FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Metro Washington Airports Auth Bank Bonds 'AA-'; Affirms Revs at 'AA-'; Outlook Neg

Wed 29 Jul, 2020 - 1:17 PM ET

Fitch Ratings - Austin - 29 Jul 2020: Fitch Ratings has affirmed the 'AA-' rating on the Metropolitan Washington Airports Authority's (MWAA) approximately $4.4 billion of airport system revenue bonds. In addition, Fitch has assigned a 'AA-' rating to MWAA's previously issued $141 million airport system revenue variable rate bonds, series 2010D, and assigned an underlying bank bond rating of 'AA-' to the series 2010D bonds. The Rating Outlook for all instruments is Negative.

The series 2010D bank bond ratings reflect a security pledge on parity with outstanding airport system revenue bonds.

The Negative Outlook reflects the substantial adverse impact on operating performance due to the coronavirus and related containment measures, along with uncertainty around the timing and magnitude of recovery.

The outbreak of coronavirus and related government containment measures worldwide create an uncertain global environment for the airport sector. Material changes in revenue and cost profile are occurring across the airport sector and will continue to evolve as economic activity and government restrictions respond to the ongoing situation. Fitch's ratings are forward-looking in nature, and Fitch will monitor developments in the sector as a result of the virus outbreak as it relates to severity and duration, and incorporate revised base and rating case qualitative and quantitative inputs based on expectations for future performance and assessment of key risks.

RATING RATIONALE

The rating reflects MWAA's very strong credit attributes, including the resilience of its complementary dual-large hub airport system serving the strong and growing District of Columbia air trade service area, well-balanced system-wide carrier mix, recently completed capital program at Dulles International Airport (IAD), with a new, smaller program at Reagan National Airport (DCA) to accommodate projected passenger demand and stable financial profile. The large debt burden results in a high fixed cost structure; however, MWAA's current airline use and lease agreement (AUL) provides enhanced revenue sharing between airports that has led to a more competitive cost per enplanement (CPE) at IAD in recent years. Rating case leverage is projected to increase in the near term before returning to approximately 6x-7x net debt/cash flow available for debt service (CFADS) by 2024.

KEY RATING DRIVERS

STRONG MARKET POSITION - Revenue Risk (Volume): Stronger

MWAA's large traffic base, anchored by a strong underlying economic region and diverse, complementary domestic and international service offerings at DCA and IAD, reached another new peak of 24.3 million enplanements in 2019 prior to coronavirus impacts. Pre-pandemic, IAD was forecast to increase more rapidly than DCA through 2024 including higher growth for international traffic; however, the coronavirus pandemic is expected to stifle MWAA's traffic base for at least the next several years. United Airlines Inc. (United; BB-/Negative) is the lead carrier at IAD with a 68% carrier market share, while American Airlines Group, Inc. (B/Rating

Watch Negative) handles approximately 52% of DCA. On a system wide basis, market share is more diverse, with United having the largest share at 37%. The airport system consistently captures roughly 63% of the regional air traffic market, with a high proportion of O&D passengers (79% in 2019) stabilizing the traffic profile.

FAVORABLE RATE SETTING APPROACH - Revenue Risk (Price): Stronger

MWAA's AUL runs through 2024 with a hybrid compensatory model, providing an overall favorable airport system cost recovery approach by bridging significant cost imbalances. Revised terms allow for tiered surplus revenue sharing from DCA to subsidize IAD's substantial costs, which are tied to debt-financed capital investments. The rate setting framework provides for an increased level of hard coverage recovery, coupled with provisions such as extraordinary coverage protection and net revenue sharing with the carriers. Proactive management has allowed the authority to contain airline costs and outperform both budget and original airport consultant forecasts for CPE while maintaining stable to improving coverage levels, though CPE will likely be pressured in the near-term given coronavirus-related effects.

MAJOR CAPITAL NEEDS ADDRESSED - Infrastructure Development/Renewal: Stronger

Both airports are modern facilities in good condition. The prior 15-year $5 billion capital construction program (CCP) focused on IAD, whereas the current $2 billion 2015-2024 CCP is predominantly for DCA. It will be approximately 92% bond funded, but DCA should have the debt capacity. IAD has benefitted from increased revenue generation following completion of the prior CCP, and Fitch expects the new CCP should similarly enhance DCA's revenue generating ability. Project Journey at DCA is approximately 52% complete and remains on time and budget for a 2021 completion. MWAA continues to review its capital plan and has deferred more than $230 million of project expenditures over 2020-2021.

LARGELY CONSERVATIVE CAPITAL STRUCTURE - Debt Structure: Stronger

MWAA's debt is fully amortizing, with 85% fixed-rate obligations, 11% synthetically fixed-variable-rate obligations, and 4% unhedged variable-rate debt. The authority's limited variable rate exposure is partially mitigated by its large unrestricted cash position. Covenants and reserve requirements are similar to comparably rated peer airports. Management is proactive with refunding opportunities and $1.2 billion of outstanding debt will be callable through 2025. Greater than 50% of the currently outstanding debt matures within the next 10 years, providing capacity for additional new money borrowings.

FINANCIAL PROFILE

Leverage in 2019 of 6x net debt/CFADS is consistent with the current rating but is forecast to peak around 8x before returning to near 6x by 2024. The debt service coverage ratio (DSCR) has improved since 2014 to 2.05x in 2019 given stronger provisions in the current AUL coupled with recent enplanement growth. Coverage is likely to soften in the near-to-medium term given coronavirus impacts, but should remain on average broadly consistent with historical levels. Liquidity remains strong at nearly 1,300 days cash in 2019 (including Western Lands funds).

PEER GROUP

Comparable large-hub, international gateway peers include Los Angeles International Airport (LAX; senior/sub AA/AA-/Negative) and San Francisco International Airport (SFO; A+/Negative). Both airports have stronger volume and price assessments, supporting relatively high debt levels incurred for infrastructure spending. LAX's higher rating reflects its larger, more resilient enplanement base with less carrier concentration, comparatively lower leverage and higher coverage. SFO has stronger pre-coronavirus enplanement trends but slightly higher leverage and a higher CPE. Further, its operational and financial profiles are tied to a single airport whereas MWAA benefits from a dual-airport system.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Upward rating migration is unlikely in the near to medium term given the authority's leverage and cost profile, combined with the negative impacts of the coronavirus;

--A return to a Stable Outlook may be warranted over the next one to two years should Fitch see sustained recovery in traffic and revenues due to the easing of the pandemic, resulting in normal air traffic patterns and credit metrics in line with indicative guidance.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Shifts in commitments from leading carriers or a continued period of material traffic declines in line with the coronavirus downside cases that result in leverage increasing to and remaining above 8x on a sustained basis;

--Additional borrowing in excess of $1.2 billion for the new capital program that materially affects financial flexibility.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

TRANSACTION SUMMARY

Fitch Ratings has been asked to assign a rating to MWAA's approximately $141 million of previously issued series 2010D airport system revenue variable rate bonds as well as to assign an underlying bank bond rating to the bonds. These are necessary to support MWAA's replacing of the aviation enterprise's variable rate Series 2010D Bonds Index Floater with a three-year letter of credit from Barclays.

CREDIT UPDATE

MWAA had a strong 2019 both operationally and financially. System-wide enplanements grew for the 10th consecutive year, increasing 2.6% over 2018 to 24.3 million and surpassing their forecast with growth coming from both DCA and IAD. Operating expense containment along with non-airline revenue growth led to DSCR increasing to 2.05x and CPE below $15 at IAD and around $11.50 for DCA.

However, the coronavirus pandemic represents a unique shock to the airport sector, with particularly negative effects to domestic and international traffic volume. For the period of January through May, enplanement losses total around 60% at both Reagan and Dulles and for the last seven days of available data (July 9 - 15), enplanements are down more than 80% at each airport. To combat these volume losses, management has taken many actions to address the pandemic including reducing budgeted expenses by at least 10% and deferring $118 million in CCP project expenditures for 2020 and another $114 million in 2021. MWAA also benefits from the $600 million refunding in 2019. Unrestricted cash remains strong at more than 1,000 days cash on hand for 2019 and similar levels for YTD 2020. When taking into account the Western Lands funds, these counts increase by approximately 195 more days. MWAA also has $229 million of CARES Act funds for any lawful airport purpose.

The $2.3 billion CCP moves forward with Project Journey 52% complete as of June with completion expected on time and budget. MWAA is taking advantage of the decline in passenger traffic to progress on some elements sooner than expected. Given the deferred CCP project expenditures and sufficient construction liquidity ($305 million of construction funds and $200 million CP capacity), new money bonds are not necessary until 2021.

MWAA has already issued $878 million of bonds for the CCP and is expected to issue another approximately $1.2 billion through 2025. More than half of the currently outstanding $4.4 billion principal will be retired within the next 10 years, providing capacity for additional borrowing.

FINANCIAL ANALYSIS

Fitch Cases

Fitch developed three scenarios that serve as the basis for this review. Fitch's rating case contemplates enplanement declines of approximately 50% in calendar-year 2020 (relative to 2019), with a recovery of 85% in 2021, 95% in 2022 and 100% in 2023 (relative to 2019). Fitch also modelled two additional coronavirus downside cases to reflect deeper traffic declines as well as prolonged recovery back to 2019 levels. See "Non-Rating Action Commentary - Fitch Updates Coronavirus Scenarios for U.S. Airports Portfolio" published April 21, 2020 and available on www.fitchratings.com.

For all three cases, non-airline revenues move broadly in relation to passenger traffic trends and airline revenues are adjusted to comply with the rate covenant and to provide for similar DSCR levels to historical performance under the AUL. Operating expenses fall slightly in 2020 as a result of cost cutting measures by management before growing at an inflationary average of around 3% for 2021-2024 per discussion with MWAA. PFC offsets to debt service increase from $54 million in 2019 to $85 million by 2022. Transfers remain relatively constant at around $195 million per year. CARES Act funds are assumed to be used entirely in 2020 as rate mitigation to contain the spike in CPE. Fitch recognizes that MWAA is still evaluating all of its options with respect to the use of the CARES funds and may apply them differently and over a several year horizon.

The result is rating case coverages that average 1.7x (indenture basis) and 1.1x excluding transfers and treating PFCs as revenues. Airport system CPE rises to more than $16 for 2020, but falls back to $13 by 2023. Leverage increases to 8.1x, but returns to 6.5x by 2024.

Fitch also ran the coronavirus sensitivity and severe sensitivity scenarios, both showing a maximum traffic reduction of 60% in 2021, while the latter case delays the recovery in the following fiscal periods. Under these scenarios, DSCR and leverage profiles are comparable to the rating case, although airport system cost per enplanement levels would approach the $24 range in 2020 and it would remain around $15 by 2024 in the severe sensitivity.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			
Metropolitan Washington Airports Authority (DC)				
• Metropolitan Washington Airports Authority (DC) /Airport Revenues/1 LT	LT	AA- Rating Outlook Negative	Affirmed	

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Infrastructure and Project Finance Rating Criteria (pub. 24 Mar 2020) (including rating assumption sensitivity)

Airports Rating Criteria (pub. 24 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

GIG AST Model, v1.1.2 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

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