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Investors Have More Faith in Bonds Issued by Airports Than Might be Expected.

KEY POINTS

- Airports offer essential services, but in a time when travel is down, some investors worry they may be highly risky investments.
- But municipal bond experts and traders say the bonds of airports are trading well, in fact outperforming the broader muni market in June and July.
- Airports typically have high levels of cash on hand, and that has helped insulate them from the loss of revenues.

With airlines suffering from low traffic and billions in losses, investing in airports right now may seem unwise.

But, in fact, airport bonds have been outperforming the broader municipal bond market. Strategists say it's because airports went into the Covid crisis with a lot of cash on hand and that should help them weather the storm.

According to Moody's, airports had an average more than 659 days worth of cash.

"I would describe that as a very good cushion of liquidity," said Tom Kozlik, head of municipal strategy and credit at Hilltop Securities. He said that data on cash holdings was from fiscal year 2018, and the airports were able to build up their hordes even more in 2019.

"They've had several years since the end of the last recession, where enplanements were relatively higher. But plenty of them also had infrastructure upgrades they wanted to do," said Kozlik. "It seems they took advantage of a situation where activity was higher-than-expected, but they also socked some money away."

Airport bonds were among the hardest hit when the credit markets seized up in February and March, as investors feared the worst for air travel. While air traffic is still weak and enplanement, or passenger boardings, are low, the airport bonds have been able to recover.

"Right now, investors are leaning toward the larger airports," said Kozlik. "I think the reason is because the market opinion is such they feel there's less risk in a situation where enplanements might continue to be lower than what we've seen pre-Covid. I think folks believe those large airports aren't going anywhere. There's just more positive sentiment for those larger airports as a result."

A $460 billion offering Thursday for Dallas-Fort Worth International Airport, for instance, was met with strong demand. The cities of Dallas and Fort Worth issued the of Series 2020B joint revenue refunding bonds for the airport. According to Bond Buyer, they were repriced to yield from 0.27% with a 5% coupon in 2021 to 1.97% with a 4% coupon in 2040. The 2045 maturity was repriced to yield 2.12%, with a 4% coupon.

There were also bonds issued for the airport last week. The spread on the 10-year revenue bond issued l was just 63 basis points above the AAA rated muni benchmark, according to Kozlik. The bonds were rated A1 by Moody's and A by Standard and Poor's. Another $1.14 billion offering is expected for the airport next week.

"Along with the boarder market, the airport sector has tightened up quite a bit," said Jeffrey Lipton, head of municipal research and strategy at Oppenheimer. "We are seeing evidence that a number of airport bonds are being priced tighter than some other higher end credits."

While airlines were given relief under the CARES Act, Congress also gave funds to airports. Kozlik said the funds amounted to 22% of revenues for a list of airports he follows.

Rating agencies have a negative outlook on the sector, and strategists warn there could be downgrades. Not all airports are attractive, and investors should pick among the better rated, bigger airports.

"Heading into Covid-19, I was a fan of the airport sector, and I'm still a fan of the airport sector," said Lipton. "But we have to be more selective now. If you look at gateway airports, those aren't going anywhere." Gateways would be Los Angeles or San Francisco or New York.

Moody's warns that airports could be at risk if they have a high concentration of service by one airline, since an airline can cancel where it travels to and from. They also are at risk if an airline undergoes massive layoffs.

"Though large airports can bear the risk of high airport concentration, they also benefit from being essential to the airline's network and are typically highly profitable for airlines," Moody's wrote. "However, small airports with high airline concentration do not share this benefit. We expect the hubs that are the most profitable for airlines to see quicker recovery from the effects of the coronavirus because of their outsized contribution to the airlines' route networks and profitability."

In a note from earlier this month, Moody's said Charlotte, N.C. Airport Enterprise, which it rates Aa3 stable, and Dallas-Fort Worth are among the airports with the best recovery in enplanements so far.

"Small airports in highly competitive markets are likely to face some service consolidations by the airlines into larger airports, as demonstrated by JetBlue's decision to consolidate its West Coast operations in Los Angeles Departments of Airports- Los Angeles International Airport Enterprise (Aa2 stable) and moving away from LGB (Long Beach Airport)," Moody's wrote.

Hawaiian airports, which posted the sharpest overall drop in passenger volume in April and May, are likely to see the slowest recovery in passenger volume as long as the state's stringent travel restrictions remain in place," noted Moody's. Hawaii requires that travelers to the state be quarantined for two weeks.

Lipton said airports are difficult to analyze because they have very different revenue streams that go into their debt service.

"Revenues come from parking, revenues can come from hot dogs being sold, alcohol and various products you see in the airports. Often times, they have minimum guarantee revenue agreements" with concessions, he said. They also collect landing fees, and can pass along some of their costs by raising fees.

Lipton said there could be downgrade activity affecting airport bonds. "I think it's going to be confined to a single notch. We're not ruling out downgrades, but those downgrades would probably be confined to a single notch as opposed to multiple notch downgrades. I think the sector overall will display relative resiliency throughout this cycle," Lipton said.

Kozlik said it helps airports to have strong carriers. In the years before Covid, airports were breaking financial records as enplanements grew. Kozlik said the airports that will be better positioned to take advantage of the recovery will be those that stress sound finances and are located in regions and cities with industries and demographic bases that are growing.

In addition to different revenue sources, airports also had widely different amounts of cash. For fiscal year 2018, Miami International, for instance, had 318 days worth of cash, while Boston's Logan Airport had 628 days, according to Moody's data. Hartsfield-Jackson in Atlanta had more than 1,000 days worth of cash. This is based on fiscal year 2018 data.

Kozlik said some investors are avoiding airports because of the hit to travel. "That may not be the way to look at it. Look at the underlying credit fundamentals," he said. Airports, like water and sewer or toll roads issue revenue bonds.

"Typically, a revenue bond, all things being equal … you're going to get a little more spread compared to the general obligation bonds, and then when you go out the risk spectrum, that's going to increase the amount of spread you're going to get," said Kozlik.

Lipper said munis overall so far are returning 1.21% month to date, based on Bloomberg Barclays data. The transportation sector, including airports, has returned 1.29% in the same period , through July 22. Health care, which outperformed in June at 2%, is returning 1.60% in July so far.

Revenue bonds typically lag general obligation bonds, but because of the outsized hit to revenue bonds earlier in the year, their comeback has helped them outperform GO debt.

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