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Want to Play the Travel Recovery With Small Risk? Airport Bonds Are Looking Better, Says Moody's.

Some U.S. airlines might still be a risky bet as domestic travel recovers, but the picture is brightening for municipal airports and their bonds. Moody's upgraded its outlook for the sector's credit to positive on Tuesday.

The ratings firm said that domestic travel is on track to rebound faster than it initially projected. Passenger screenings at U.S. airports have picked up substantially over the past few months, and in April there were 60% as many passengers screened as there were for the same period in 2019, compared with 38% at the end of last year, the analysts found. Even in its forecasts for a "faster recovery," Moody's had estimated passenger screenings would average just 44% of prepandemic levels.

"Constraints on travel and activities have been loosened recently in the US, despite some fluctuation in case counts in recent weeks. Given these positive developments, we expect [air travel] to continue to either meet or exceed our fast recovery case," the credit analysts wrote in a May 4 note. "We expect the recovery to reach another peak as the summer season starts, with an advanced vaccination rollout and pent-up demand driving strong domestic travel activity."

That should mean good things for municipal bonds issued by airports. While that market was temporarily hit by the pandemic, losing 5.7% in March of last year, it has rebounded since then, according to ICE Indices. The sector offers a tax-exempt effective yield of 1.7% and an effective duration of 6.8 years, according to ICE. While that may not sound great, it still measures up pretty well against the taxable 2.2% effective yield of the U.S. corporate bond market, with its 8.2-year effective duration.

"The resilient demand is also driven by stimulus funding and overall strong economic recovery. We expect that the economic momentum will accelerate over the course of this year and the next because of the improved pandemic control, fiscal support and more predictable policy environment," wrote Moody's. "With the new stimulus, not only for airports and airlines, but also for households and businesses, further boosting the pent-up demand, we expect economic activity to considerably pick up in the second half of the year."

The downside is that markets already reflect some of this optimism. Airport bonds have returned 1.3% so far this year, outperforming the broader muni market's 0.8% return, according to ICE Indices. And transportation and airport bonds have posted the best year-to-date performance of any muni-bond sector, according to CreditSights.

Even so, last month BlackRock stood by a bullish call on airport bonds, saying they still had a "preference for lower-rated credits and sectors that have been more impacted by the pandemic such as transportation, travel-related (hotel tax, airport, etc.), and health care."

Investors who want to be selective may want to look at airports that have less exposure to international and business travel, and more exposure to domestic and vacation travel.

“Although some airports have significant exposure to international and business travel, others are focused on domestic and leisure travel and are likely to show a faster recovery in enplanements,” Moody’s said. Airports in New York, Los Angeles, and San Francisco are some of the biggest international gateways in the U.S., according to government data.

Across the whole sector, however, a slow rebound in domestic and business travel may not significantly hamper the recovery. International travel made up only 13% of total travel in 2019, so even international-flight hubs may fare better than some investors might fear.

“We expect the strong domestic recovery to offset the slower pick up in international travel,” Moody’s wrote.

Barron’s

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