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Chicago Readies $1.1 Billion O'Hare Refunding.

CHICAGO – Chicago heads into the market next week with nearly $1.1 billion of O'Hare International Airport paper.

The airport paper is one of the city's more digestible revenue-backed credits because it is generally insulated from the city's pension and budget ills.

The general airport revenue bond senior lien refunding issue is tentatively scheduled to price mid-week and would be followed the week of Nov. 28 with $1.2 billion of senior lien new money GARBs.

Bank of America Merrill Lynch is running the books on the refunding, which was approved by the Chicago City Council in September.

"Overall the city expects to achieve significant present value savings currently estimated at $111 million from this transaction," the city's deputy chief financial officer, Kelly Flannery, said in an investor presentation released this week. Frasca & Associates LLC and Columbia Capital Management LLC are advising the city on the deal.

The sale offers three series.

A $28.6 million series that matures in 2037 is subject to the alternative minimum tax and refunds 2006 paper.

A second series for $479.1 million of non-AMT bonds matures in 2041 and will refund 2008 and 2011 bonds.

A third series for $548.1 million of non-AMT bonds matures in 2038 and will refund 2008 bonds. The third series carries an additional backing of passenger facility revenue charges through 2018.

The bonds are rated A with a stable outlook by Fitch Ratings and S&P Global Ratings. The city did not ask Kroll Bond Rating Agency or Moody's Investors Service to rate the new issue.

Kroll assigns a higher rating of A-plus to existing O'Hare bonds. Moody's rates existing O'Hare bonds A2.

The ratings are more solid than the city's general obligation credit and recent O'Hare deals have seen minimal penalties in line with those typically imposed on any Illinois-based paper.

"We really look at the airport credit as a stand-alone credit that is independent" of the city's GO struggles, said Robert Miller, senior portfolio manager at Wells Capital Management.

The deal, however, faces general market headwinds that make a prediction on pricing or penalties difficult.

"There is a lot of supply and the market is sloppy with new deals struggling and a general cheapening," Miller said.

The city's finance team, Aviation Commissioner Ginger Evans, and advisors used the investor presentation to highlight the airport's role in the national and international air system and progress in its modernization program.

The airport is the second largest nationally, behind Atlanta, with more than 34 million passengers and 875,000 flights last year. It enjoys dual hub status, accounting for 18% of United Airlines revenues and 10.7% of American Airlines' revenue.

The two account for about 80% of passengers traveling through the airport. Nearly 1,100 departures daily serve 166 non-stop destinations.

"The O&D [originations and destinations] market provides the strong foundation for O'Hare that makes it such an attractive hub in part," Evans said.

Passenger levels rose 9.9% in 2015 and are up 2.5% for first eight months of 2016 after years of flat growth. "Our growth has been driven by both new carriers and new routes," Evans said.

Airport consultant Ricondo & Associates said in the presentation that O'Hare's compounded growth assumptions are conservative at less than 1% through 2025, compared to the Federal Aviation Administration's 2.5% national estimate. The city must maintain 1.1 times debt service coverage and narrowly meets the requirement with coverage projected at about 1.13 times through 2025.

Cost per passenger rises to $25.50 in 2025 from $17.49 this year. The city currently has a $420 million O'Hare commercial paper program with no outstanding balance and plans to establish a $180 million credit agreement note program.

The city and key O'Hare airlines reached agreement earlier this year on the next $1.3 billion phase of the O'Hare Modernization Program, which includes a final runway and new gates.

About $1.6 billion of projects remain under the roughly $10 billion OMP unveiled more than a decade ago.

"Future requirements are still significant and rely heavily on future debt borrowings for funding," Fitch Ratings said.

The primary purpose of OMP is to redesign and expand the airport's runways, shifting to a parallel design from an intersecting layout that forces the closure of runways during poor weather, as well as provide additional capacity if needed.

The city has completed four of six new runways.

The airport also has a $1.8 billion five-year capital improvement program. "We are continuing to take significant steps to reconfigure and modernize our airport for long term growth," Evans said.

Projects that will receive funding from the new-money sale include a runway, new hangars, a centralized de-icing pad, and taxiway improvements. The OMP also called for a new terminal on the western edge of the airport. That has been put on hold without airline support.

Fitch Ratings in May upgraded O'Hare's $6.4 billion of senior lien general airport revenue bonds rating to A from A-minus. The rating reflects O'Hare's "strong local market, the strategic location of Chicago as a hub, and the demonstrated importance" to United and American, Fitch wrote in its new report.

Leverage is high compared to most large-hub airports at the A level but is expected to taper off and align with A level rated counterparts. Rating risks include changes in the airport's traffic base influenced by hubbing operations and higher debt costs.

Fitch said overall GARB debt levels are projected to rise to about $8.5 billion over the next five years. Coverage levels on overall airport debt are expected to remain largely at the minimum required 1.10 times level but will require substantial increases in airline fees to cover higher debt costs.

"The ratings incorporate our view of O'Hare's steady financial performance, relatively high traffic levels, generally stable demand characteristics, local economy that we consider deep and diverse, and status as one of the world's largest and most important connecting hub airports," S&P analyst Joseph Pezzimenti wrote in the new report.

Challenges include the significant additional debt needs, exposure to connecting traffic, and moderately high air carrier concentrations.

The city acknowledges future debt demands and the 2018 expiration of the existing airline use agreement under "investment considerations." It also warns of substantially higher pension contributions should two of the city's four pension funds become insolvent in the next decade.

The city has proposed restructurings that call for higher contributions but final approval is needed from state lawmakers. The city's pension burden has dragged its general obligation ratings down as low as junk.

O'Hare enterprise revenue accounts for $18 million of the city's $267 million municipal fund payment scheduled for 2017; $2.3 million of the city's $36 million laborers fund contribution; and $18.3 million of the city's $727 million police and fire contribution, according to the offering statement.

"The stable outlook on the GARBs reflects our expectation that GARB debt service coverage will continue at or above 1 times, ORD's liquidity position will stay near current levels, and enplanements will be relatively stable," S&P wrote.

Morgan Stanley will run the books on the November new money GARB issue.

The city also is planning later this year to issue up to $500 million of new money and refunding PFC backed bonds with Loop Capital Markets selected as the bookrunner. About $600 million of existing PFCs carry A-level ratings.

The Bond Buyer

By Yvette Shields

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