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James M. Cox Dayton International Airport, Ohio; Airport

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Table Of Contents

James M. Cox Dayton International Airport, Ohio; Airport

Credit Profile		
James M. Cox Dayton Intl Arpt airport imp (AGM)		
Unenhanced Rating	BBB+(SPUR)/Stable	Outlook Revised
James M. Cox Dayton Intl Arpt airport imp (AGM)		
Unenhanced Rating	BBB+(SPUR)/Stable	Outlook Revised
Dayton, Ohio		
James M. Cox Dayton Intl Arpt, Ohio		
Dayton (James M. Cox Dayton Intl Arpt) airport (AGM)		
Unenhanced Rating	BBB+(SPUR)/Stable	Outlook Revised
Dayton (James M. Cox Dayton Intl Arpt) arpt (AGM)		
Unenhanced Rating	BBB+(SPUR)/Stable	Outlook Revised

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings revised its outlook to stable from negative and affirmed its 'BBB+' rating on James M. Cox Dayton International Airport (DAY), Ohio's bonds outstanding.

The outlook revision reflects our view that DAY's enplanement levels are stabilizing after year-over-year declines since 2013. In addition, we expect the airport to maintain debt service coverage (DSC; S&P Global Ratings-calculated) at levels we would consider at least adequate.

The rating reflects the application of our "U.S. And Canadian Not-For-Profit Transportation Infrastructure Enterprises" criteria, published March 12, 2018. The rating further reflects our opinion of the airport's adequate enterprise risk profile and strong financial risk profile. The enterprise risk profile assessment reflects DAY's vulnerable market position as a small-hub airport (at about 899,000 enplaned passengers), with declining enplanement trends due to competition from the larger nearby medium hub airports, such as John Glenn Columbus International Airport (CMH) and Cincinnati/Northern Kentucky International Airport (CVG), which each serve about 3.7 million enplaned passengers. The financial risk profile reflects DSC metrics that we expect to remain within a range we consider adequate, and a very strong debt and liabilities capacity given the lack of additional debt plans.

The adequate enterprise risk profile reflects our view of DAY's:

- Vulnerable market position due to the airport's decent baseline level of air travel demand, but an enplanement base that has declined by almost 40% since 2008 due to competition from nearby larger airports in Columbus and Cincinnati as well as reduced airline service offerings;
- Very strong economic fundamentals reflecting favorable economic activity as measured by GDP per capita, below-average unemployment, and a smaller service area, as well as a below-average projected population growth rate;

- Low industry risk relative to that of other industries and sectors; and
- Strong management and governance that has established a track record of managing and operating its airport facilities, particularly adjusting operating expenses when needed to offset declining revenues.

The strong financial risk profile reflects our view of the airport's:

- DSC (S&P Global Ratings-calculated) that we expect will remain adequate given the lack of additional borrowing;
- Very strong debt and liabilities capacity that we expect to remain so given the lack of additional borrowing; and
- Strong liquidity and financial flexibility. The airport's $22 million in unrestricted liquidity equaled 294 days' cash on hand for fiscal 2017, and 24% of total debt outstanding.

Securing the bonds is a pledge of net airport revenue; pursuant to the 2016 supplemental bond indenture, DAY is now required to deposit collected PFCs in an irrevocable trust fund the city maintains in the fiscal year before they are due. Customer facility charge (CFC) revenue is also pledged, to the extent it is appropriated for payment of debt service on airport obligations. A surety bond or bond reserve funded to the IRS limit also secures the bonds. In the event of a draw on the bond reserve fund, it will be replenished in 12 monthly installments.

DAY is on 4,698 acres, approximately 11 miles north of downtown Dayton. The airport is composed of three runways, two concourses with 22 dates, 5,720 parking spaces, and an additional 700 rental car spaces on the first floor of a garage.

The additional bonds test requires that either projected net revenue equal 1.25x maximum annual debt service (MADS) on existing and proposed senior-lien bonds and 1.1x MADS on subordinate bonds; or net revenue for the previous two fiscal years, adjusted to reflect rate changes, equal 1.25x MADS on existing and proposed senior-lien bonds and 1.1x MADS on subordinate bonds. The rate covenant requires that net revenue equal 1.25x annual debt service and 1.1x subordinate debt service plus 1.00x required deposits to the debt service reserve fund.

Outlook

The stable outlook reflects our expectation that enplanements will be maintained near current levels, with some modest fluctuations, and that DAY's very strong debt capacity and adequate DSC (S&P Global Ratings-calculated) will not diminish.

Upside scenario

Although unlikely, we could raise the rating during the two-year outlook period if enplanements show sustained stability or DSC improves to a level we consider strong and sustainable.

Downside scenario

We could lower the rating during the outlook period if the airport's DSC or debt capacity were to fall below current levels.

Enterprise Risk

Our assessment of the enterprise risk profile as adequate reflects DAY's very strong service area economic fundamentals, low industry risk, vulnerable market position, and strong management and governance.

Economic fundamentals

In our view, the primary service area maintains very strong economic fundamentals. This is exemplified by the region's GDP per capita of approximately $49,892; the 2016 unemployment rate of 4.72%, slightly below the national rate of 4.87% for the same period; and a projected three-year growth rate for its population (approximately 802,000) that, at 0.2%, is less than half the U.S. rate of 2.2%.

Dayton is the sixth-largest city in Ohio, approximately 55 miles north of Cincinnati and 70 miles west of Columbus. The city is the regional economic center for the area, offering a variety of employment opportunities. A majority of Dayton's income tax revenue comes from nonresidents who work in the city. The largest employers in the city include Premier Health Partners (12,138), Kettering Health Network (8,909), Kroger Co. (4,855), and Montgomery County (4,366). In addition, although not directly in the city, Wright Patterson Air Force Base employs approximately 28,000, and provides stability to the regional economy. The region is also home to a large number of aerospace-related companies.

Market position

We consider DAY's overall market position vulnerable. The airport faces significant competition from nearby CMH and CVG which are roughly 55 and 70 miles away, respectively. CMH and CVG offer more service, and serves a more diverse base compared with DAY, and has historically enplaned more passengers. We believe the market share dominance of these two nearby airports constrains DAY's enplanement levels. Total enplanements declined to 899,000 in fiscal 2018 from 951,000 in fiscal 2017 following Southwest Airlines' decision to cease operations at the airport entirely in mid-2017. Absent additional major service level changes, we expect that enplanements could stabilize near the 2018 levels given the airport's strong origin and destination nature. An updated forecast and the most recent airport budget assumes enplanements stabilizing at about 900,000 in 2019 before increasing 1.5%, on average, per year through 2022. We consider the forecast assumptions reasonable in the near term and the 2% annual growth rate for 2020 and beyond moderately aggressive given DAY's five consecutive years of falling enplanement levels, and the limited nature of its local economy and the surrounding MSA.

We consider the airport's carrier mix moderately concentrated, with the top three carriers enplaning 84.2% of traffic in fiscal 2017. American Airlines Inc. constituted about 44.3% of traffic, followed by Delta Air Lines Inc. at 29.8%, and United Air Lines Inc. with 20.1%.

Management and governance

DAY's management and governance, in our view, is strong. This reflects our view of the airport's strategic positioning; risk management and financial management; and organizational effectiveness.

Management consistently maintains adequate cash reserves, and ample debt and liabilities capacity, which we believe mitigates risks associated with unforeseen expenses, while enabling the airport to absorb higher capital costs if growth dictates. Specifically, management has informal policies to maintain at least $15 million of unrestricted cash on hand, which it has historically achieved. Dayton sets rates and charges employing a hybrid rate-setting approach in accordance with its airport operating and terminal building occupancy permit. The permit, although not long-term, still provides the city with the operating flexibility to accommodate new entrants and to adjust to changes in industry practices. All airlines operating at DAY have signed the permit. Airport management prudently eliminated an airline subsidy beginning in 2015 in response to capacity cuts and opted for a phased approach to increase costs to levels that are moderate, in our view.

Based on the fiscal 2019 budget, we expect cost per enplanement to increase to $10.17, which we view as moderate; enplanement costs will likely remain below $11 through 2023. Management evaluates rates annually and periodically adjusts airline rentals, fees, and charges.

Financial Risk

Our assessment of DAY's financial risk profile as strong reflects the airport's adequate financial performance, very strong debt and liabilities capacity, and strong liquidity and financial flexibility. We base our financial profile risk assessment on historical and pro forma figures. Our financial profile assessment also considers the airport's financial policies, which we view as credit neutral.

Financial performance

The adequate financial performance assessment reflects our expectation that DSC, as per our calculations, will fluctuate but remain in the adequate category given the lack of additional debt plans and continued amortization of debt. DSC was 1.33x in fiscal 2017 and is projected to decline to 1.21x in fiscal 2018 due to rising debt service requirement but expected to stay within the adequate range given level debt service. The airport's ability to maintain an adequate financial profile if enplanements continue to decline is a key factor.

Debt and liabilities capacity

We view DAY's debt and liabilities capacity as very strong. Debt at the end of fiscal 2017, the most recent audited year, yields a relatively low debt-to-net revenue of 10.5x and moderate $153 per enplaned passenger. It is projected to decline to 10x in 2018 and stay at or below 10x given the lack of additional debt plans at the airport. DAY has no interest-rate swaps outstanding or variable-rate debt.

We consider the airport's capital improvement plan (CIP) manageable, with projects centered on rehabilitation and upgrades in the near term. DAY's capital improvement plan totals $69.8 million through 2023 and is largely funded from Federal Aviation Administration airport improvement program grants ($47.2 million), as well as state grants ($4.1 million) and other sources ($3.3 million) with the remainder out of restricted airport funds, of which the airport has $34.2 million as of Dec. 31, 2018.

Liquidity and financial flexibility

We view DAY's liquidity and financial flexibility as strong. The airport's $22 million in liquidity equaled 294 days' cash on hand for fiscal 2017, and 24% of total debt outstanding. As DAY funds its modest CIP, we expect that liquidity will remain near levels we consider very strong.