Fitch Affirms Burlington's (VT) Airport Rev Bonds at 'BBB-'; Outlook Positive

Fitch Ratings has affirmed Burlington, VT's approximately $37 million of outstanding airport revenue bonds at 'BBB-'. The Rating Outlook is revised to Positive from Stable.

The Positive Outlook reflects an improving fiscal profile demonstrated in recent years which should continue under a recently implemented airline agreement with strong cost recovery mechanisms, mitigating the impact of a stagnant traffic base with risk of volatility. To the extent BTV's traffic and cost profile remains intact, resulting in a manageable cost per enplanement (CPE) level as well as growing liquidity and stable coverage at 1.50x while leverage evolves downward, the rating could migrate to the 'BBB' level.

KEY RATING DRIVERS

Summary:

The rating reflects Burlington International Airport's (BTV) small traffic base of 600,000 enplanements with some observed volatility in a limited catchment area, which is also partially dependent on fluctuating Canadian demand. The rating is further supported by BTV's implementation of an airline agreement with strengthened cost recovery terms which reduces the effects of traffic volatility, limited airport capital needs without borrowings for funding, an increasing liquidity position, and stabilizing debt service coverage ratios (DSCR) and leverage.

Primarily O&D Traffic Base with Volatility (Revenue Risk - Volume: Weaker)
BTV provides primary air service with about 600,000 enplaned passengers for the Burlington metropolitan statistical area (MSA) with no nearby domestic competition. Traffic is entirely origin & destination (O&D), with approximately 19% of enplanements driven by Canadian demand. BTV does not have significant single carrier concentration with only United Airlines having the leading market share of about 32%. Still BTV is exposed to traffic volatility from carrier service and current enplanements are still 20% below peak levels in 2009.

Moderate Cost Recovery Framework (Revenue Risk - Price: Midrange) (Revised from Weaker)
BTV transitioned to a residual airline use and lease agreement (AUL) beginning in fiscal 2017 and extending for five years. The AUL provides improved cash flow visibility versus previous

rate setting terms under a monthly hybrid rate setting AUL that offered substantial airline subsidies and less robust cost recovery mechanisms. The new AUL is intended to maintain a DSCR of 1.5x going forward, taking into account non-airline revenue performance, with excess net revenue sharing distributed among the carriers. Airline costs have been increasing in recent years, with $7.21 per enplanement in fiscal 2016, and could further increase over the next few years.

Manageable Infrastructure Plan (Infrastructure & Renewal Risk: Stronger)
The airport's four-year capital improvement plan (CIP) totals $85.9 million and will be largely funded through grants and passenger facility charges (PFCs). Major projects include airfield related improvements, terminal upgrades, and an environmental/land acquisition project. BTV does not plan to issue additional debt to support their capital program.

Conservative Debt Structure (Debt Structure: Stronger)
All BTV's debt is senior, fixed-rate, and fully amortizing with a level debt service profile of approximately $3.7 million through 2028, stepping down to $1.5 million in the final two years. Structural features contain adequate coverage tests and a 12-month cash-funded debt service reserve fund (DSRF).

Financial Metrics: BTV's metrics are expected to stabilize going forward with the adoption of a residual AUL that targets a 1.5x DSCR. As a result, Fitch's rating case projects stable coverage while net debt-to-cash flow available for debt service (CFADS) continues to devolve down to about 3x. Airport liquidity has been historically weak but improved in recent years to 191 DCOH (Fitch-calculated excluding CFC account funds) and should remain intact given the stabilizing coverage levels.

PEER GROUP
BTV's peers include Pensacola, FL (Pensacola; rated 'BBB-'/Outlook Stable) and Fresno, CA (Fresno; rated 'BBB'/Outlook Positive). Each airport exhibits weaker volume assessment scores due to their small markets and potentially volatile enplanement bases, while Fresno has stronger financial metrics when compared to BTV in terms debt service coverage (2.4x) and lower future leverage of 2.5x. Pensacola has a higher risk to market competition as well as slightly higher projected leverage and airline costs.

RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action:
--Continued improvement in BTV's financial performance supported by both the recently effected airline agreement and demonstrated traffic stability.
--Leverage evolving below 4x and coverage levels maintaining at the 1.5x level could support a positive rating action on a sustained basis.

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action:
--Sustained declines or uneven trends in passenger traffic levels leading to fluctuating or unsustainable CPE levels.
--Leverage increasing materially above 4x and/or debt service coverage remaining below 1.5x, on an ongoing basis.

CREDIT UPDATE
BTV traffic has experienced enplanement fluctuations and periods of declines since reaching peak levels in 2009, though volatility has marginally diminished in recent years. Enplanements fell below 600 thousand in 2016, representing a 1% decrease from the previous year. Recent losses are attributed to decreased Canadian demand, which accounts for about 19% of enplanements. The airport has recently undertaken various steps to increase demand, including offering new airline service incentives and launching aggressive marketing campaigns to attract new travellers. Recovery is slow, with 11 month YTD 2017 enplanements up by 1%, but management expects higher growth thereafter.

Airline revenues grew 5.2% in 2016 due to an increase in terminal rental rates and landing fees, based on the airport's cost recovery needs. Non-airline revenues fell 6.8% due to reduced parking and concession revenues driven by enplanement declines. Overall, total operating revenues decreased 3.8% in 2016. Preliminary 2017 operating revenues are up by 5.3%. BTV recently adopted a five-year residual AUL (previously a monthly hybrid AUL) that requires maintenance of 1.5x DSCR, and airline revenues are expected to increase in the future to support this coverage level.

2016 operating expenses grew a modest 1% due to increases in employee salaries and benefits. Preliminary 2017 expenses are down -1%. BTV recently resolved a property tax dispute with South Burlington, which will result in annual tax savings of roughly $800,000 for the airport going forward.

Despite a reduction in cash flow in 2016, coverage was high, increasing to 1.6x (1.7x w/ PFCs pledged for debt service) due to a lower debt service requirement that year. Cash continued to grow in 2016, reducing net leverage to 5.7x. Airport liquidity (unrestricted cash and DSRF only), which was nearly zero in 2011, improved to 191 DCOH in 2016 from 182 days the prior year, and is expected to remain stable or grow, while CPE grew to $7.21. Under the new AUL, Fitch expects coverage to remain stable at 1.5x going forward, while CPE will increase to about $9, which is comparable to peers.

BTV's four-year capital plan is manageable and totals $85.9 million. The plan includes a land acquisition, airfield and terminal projects, a new quick-turnaround facility for rental cars, and other major maintenance projects. The plan is primarily funded by grants and PFCs and, to a lesser extent, by CFCs and airport cash flow. There are no plans to issue additional debt for the program.

Fitch Cases

Due to the residual nature of the AUL, Fitch's cases assumed a stable annual DSCR maintained at 1.5x. Fitch's base case assumed conservative enplanement growth of 1% in 2018, followed by flat growth thereafter, with expenses increasing 3% each year and unrestricted cash levels held flat. This profile produced an average leverage of 3.9x with CPE reaching just over $9 by fiscal 2022. Liquidity is expected to remain around 177 DCOH.

Fitch's rating case was similar but applied an 8% traffic stress in 2018 followed by flat growth thereafter, while operating expenses were increased by 0.5% above base case levels. With the residual AUL, coverage is still maintained at 1.5x, but CPE is inflated to nearly $13 by fiscal 2022. Leverage remains the same as the base case, averaging 3.9x, while liquidity is expected to remain around 174 DCOH.

SECURITY

The bonds are secured by the airport's pledge of net revenues from operations.

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