S&P Global
Ratings

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Summary:

Port of Portland, Oregon
Portland International Airport; Airport

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Long Term Rating	AA-/Stable	New

Rationale

S&P Global Ratings has assigned its 'AA-' long-term issuer credit rating (ICR) to the Port of Portland, Ore. and affirmed its 'AA-' long-term rating on the port's subordinate-lien general airport revenue bonds (GARBs) issued for the Portland International Airport (the airport, or PDX). In addition, S&P Global Ratings affirmed its 'A' rating on the port's stand-alone passenger facility charge (PFC) bonds outstanding, issued for PDX. The outlook on all ratings is stable.

Our ICR reflects the airport's very strong capacity to meet its financial commitments. The ICR also reflects our forward-looking opinion about the airport's overall creditworthiness. It does not apply to any specific financial obligation because it does not take into account the nature of and provisions of any specific financial obligation, the airport's standing in bankruptcy or liquidation, statutory preferences, or the legality and enforceability of any specific financial obligation.

The ratings reflect our view of the following credit strengths:

- The predominantly origin-destination (O&D) nature of passenger traffic and the airport's dominant market position in the region;
- The airport's strong-to-very strong liquidity position and historically strong debt service coverage (DSC) that we expect will remain strong, despite the port's additional borrowing plans; and
- The demonstrated strong management of operations, finances, capital projects, and administration of the PFC program.

In our view, these credit strengths are partly offset by a very large $1.7 billion five-year capital improvement program (CIP) (excluding prior expenditures) that requires substantial additional debt.

The GARBs are secured by a senior lien on the net revenues of the airport only; there is no pledge of additional port revenues. The PFC bonds are secured and payable solely by PFC revenues pledged up to $4.50 per enplaned passenger. At fiscal year-end 2017, the airport had about $140 million in stand-alone PFC bonds outstanding, including a direct purchase agreement with Wells Fargo. In addition, the airport has approximately $645 million in GARBs outstanding, at present, compared with $734 million reported in fiscal 2017 (including the current portion due that year). The airport has entered into six swaps with three counterparty financial institutions. The swaps carry a notional amount of $130 million and a current mark-to-market value of negative $20 million, in favor of the financial institutions.

The port district is a municipal corporation and a legal subdivision of the state that operates maritime, aviation, and industrial properties. The airport is located on 3,200 acres on the southern edge of the Columbia River, 12 miles northeast of downtown Portland. It is considered a large hub by the Federal Aviation Administration (FAA) as of calendar year 2016 enplaned passengers and was the 30th-largest airport in the U.S., according to Airports Council International, based on 2015 total passengers. Seattle-Tacoma International Airport is the closest major airport facility (160 miles to the north) and does not, in our opinion, provide a viable alternative for air access to the Portland region. As such, we believe competitive pressure on PDX is limited.

PDX has a strong market position, in our opinion. The primary air service area includes seven counties--five in Oregon and two in Washington. Population growth within the air service area has been strong over the past decade, outpacing both the state and national annual growth rates. Historically, Portland experienced steady growth in passenger traffic.

In our view, the airport's enplanement trends over the last two to three decades have demonstrated generally strong demand characteristics, with the exception of notable declines during significant economic downturns. Although we note that air travel demand is susceptible to substantial economic downturns, such declines in traffic were followed by relatively quick recoveries in demand. We attribute the port's relatively resilient air travel demand to the strength of PDX's service area economy, limited competition, and air travel demand that is primarily driven by O&D passengers. We expect these factors will support generally strong air travel demand for the foreseeable future. From 2010-2017, enplanements grew at a compound average annual rate of 5.5%. Growth in recent years has been especially strong, as enplanements increased 9.1% in fiscal 2016 and 7.2% in fiscal 2017. For planning purposes, management forecasts 2.3% annual enplanement growth through 2022. We view this as a conservative assumption that is likely to be achieved or exceeded. While the continued strong growth is a primary factor contributing to the airport's strong financial performance, it is also driving what we consider to be a very large CIP (see below).

We consider PDX's consistently high percentage of O&D passengers a credit strength, providing generally stable activity levels. Approximately 84% of total enplanements at PDX are O&D passengers. The top three carriers account for about three-fourths of total market share (73% in fiscal 2017). Alaska Air Group, which includes Alaska and Horizon Airlines, had a 40% market share in fiscal 2017, followed by Southwest Airlines, with an 18% market share, and Delta Air Lines, with a 13% market share. PDX's strong O&D nature mitigates some risks regarding air carrier hubbing decisions, in our view.

The airline agreement was effective July 1, 2010, and expired June 30, 2015; however, management and the airlines extended the term of the agreement through 2025. The agreement has a hybrid rate-making model, with residual rate-making for the airline cost center covering operations and maintenance (O&M) expense plus 1.3x annual funded DSC. The agreement has a majority-in-interest disapproval process for airline cost center projects, exceeding $1 million in project cost, and includes a provision for revenue-sharing of nonairline revenues of up to $6 million per year (plus additional revenue sharing if the airport DSC exceeds 1.75x). Beginning with the July 1, 2015 extension of the airline lease and operating agreement, the cost per enplanement (CPE) methodology includes airline common use rentals and excludes the airfield cargo carrier requirement. We consider this change to be credit neutral. We consider the airline agreement to be credit neutral.

Airport management implemented a formalized strategic planning process over the past four years. This Project

Portfolio Office (PPO) process provides a framework for prioritizing capital projects and for aligning capital and financial planning. The port adopted a debt management policy in May 2017. The policy details several financial targets, including maintenance of PFC DSC of at least 2.0x, maintaining at least 1.25x coverage from net revenues of all GARB plus PFC debt service, and maintaining liquidity from airport funds equivalent to at least 300 days' cash on hand. The targets in the debt management policy underscore the prudent financial management practices we consider PDX management to have, and this prudent financial management is an important factor contributing to our view that the airport will likely be able to maintain a credit profile consistent with the current rating as it funds its large five-year CIP.

PDX's financial performance is consistently strong, in our view. S&P Global Ratings calculates DSC based on audited financial results, netting non-cash items from operating expenses and including only the portion of total interest income that is pledged and/or legally available to support GARB debt service. We also include the portion of the port's pension bond debt service that is allocated to the airport fund as a fixed obligation in the denominator of our DSC calculations. Per our calculations, DSC improved from 1.96x in fiscal 2015 to 2.02x in fiscal 2016, and to 2.09x in fiscal 2017. We consider these levels as very strong and as supportive of the current rating level. As the port issues additional debt to fund its airport CIP, we expect DSC will likely fall to around 1.7x in fiscal years 2021 and 2022. At the same time, we expect that rising annual debt service obligations will contribute to rising costs per enplanement. Based on management's financial forecast, which we believe was formulated via reasonable and somewhat conservative assumptions, we expect CPE will increase to around $13.50 by fiscal 2021, a moderately high figure. In fiscal 2017, CPE was about $9.70.

The airport's liquidity position remains a key credit strength. Cash and equivalents within the airport fund alone amounted to approximately $106 million at fiscal year-end 2017, equivalent to nearly 300 days' cash on hand. In addition to the airport fund, the airport may also apply port general fund cash to support the airport's expenses. Port-wide liquidity for fiscal 2017 was much stronger, at $350 million, equivalent to 635 days' cash on hand (including total port operating expenses). In our view, this provides the airport with an ample financial cushion, offsetting some risks associated with the prospect of fluctuating enplanement levels and a very large CIP. We expect management will maintain a relatively strong liquidity position as the port funds its significant CIP.

PFC revenues collected by the airport provide what we consider to be consistently strong maximum annual debt service (MADS) coverage. PFC MADS coverage improved to 2.6x in fiscal 2017, from 2.4x in fiscal 2016, 2.2x in fiscal 2015, and 2.1x in fiscal 2014, according to our coverage calculations. We expect PFC MADS coverage will remain strong, assuming enplanements remain generally stable and the port does not issue a significant amount of stand-alone PFC bonds to fund a portion of its CIP, which port officials have no plans to do at this time. If PFC MADS coverage remains near recently demonstrated levels and we believe those levels are sustainable as the airport funds its CIP, we could raise the PFC debt rating one notch in the medium term.

Continued strong demand growth at PDX, in addition to management's striving to maintain a top quality airport experience for passengers, is leading the airport into an especially capital-intensive period. The airport's five-year CIP totals $1.7 billion, which we consider very large. Projects include a terminal balancing project, which will result in increased efficiency in distributing operations throughout the north and south sides of the terminal, as well as

increased capacity; loading bridge replacements; taxiway and apron rehabilitations; the addition of a new public parking facility and a consolidated rental car facility, which will increase parking and rental car capacity while enhancing revenue generation in future years; and a terminal core redevelopment project that will ultimately expand terminal capacity and enhance the passenger experience at PDX.

Given the airport's additional bonding plans, we expect total GARB debt outstanding will rise to about $1.6 billion by fiscal 2022. Assuming 2.3% annual enplanement growth--a level of growth we consider reasonable--GARB debt per enplaned passenger could rise from the fiscal 2017 figure of $75 to around $150-$160 by fiscal 2022. We believe this level of debt is high, but we believe it will be manageable because of PDX's generally resilient demand characteristics. Although preliminary, the port's current CIP financing plans call for approximately $160 million in bonds secured by customer facility charge (CFC) revenues bonds, and approximately $1 billion in additional GARBs. We expect that management will effectively manage the CIP and rising debt service requirements, adjusting rates and charges as needed to maintain its strong DSC and liquidity position.

The GARBs are secured by the net revenues of PDX and by the money held in certain funds and accounts established by the bond ordinances. The pledged revenues for the GARBs do not include other nonairport activities, such as maritime operations, under the port's control. Overall, the legal structure of the airport enterprise is favorable, in our opinion.

While the GARB provisions regarding the flow of funds and debt service reserve levels are typical, we believe the airport has a strong additional bonds test of 1.30x, which may be calculated on either historical or projected net revenues. Under the bond ordinance, the airport has agreed to impose rates and charges so that the annual net revenues are equal to 1.30x debt service; it also requires annual payment of DSC from the airlines, rather than the industry's standard rolling coverage. While PFCs are legally defined as revenues, federal law restricts their use to specific, approved projects. The airport does not use these revenues in the calculation of rates and charges. PFC revenues are excluded from the calculation of net available revenues under the bond covenants, and are not considered available for the payment of GARB debt service at this time.

Technically, the airport's GARBs were issued on a subordinate-lien basis; however, there is no other debt with a prior claim on airport revenues. The port has covenanted to not incur any obligations superior to the lien on the GARBs, with the exception of O&M expenses.

The airport has six swaps with three counterparties outstanding. The combined current mark-to-market for the airport is approximately negative $20 million, in favor of the financial institution counterparties. We consider the risk of termination risk low, given the rating differential (greater than two-notch differential) between airport's rating level and the rating triggers for swap termination.

The airport currently has about $3.8 million in collateral posted under one of the swaps, which is required because the swap carries a negative fair value. Additional collateral postings would be required if the mark-to-market on the PFC swaps exceeds negative $15 million, or if the ratings on the airport fall below certain thresholds. At present, we do not consider the possibility of required collateral postings a credit risk, due to the strong liquidity available to the airport, in addition to the fact that the airport bond ratings would have to fall by at least two notches, which we view as unlikely.

The airport's series 2012A PFC bonds are direct purchase bonds held by Wells Fargo Municipal Capital Strategies LLC. There is currently about $57 million outstanding under the direct purchase agreement. We do not consider the direct purchase as carrying material contingent liquidity risk, given the airport's strong liquidity, with over $350 million, including the port's general fund unrestricted cash balances, available to the airport at fiscal year-end 2017.

The PFC bonds are secured solely by PFC revenues and PFC revenue interest earnings. The airport may pledge additional revenues to the bonds, though currently no additional revenues are pledged.

The airport deposits PFC revenues as collected to the PFC fund, and applies the fund in the following order: to pay debt service on the PFC bonds, to make any required deposits to the reserve account, to make any subordinate-lien PFC obligation payments, to make any required deposits to a subordinate-lien PFC reserve account, and to deposit to the PFC Capital Account to be used for approved projects or any other use authorized under federal PFC regulations.

Under the PFC bond ordinance, the port must, at all times, comply with a first-lien sufficiency covenant. Under this covenant, the following calculation must exceed 1.05x at all times:

PFC authority:

- Less: costs paid to date on PFC pay-as-you-go improvements
- Less: pay-as-you-go contractual commitments
- Less: debt service paid to date on PFC bonds
- Less: projected aggregate subordinate-lien debt service
- Plus: any funds on deposit in the subordinate-lien obligations account or reserve and any additional pledged revenues
- Divided by: projected aggregate first-lien debt service, less funds on deposit in the first-lien debt service account and first-lien reserve fund

The airport may issue additional first-lien PFC bonds if an aviation consultant certifies that the first-lien sufficiency covenant will be met after the issuance, and projected pledged revenues for the five years after issuance provide at least 1.50x MADS.

Outlook

The stable outlook reflects our expectation that demand for the airport will remain generally stable or exhibit positive growth, that management will adjust rates and charges to maintain strong financial margins despite rising debt levels from future debt issues planned to fund the CIP, and that the port's liquidity position will be maintained near current levels.

Upside scenario

We do not expect to raise the ratings, given the port's future borrowing plans that we expect will pressure DSC and debt metrics, though we expect that the financial metrics will remain supportive of the current ratings. If PFC MADS coverage remains very strong as the airport issues additional debt, and if we expect PFC MADS coverage will remain very strong, we could raise the PFC debt rating by one notch.

Downside scenario

We could lower the ratings within the next two years if the port's DSC or liquidity position materially erodes as a result of funding the CIP. We do not expect to lower the PFC debt rating, as we expect PFC MADS coverage will remain at least at levels that support the current 'A' rating.

Ratings Detail (As Of December 13, 2017)		
Port of Portland, Oregon		
Portland Intl Arpt, Oregon		
Port of Portland (Portland International Airport)		
Long Term Rating	AA-/Stable	Affirmed
Port of Portland (Portland Intl Arpt) passenger fac chg rev bnds		
Long Term Rating	A/Stable	Affirmed

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