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Susquehanna Area Regional Airport Auth., PA

Update to credit analysis

Summary

The credit profile of the Susquehanna Area Regional Airport Authority (SARAA or authority, Baa3 stable) is based on its market position providing air service to Harrisburg and the surrounding area as well as the highly competitive broader area, which has two large-hubs in a reasonable driving distance. The credit also reflects the stable service area economy, which is supported by the presence of the state capital, and that resulted in airport enplanements growth over the past two years pre-pandemic. The authority is highly levered with narrow financial metrics, including debt service coverage ratio (DSCR), which has averaged 1.12x over the past five years.

Until the coronavirus impact, the airport had a trend of enplanement growth following a stable performance historically. Even with some volatility linked to airline carriers coming in and out of the market financial metrics demonstrated steady improvement. In 2018 and 2019, the airport saw an enplanement increase which positively impacted financial metrics and CPE, though just at a slightly better position than the 10-year average level performance. With the negative impact rising from the coronavirus influence in air travel demand, enplanements were 58% down from 2019 levels and recovery will likely continue to track the sector average. This will further pressure the historically narrow financial metrics such as coverage and liquidity. On the other hand, the stimulus funds have helped the authority offset the decrease in its liquidity balance. The authority doesn't have any plan to issue new debt, therefore leverage, measured by adjusted debt to O&D enplanement, is expected to be negatively impacted in the short term due to enplanement declines only. Thereafter it is expected to continue to decrease even with a flat enplanement trend due to the debt amortizing profile.

The expired airline agreements leave the airlines unrestricted if they choose to significantly reduce their presence at the airport in the wake of the coronavirus. However, the authority is currently under negotiation with the airlines and expect to have the renewed agreements signed in the second half of 2021. The airline agreements have provided crucial credit support in light of historically narrow financial metrics.

Credit Strengths

» Capital needs are manageable and are primarily funded by grants due to the expanded and renovated terminal facilities with no new debt expected

» Stable service area economy with signs of expansion has generated stable traffic demand over the past decade

» Enplanement growth over a couple of years pre-pandemic due to a strong economy and an increase in capacity from all the airlines at the airport

Credit Challenges

» A pattern of past enplanement volatility returned with the pandemic

» Uncertainty regarding terms and conditions of airline agreements to be renewed given unprecedented enplanements decline

» High debt levels are expected to keep financial and debt service coverage margins narrow and airline costs relatively high

» The airport operates in a highly competitive environment with two larger airports, Philadelphia and Baltimore, within 110 miles

Rating Outlook

The stable outlook considers the impact from the coronavirus in enplanements and consequent impact in financial metrics in the short term somewhat offset by management's measures to implement cost cuts and preserve the low liquidity in historical range.

Factors that Could Lead to an Upgrade

» Sustained enplanement and revenue growth that supports financial margins and total DSCRs above 1.10x on a net revenue basis

» Further reduction in CPE that continues to enhance the airport's competitiveness

» Liquidity above 300 days cash on hand

» Airline agreement renewal that continues to provide the airport with adequate coverage and service levels

Factors that Could Lead to a Downgrade

» Slower than expected recovery of enplanements and operations levels at the airport

» Delayed airline agreement renewal and carriers ceasing to operate at the airport

» Change in operations at the airport that results in meaningful enplanement decrease

» An indication that any of the three legacy carriers serving the airport may significantly reduce their presence

» Liquidity below 100 days cash on hand

Key Indicators

Exhibit 1
Key Indicators
Susquehanna Area Regional Airport Authority, PA

	2016	2017	2018	2019	2020
Enplanement Annual Growth (%)	2.9	(1.1)	8.6	16.8	(58.3)
Debt Outstanding ($'000)	152,057	143,439	139,422	134,722	129,894
Adjusted Debt to Operating Revenues (x)	5.5	5.1	4.8	4.5	6.0
Adjusted Debt Per O&D Enplaned Passenger ($)	250.4	238.9	213.7	176.8	408.9
Days Cash on Hand	191	246	238	209	206
Senior Lien Coverage By Net Revenues (x)	1.73	1.07	1.15	1.20	1.08
Total Coverage By Net Revenues (x)	1.10	1.07	1.15	1.20	1.08

Source: Moody's Investors Service

Profile

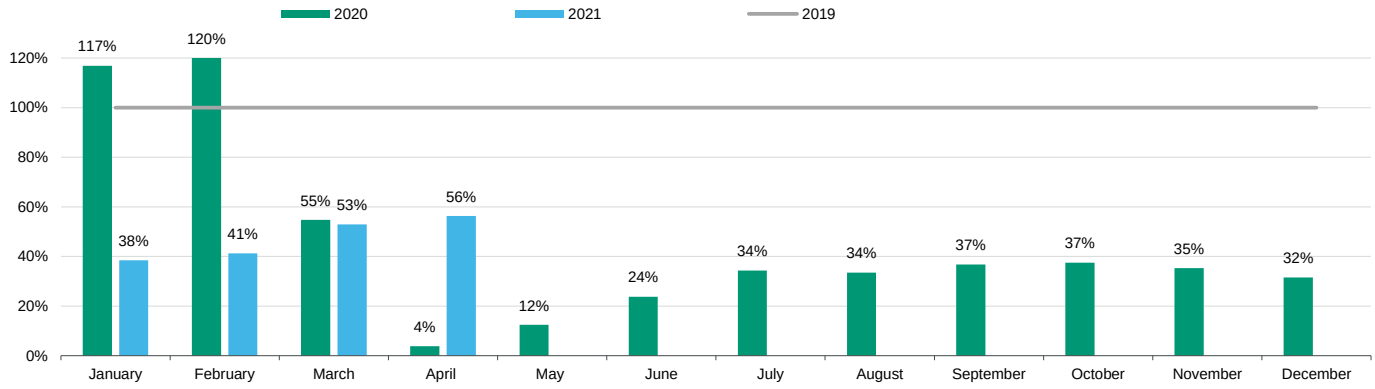
SARAA owns and operates Harrisburg International Airport (MDT), along with three small general aviation airports. The authority is an independent joint municipal authority created in 1997 under the Pennsylvania Municipal Authorities Act to assume ownership and control of the airports from the Pennsylvania Department of Transportation (PennDOT) and includes the counties of Dauphin, Cumberland, and York; the cities of Harrisburg and York and the townships of Fairview and Lower Swatara.

Detailed Credit Considerations

Revenue Generating Base

With the coronavirus negatively impacting air travel demand, enplanements in 2020 were 58% down versus 2019, and we expect the recovery at SARAA to continue to track the sector.

Exhibit 2
MDT enplanement recovery has tracked the sector performance
Enplanement recovery indexed to 2019



Source: Susquehanna Area Regional Airport Authority, PA

Traffic at the airport remains modestly concentrated in the primary carrier, American Airlines, which accounted for 42% of total enplanements in 2020. The airport is served by five airlines in total, three legacy carriers, Allegiant Airlines and Frontier, all of which are signatory to the airline agreement. As of June 2021, all airlines have remained in the market.

Pre-pandemic, enplanements increased 16.8% in 2019 compared to 2018, following a 8.6% enplanement increase in the previous year. The gains were due to a strong economy and capacity growth by all the airline carries, mainly American and Allegiant as well as by Frontier, which returned to the airport in 2018. We note that Frontier had stopped serving the airport in 2013.

In 2020, the airport saw a 2% increase in tons of cargo flown into and out of MDT, with UPS tonnage increasing 5%, while FedEx decreased 3% and commercial airline belly cargo decreased by 64%. The regional cargo airlines increased air cargo tonnage nearly 55% mainly due to DHL's upgraded service in peak holiday season, which is now added on a permanent basis.

Revenues are primarily generated at MDT and are driven from origin and destination (O&D) demand from the local service area. Harrisburg is the state capital, and according to Moody's Analytics, as of January 2021, Harrisburg-Carlisle's economy has come back strong from the 2020 downturn, but there were warning signs at year's end. Harrisburg-Carlisle will soon lose its edge over the state and Northeast since it recovered more jobs in 2020. Gains in logistics and healthcare will fuel growth in jobs, income and spending. A middling population outlook makes Harrisburg-Carlisle an average long-term performer among Northeast metro areas. The airport is located within a one hour drive from the counties of Adams, Cumberland, Dauphin, Franklin, Lancaster, Lebanon, Perry and York.

The authority operates in a highly competitive air service region, with two large hub airports, Philadelphia and Baltimore-Washington, within 110 miles of the airport. The airport's service area is dominated by the larger airports and the authority consistently maintains only a small portion of market share in the region. The airport's primary carriers, including American, Delta and United, also serve these nearby competing airports. Due to their larger route networks and more expansive service offerings, these large hubs will continue to dominate the service area market, absorbing a majority of traffic growth in the region.

The authority's airline use and lease agreement (AUA) expired in December 2019 and the authority has agreed with the airlines that it will hold over the agreement, which is renewed on a month-to-month basis. The renewal was originally expected to happen in mid-2020, but given disruptions from coronavirus, the process was put on hold but it is now back on track and it is expected to conclude in the second half of 2021. The current authority's airline use and lease agreement (AUA) provides the authority with downside protections and is a key consideration in the rating, given the authority's narrow financial metrics. The AUA includes several key features that address rate structuring, extraordinary protections and revenue sharing. The AUA defines the rates charged to the airlines, and includes several financially supportive provisions, such as the makeup of landing fees if collections are 10% or more below projections. It also allows for the makeup of lost pre-petition debt if it represents 10% or more of total airline payments, and the makeup of reduced passenger facility charge (PFC) revenue if collections are more than 10% below projections. Signatory airlines that lease at least one gate are eligible for revenue sharing.

Financial Operations and Position

As a result of the unprecedented negative impact from the coronavirus in the enplanements level, the historically narrow financial metrics such as coverage and liquidity will be further pressured in the coming years. This will follow recent years of some improved metrics due to recent enplanements' increase of 16.8% in 2019, following 2018 with an enplanement increase of 8.6%. Despite this recent trend, the authority has mainly showed a narrow but stable financial performance over the past years.

In 2020, the authority was able to meet its rate covenant of 1.25x with the use of $4.4 million CARES Act grants as an offset to debt service, resulting in bond ordinance DSCR of 1.43x down from 1.74x in 2019. SARAA was awarded $10 million of CARES Act grant funding in 2020 and in March 2021, SARAA applied for $4.3 million of Coronavirus Response and Relief Supplemental Appropriations Act grant funds. Management expects to continue to use these grant funds through 2024 to offset debt service, therefore improving coverage and preserving the authority's liquidity. Considering the DSCR by net revenues, DSCR was 1.08x in 2020 and going forward, we expect DSCR to continue to be near 1.0x in the short to medium term, based on management's expectation of using its remaining stimulus funds to debt service payment.

The airport had been able to maintain stable financial metrics and mitigate enplanement volatility on account of conservative budgeting and cost management combined with some non-airline revenue growth. The authority has been able to maintain an average DSCR of 1.12x over the past five years. In 2020, the authority continued to put its conservative budgeting and cost management into practice, with a reduction of 21% in operating costs in 2020, which helped offset the negative impact from enplanements decline.

In 2020 CPE increased to $27.59, from $13.24 in 2019, as expected due to coronavirus-related enplanement decline. Going forward, we expect CPE to return to historical levels as enplanements recover, annual debt service schedule stays flat and operating expense is kept at current levels with no considerable increases.

LIQUIDITY

Unrestricted cash balance and discretionary reserves balances decreased in 2020 as expected due to unprecedented enplanement declines to $8.7 million from $11.2 million. The decline would have been greater if had the airport not received stimulus grants. Even with the unrestricted balance decrease, days cash on hand metrics was kept stable (206 DCOH in 2020 versus 209 DCOH in 2019) due to lower operating expenses arising from cost cutting measures.

Going forward, the authority expects to continue using its stimulus grants to pay debt service to preserve liquidity. The authority's capital spending is manageable and largely funded by third-party sources. The authority has no plans for additional debt. The five year capital plan through 2027 is sized at $88 million, which includes some additional projects such as the rehabilitation of flood dike project of approximately $10 million, which is 90% funded by AIP grants. The largest source of funding will be federal grants, which will provide approximately 71% of the funding. Other state and local grants are also included providing approximately 7% of the funding and internally generated cash flow will provide 14% of the funding. The rest of the funding sources is still to be defined.

The authority also has access to a line of credit of $1 million which outstanding balance is 0 as of now according to management and this would be an additional source of liquidity in a scenario of further depletion of cash balances. SARAA also counts with a debt service reserve fund which is cash funded at maximum annual debt service.

Debt and Other Liabilities

In the short to medium term, leverage measured by adjusted debt per O&D enplanement is expected to increase due to the negative impacts from coronavirus on enplanement levels. Following the recovery from coronavirus, leverage is expected to return to its decline trend due to its amortizing profile through maturity without expectation of issuance of new debt.

Leverage has remained very high at the airport since the terminal debt issuance in 2003. As of December 31, 2020, the airport had $129.05 million of revenue bonds outstanding, all of it fixed rate, plus $844,383 in notes payable. In 2020, leverage was $408.91 adjusted debt per O&D enplanement. It increased from $176.84 in 2019 due to the large decline in enplanements from the pandemic. We will see this metric fall in 2021 as enplanements continue to recover.

LEGAL SECURITY

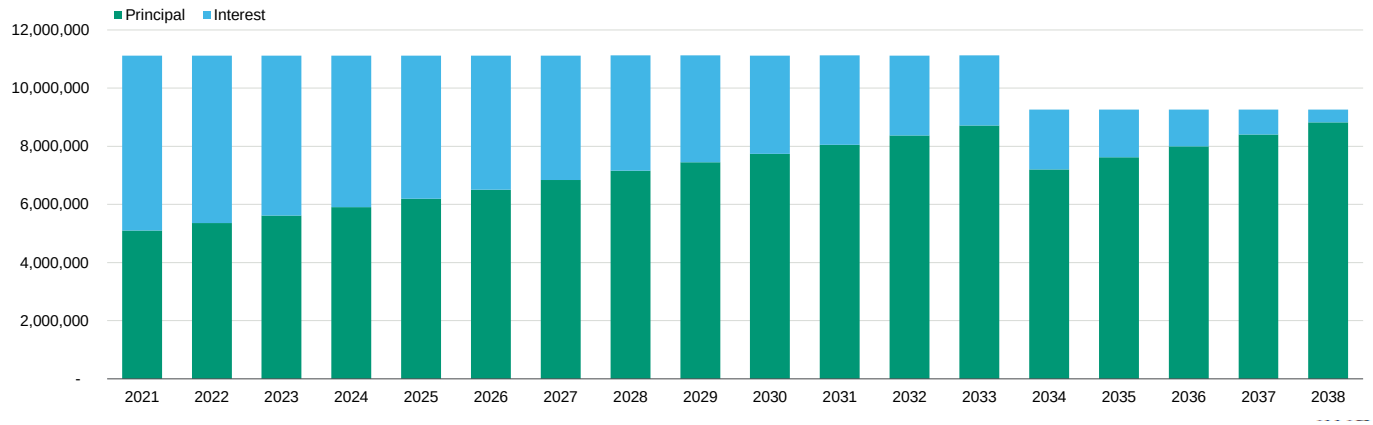
The bonds are secured by the net revenues of the airport system. A debt service reserve fund is cash funded at maximum annual debt service. SARAA covenants to set rates so that net revenues (including rolling coverage of 25% of senior debt service) meet or exceed 1.25x senior lien debt service and 1.10x total (senior lien and subordinate lien) debt service. Senior lien bonds are protected by an additional bonds test requiring historical revenues (without coverage) to cover maximum annual senior lien debt service by 1.10x or a consultant certificate that after issuance the authority will be in compliance with the rate covenant.

DEBT STRUCTURE

The debt service profile is level through final maturity. Amortization on outstanding senior obligations was delayed to create a flat debt service profile at about $11.1 million annually through 2032, when it then decreases to about $9.3 million annually through final maturity in 2037. The authority only has senior obligations outstanding as the subordinate obligations matured in January 2017.

Exhibit 3

Flat debt service profile with backloaded principal amortization



The period ending January 1st on the years above correspond to the previous calendar year

Source: Susquehanna Area Regional Airport Authority, PA's Official Statement

DEBT-RELATED DERIVATIVES

None.

PENSIONS AND OPEB

The authority does not participate in any defined benefit plans, and as such, does not have any pension or other obligation liabilities. The authority has established a 457(b) defined contribution plan and a 401(a) plan for employees. SARAA makes no contributions to the former and matches up to 4% of salaries and wages of employee contributions of the latter. From 2020 onwards, SARAA will make a 4% match for the first 4% and half match from 4-8%. The contribution amount was $306,415 in 2020.

ESG Considerations

Environmental

The primary risk is a reduction in passengers if more stringent air emission and carbon regulations on airlines significantly increase airfares. This would have the greatest impact on airports that have increased leverage to expand capacity. Airports may face more regulation regarding air quality, including noise pollution, in and around airports. Disasters (SARS, Icelandic volcanoes, hurricanes) can temporarily reduce volumes. Airports encounter a manageable level of soil pollution exposure, through fuel leaks, de-icing fluids, and by-products from fire fighting activities. New airports in expanding markets may also face environmental issues depending on the environmental sensitivity of the proposed sites. The sector is generally able to pass along added costs stemming from these exposures. Growth in demand for air travel, particularly long-haul routes, which are most exposed to costs of carbon legislation, will likely remain steady, leading to increasing carbon costs with growing passenger volumes. We do not see any major environmental risk for this issuer.

Social

Airports can be at risk of social factors such as labor agreements and noise issues with communities. However, the most pressing social concern is in regard to the COVID-19 outbreak which has disrupted global airport passenger traffic volume reducing passenger numbers and causing flight cancellations which has hindered commercial revenue and airport charges. COVID-19 will have a major impact on all airports in the following years.

Governance

The authority is governed by a 15 member Board of Directors. Board members serve staggered five-year terms and are not compensated. The Counties of Dauphin, Cumberland, and York appoint three board members, respectively, the Cities of Harrisburg and York appoint two board members, respectively, and the Townships of Fairview and Lower Swatara each appoint one board member. An executive director is appointed by the board to act on its behalf in connection with the administration of the operational responsibilities of the authority.

Rating methodology and scorecard factors

The Baa3 assigned rating matches with the Baa3 scorecard indicated outcome.

The grid is a reference tool that can be used to approximate credit profiles in the publicly operated airport industry 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 for more information about the limitations inherent to grids.

Exhibit 4

Publicly Managed Airports and Related Issuers Methodology Scorecard

Susquehanna Area Regional Airport Authority, PA

Regional Position:	**Regional**		
Rate Making Framework:	**Hybrid**		
Factor	**Subfactor**	**Score**	**Metric**
1. Market Position	a) Size of Service Area (millions)	A	1.27
	b) Economic Strength and Diversity of Service Area	Baa	
	c) Competition for Travel	Baa	
2. Service Offering	a) Total Enplanements (millions)	Ba	0.318
	b) Stability of Traffic Performance	Baa	
	c) Stability of Costs	A	
	d) Carrier Base (Primary Carrier as % of Total Enplanements)	A	41.5%
3. Leverage and Coverage	a) Net Revenue Debt Service Coverage	Baa	1.08x
	b) Debt + ANPL (in USD) per O&D Enplaned Passenger	B	$408.91
		Metric	**Notch**
4. Liquidity	Days Cash on Hand	206	-1.0
5. Connecting Traffic	O&D Traffic	100.0%	0.0
6. Potential for Increased Leverage			0.0
7. Debt Service Reserves			0.0
Scorecard Indicated Outcome:		**Baa3**	

Source: Moody's Investors Service

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