and approximately 300,000 of leasable square feet.

Detailed Credit Considerations

Revenue Generating Base

A steady underlying economic service area will support continued enplanement growth at the jetport. The air trade area consists of the cities of Portland (Aa1, stable) and South Portland (Aaa, stable), as well as a seven-county area, which is the primary economic region for the state of Maine (Aa2, stable). The area's industry profile includes a diverse group of businesses, particularly focused in education and health services, representing 19% of total employment. Population growth is below-average at 0.6% annually since 2013, but is supported by positive in-migration to the area. The city of Portland has comparatively low unemployment at 2.5% as of May 2019 versus 3.4% at the national level, despite a recent in-migration surge from job seekers. Employment growth has been largely in high-wage jobs, including medical and financial positions. Additionally, employers are increasing wages to attract qualified workers, due to the already very low unemployment rate. Gains in employment will bolster other sectors, including construction and healthcare, which will also grow at an above-average pace due to the increase in retiree population in the area. Recent mild winters have made the area more attractive to both retirees and young professionals, which are the two age groups that are driving the in-migration trends. Portland continues to benefit from local defense spending, as the U.S. Navy recently awarded an $11 million contract to Bath Iron Works to provide lead yard services for Arleigh Burke-class destroyers, in addition to the prior $49.8 million contract awarded last year to provide design assistance for the defense destroyers that could rise to $304.8 million if it is extended over four years. Therefore, BIW is recalling laid-off workers and is adding high-paying engineering jobs. These strong migration trends, along with gains in the local economy will support continuing growth in demand for air service in the region.

The jetport operates in a highly competitive market and will continue to have a minority of passenger traffic as the region continues to favor the nearby large, international hub at Boston-Logan International (BOS). The jetport faces substantial competition from Boston-Logan International and, to a lesser degree, Manchester-Boston Regional Airport, which are 112 miles and 78 miles away from the jetport, respectively. The jetport also benefits from its capacity to capture north-south traffic in areas north of Portland. BOS is a hub for JetBlue and offers an array of carriers and routes, including many low-cost, ultra low-cost, and international carriers. Enplanements at Logan increased 6.7% in 2018 compared to an increase of 6.2% at the jetport and -0.7% at Manchester. Historically, the large-hub airport in the Boston region has absorbed much of the region's enplanement growth. However, within the northeast, BOS and the jetport are the only two airports to surpass their prior peak passenger volumes, showing the jetport's strong and growing passenger base and travel demand. Additionally, the jetport reached an all-time enplanement record in 2018, reaching 970,649 enplanements, which is expected to be surpassed in 2019 with over 1,100,000 enplanments.

The jetport benefits from a high level of airline diversity, which is unusual for small-hub airports, and the diversity should continue to improve due to the growing presence of new entrants. American Airlines is the jetport's primary carrier, however, it only accounts for 28.5% of enplanements. Airline diversity has been increasing, due to the entrance by Southwest in fiscal 2013 (now accounting for 15.5% of enplanements) and Frontier in July 2018. Airlines also have been up-gauging aircraft, and American Airlines and Delta have implemented new service routes.

In 2016, the jetport executed a new airline agreement with all of the carriers that operate at the jetport and extends until June 30, 2021. The agreement is substantially similar to the prior contract with the addition of a new signatory class, which applies to smaller carriers with maximum gross landed weight of 12 million pounds. The additional class allows for local and regional carriers to have some of the benefits of being a signatory airline while not having to meet the same minimum requirements as larger carriers. The agreement remains a compensatory rate making methodology with a provision for majority-in-interest approval for capital improvements similar to the prior agreement. Additionally, the agreement includes an extraordinary coverage provision offering some additional rate recovery to meet the rate covenant on Series 2010 debt service, allowing the jetport to adjust rental and landing fee rates when estimated costs vary by 30% or more, ensuring a 1.25 times coverage of debt service and required deposits. In the event such extraordinary payments are made, the jetport must repay the airlines when uncommitted funds become available. All of the airlines that were signatory carriers in 2016 have executed the new agreement. Elite Airways and Frontier commenced service from the Jetport in 2016 and 2018, respectively, and continue to operate as non-signatory airlines.

Financial Operations and Position

Increasing activity at the jetport will support stable financial metrics moving forward. In fiscal 2018, net revenue DSCR declined to 1.15x compared to 1.39x and 1.29x in fiscal 2017 and 2016, respectively, slightly below historical levels, which have averaged 1.29x since fiscal

2014. The decline was due to an increase in debt service of approximately 16%, and rising expenditure, despite positive enplanement and revenue growth, though debt service will remain flat going forward, resulting in stable coverage more in line with historic levels. Bond ordinance DSCR in 2018 declined as well to 1.34x from 1.55x in fiscal 2017. Management expects increased coverage in fiscal 2019 and 2020, at 1.61x (projected) and 1.49x (budgeted), on a Moody's net revenue basis. The increases are the result of expected increases in airline revenues and minimal increases in operating expenses and debt service. A refunding planned for Q4 of 2019 is expected to lower annual debt service and improve coverage metrics moving forward.

Since the terminal expansion project was completed, the jetport's cost per enplanement (CPE) has remained very stable at about $8, and should continue to remain near current levels. For fiscal 2018, CPE was $7.72, which represents a compound annual increase of 1.7% per year since fiscal 2014. The modest increase is the result of the level annual debt service schedule and adequate cost control by management. Preliminary, unaudited result show CPE for fiscal 2019 to be $7.80. CPE at the jetport is the lowest in the Boston region, with nearby Manchester-Boston Regional at $13.13 and Boston-Logan International at $14.37, favorably differentiating the jetport as a low-cost option for carriers. CPE should continue to remain stable, which will support the jetport's market position in the highly competitive Greater Boston region.

LIQUIDITY

Liquidity levels have moderated somewhat recently, after several years of rising due to the jetport's compensatory airline agreement and minimal capital funding from cash flows. At fiscal 2018 year-end, the jetport's liquidity was 394 days cash on hand, up from 300 days cash on hand at fiscal 2013 year-end though moderately lower than the last three years. For fiscal 2019, 516 days cash on hand is projected and for fiscal 2020, 451 days cash on hand is budgeted. Through fiscal 2022, there is potential for some reserves to be utilized for several capital projects, but management expects to maintain an unrestricted cash balance of at least 365 days cash throughout this period. Liquidity will also be supported by any benefits stemming from a refunding expected to take place later this year.

Debt and Other Liabilities

While leverage remains high, the jetport should continue to delever due to scheduled debt amortization and no plans for additional general airport revenue bond (GARB) debt. As of fiscal 2018 year-end, the jetport had $112 million of GARB debt outstanding, which translates to $115.45 debt per O&D enplaned passenger. This amount of leverage is high compared to other similarly rated small-hub airports and is the result of debt funding for the terminal expansion project, which was completed in 2012. This is partially offset by the relatively low pension liability. Moreover, the jetport has a modernized terminal and leverage has decreased annually since fiscal 2012, when it peaked at $155.82, due to debt amortization and continued enplanement increases. No new GARB borrowing and strong passenger growth should allow the jetport continue to delever over the next few years.

In fiscal 2020, the jetport could potentially issue approximately $9 million in Passenger Facility Charge (PFC) debt to finance a Federal Inspection Services Facility and a baggage claim expansion.

DEBT STRUCTURE

The jetport's $112.1 million of GARB debt outstanding are all fixed rate and amortizing. Debt service will be $8.6 million in fiscal 2019, will remain relatively stable through 2032, and then decrease annually through final maturity in 2040.

DEBT-RELATED DERIVATIVES

None.

PENSIONS AND OPEB

For fiscal 2018, our adjusted net pension liability for the jetport was $9.5 million compared to a reported liability of $2.1 million. This unfunded pension liability is not a key credit consideration for the jetport as it is less than 9% of total debt outstanding. We adjust the reported pension liabilities of entities that report under governmental accounting standards, to enhance comparability across rated issuers. Under governmental pension accounting, liabilities are discounted using an assumed rate of investment return on plan assets. Under our adjustments, we value liabilities using a market based discount rate for high quality taxable bonds, a proxy for the risk of pension benefits.

Management and Governance

The jetport is owned and operated by the city (Portland (City of) ME, Aa1 stable) and is managed by its airport director who is appointed by the city manager. The city manager is appointed by majority vote of the city council, is the administrative head of the city and is responsible to the city council for the administration of all departments. The airport director has sole responsibility for hiring all personnel necessary to operate the jetport.

Methodology and Scorecard Factors

The principal methodology used was Publicly Managed Airports and Related Issuers published in March 2019. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.

Note: The grid is a reference tool that can be used to approximate credit profiles in the airport sector in most cases. However, the grid is a summary that does not include every rating consideration. Please see the Publicly Managed Airports and Related Issuers methodology report for more information about the limitations inherent to grids.

The actual rating of Baa1 is one notch above the Baa2 grid indicated rating. The actual rating considers the strong level of airline diversity that the jetport has, which is uncommon for a small hub. This limits potential downside enplanement trends as indicated by the minimal enplanement declines during the most recent recession. The actual rating further expects that leverage will continue to decline as a result of amortizing debt and all future borrowing can be deferred if uneconomical.

Exhibit 3

Portland (City of) ME Airport Enterprise Methodology Scorecard

Regional Position:	**Regional**		
Rate Making Framework:	**Compensatory**		
Factor	**Subfactor**	**Score**	**Metric**
1. Market Position	a) Size of Service Area (millions)	Baa	0.535
	b) Economic Strength and Diversity of Service Area	Baa	
	c) Competition for Travel	Baa	
2. Service Offering	a) Total Enplanements (millions)	Ba	0.97
	b) Stability of Traffic Performance	Baa	
	c) Stability of Costs	A	
	d) Carrier Base (Primary Carrier as % of Total Enplanements)	Aa	28.5%
3. Leverage and Coverage	a) Net Revenue Debt Service Coverage	Baa	1.15x
	b) Debt + ANPL (in USD) per O&D Enplaned Passenger	Ba	$125.19
		Metric	**Notch**
4. Liquidity	Days Cash on Hand	394	0
5. Connecting Traffic	O&D Traffic	0.0%	0
6. Potential for Increased Leverage			0
7. Debt Service Reserves			0
Scorecard Indicated Outcome:		**Baa2**	

Source: Moody's Investors Service

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