MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns A1 to South Carolina State Ports Authority's $290M revenue bonds; stable outlook

Global Credit Research - 12 Oct 2015

Affirms A1 rating on $155M of parity debt outstanding

SOUTH CAROLINA STATE PORTS AUTHORITY
Ports
SC

Moody's Rating

ISSUE		RATING
Revenue Bonds Series 2015 (AMT)		A1
Sale Amount	$289,105,000	
Expected Sale Date	10/15/15	
Rating Description	Revenue: Government Enterprise	

Moody's Outlook STA

NEW YORK, October 12, 2015 --Moody's Investors Service has assigned an A1 to South Carolina State Ports Authority's $290 million Revenue Bonds, Series 2015. Moody's has affirmed the A1 rating on the authority's $155 million of parity Series 2010 bonds outstanding.

SUMMARY RATING RATIONALE

The A1 rating considers the strength of the authority's growing regional economy; the significant capital support and economic development efforts provided by the state of South Carolina (Aaa/stable); and the authority's strong operating profile with competitive advantages that position it well to defend share on the southeastern seaboard, the most notable of which is its current depth at 45 feet with time and tide windows of up to 48 feet and the potential to be the deepest port on the east coast with approval to deepen to 52 feet by the end of the decade.

The rating additionally reflects the uncertainty that comes with upcoming renewal of substantially all of the shipping contracts and the related ability to increase prices to provide new revenues to match higher expected spending levels in the coming years, as well as the size of the additional debt burden and complexity of the capital plan relative to what the authority has undertaken to date. These risks are mitigated by a low base level of debt relative to peers, a strong financial position with strong debt service coverage ratios that have the headroom for additional debt, and the demand-driven nature of the capital plan that provides the authority with flexibility to adjust should operating performance fall short of expectations or finances experience pressure.

OUTLOOK

The stable outlook is based upon our expectation that the authority will continue to exhibit strong financial and operating performance, and that it will be able to achieve sufficient revenue growth to support the increased debt without significant detriment to coverage and liquidity metrics. The authority will be entering a period of heightened risk as it plans to significantly increase leverage. Key to our outlook is the assumption that the authority will achieve favorable price terms on the renewal of contracts in 2016. If contract rates fall upon renewal, if cargo throughput begins to weaken, or if debt is issued more quickly or in a greater aggregate amount than currently planned, the outlook would likely be reevaluated. Longer term, the stability of the credit will depend on how the authority balances planned debt for the Navy Base Terminal with the trajectory of revenue growth.

WHAT COULD MAKE THE RATING GO UP

- Demonstrated ability to solidify market share and command premium rates for harbor capacity and operating performance, resulting in improved operating margins and consistently strong debt service coverage ratios

WHAT COULD MAKE THE RATING GO DOWN

- Significant additional borrowing for Navy Base Terminal despite below-plan volumes and revenues, leading to narrower debt service coverage ratios and liquidity

- Change in competitive position that results in lower throughput and revenues

STRENGTHS

- Deepest port on the southeastern seaboard with a 5-foot advantage over neighboring Savannah, two hour steam time to open ocean and highly efficient ship and cargo turns

- Significant deepening program to be realized by the end of the decade, no water restrictions or air draft restrictions for 14,000 TEU ships

- Strong support from state of South Carolina (Aaa/stable), with $700 million in commitments for dredging, access roadway improvements and a new intermodal container transfer facility

- Strong export economy and growing population in South Carolina and southeastern US

CHALLENGES

- Risks posed by short-term contracts and volume-oriented rate structure with very minor amount of minimum annual guarantees

- $300M, or ~1.5x, increase in debt since FY 2013 compared to ~0.4x increase in revenues for the same period; significant additional borrowing identified, but demand driven

- Evolving shipping patterns on east coast toward larger ships and fewer calls may place Charleston at a disadvantage relative to New York, Virginia and Savannah

RECENT DEVELOPMENTS

The authority delivered strong financial and operating performance in FY 2015. TEUs increased 13.7% over FY 2014, driving 20% growth in operating revenues to $197 million, and total (senior and subordinate) debt service coverage to 4.53x on a net revenue basis. In September 2015, the authority received final substantive approval from the US Army Corps of Engineers for the 52-foot harbor deepening, and preconstruction engineering and design work is set to begin this year.

FY 2016 year-to-date performance has continued the strong growth evidenced in FY 2015, with pier container volumes increasing 8.6% year-over-year through the first three months of FY 2016. However, there is uncertainty over how volumes will be impacted by the recent severe weather and flooding in the state. Rail service to the authority's inland terminal is currently being rerouted via Charlotte, which adds an additional 12 hours until repairs are complete. Additionally, the port is using drayage companies within its RapidRail program to ensure that critical cargo is drayed to/from Charleston and Greer until rail connections are restored. The cost of the drays are being absorbed by the ocean carriers or the beneficial cargo owners.

DETAILED RATING RATIONALE

REVENUE GENERATING BASE

The South Carolina State Ports Authority runs one of two publicly owned operator ports on the east coast of the United States (the other being Virginia Port Authority, Aa3/stable). The authority owns and operates six cargo terminals and a cruise terminal in two seaports with more than 18,000 linear feet of berthing space, more than 1.1 million square feet of warehouse space, and over 500 acres of cargo storage yards. The authority also owns and operates a 90-acre intermodal inland port facility 200 miles northwest of Charleston. The core states served through the authority's facilities include South Carolina, North Carolina, Georgia, Tennessee & Florida, comprising a region that is one of the fastest growing in terms of population in the country.

Charleston currently enjoys among the deepest water draft of ports on the southeastern seaboard and has a short steam time to open ocean, although a dredging program underway at major competitor Savannah will erode this competitive advantage in the short-term. Charleston is in the preconstruction engineering and design phase on its deepening program, which could begin as early as January 2017. Charleston will have the required depth and access to growing population centers and industrial customers to continue to attract the larger ships to which the shipping industry is transitioning, although we note that Savannah has better connections to distribution networks in Atlanta and Nashville through on-dock rail and related rail networks. Charleston will likely retain large ship service given its draft and productive capacity, but it is at risk of losing service if shippers choose to limit the number of ports they call to only the largest east coast ports; New York, Norfolk, and Savannah.

The authority, anticipating a greater demand for the deep water depth of its facilities, is engaged in a short-term contracting strategy in which most contracts come up for renewal in December 2016. Now that the raising of the Bayonne Bridge is delayed, the contracting strategy places the authority at increased risk that shippers will renew at rates lower than what the authority had expected to command. We think it is unlikely that the authority will be unable to renew these contracts without similar or even modest rate increases given the strong growth in the region and the cost-competitive and efficient features of the authority's operations. Renegotiation of contracts at higher rates are necessary to support the magnitude of revenue increases required to maintain current financial metrics through the issuance of capital plan debt.

FINANCIAL OPERATIONS AND POSITION

FY 2015 container throughput at the authority's port facilities eclipsed even the strong performance of FY 2014. The ports handled 1.92 million TEUs in FY 2015, up 13.6% from FY 2014. It was the fifth consecutive year of TEU growth and the fourth time in these five years that annual growth has been above 8%. Container throughput is now approaching the authority's peak level of 1.98 million TEUs set in FY 2006 before the intense competition from Savannah and the economic downturn drove volumes down a cumulative and significant 35%. Total breakbulk and bulk cargo volume increased 8% to 1.42 million pier tons in FY 2015, on the back of strong automotive exports and normalized demand following a large spike due to a one-time "project" customer of paving commodities in FY 2013. The authority has budgeted TEU growth of 5% in FY 2016. In the first three months of FY 2016, pier container volumes are up 8.6% over FY 2015.

This strong volume growth translated to a substantial 20% increase in operating revenues to produce very strong debt service coverage ratios of 5.21x for senior debt and 4.53x for senior and subordinate debt in FY 2015. Operating margin improved despite one-time expenses to relocate two cranes, as the port's new gate and drayage programs required lower net subsidies. Debt service coverage ratios are expected to remain healthy but experience pressure with the doubling of annual debt service from $13.2 million to $28 million with the current sale. Moody's base case is for continued throughput growth and price increases enacted upon contract renegotiation in mid-FY 2017, which will provide important additional revenue to the authority. However, if debt issuance is accelerated or the authority is not successful at increasing revenues, its coverage metrics would likely fall short of targets and result in negative pressure on the rating.

Liquidity

The authority's unrestricted cash balance increased to an equivalent 740 days of O&M expenses in FY 2015. The authority plans to maintain a minimum of 270 days unrestricted cash on hand through the capital expansion, prior to the impact of any price increases. This level of liquidity is lower than the range of 300 to 400 days that was budgeted last year to be the floor for liquidity through the capex phase, and cash below 300 days would be a notable weakness if the authority were to retain its existing short-term contracting strategy. Given the conservative assumptions incorporated in the authority's planning, we believe it is likely to maintain liquidity metrics that continue to support an A1 rating.

DEBT AND OTHER LIABILITIES

Inclusive of the current sale, the authority's five-year capital plan calls for $1 billion of investment in existing assets as well as further development of the Navy Base Terminal (NBT). The NBT project is demand driven, providing flexibility in the event of an economic downturn, but is planned to require $600 million of funding over the next five years, with additional demand driven expenditures in future periods. If issued as currently planned, the additional NBT-related debt of $335 million through FY 2020 would mark a significant increase in leverage, equivalent to a tripling of the authority's debt levels from FY 2014 to FY 2020. However, we note that at a 1.19x debt to operating revenue ratio at the end of FY 2014, the authority is lowly levered and is better positioned than more weakly rated peers to accommodate the increased debt.

Debt Structure

In the event of modest, sustained volume growth through FY 2018, the authority's base case assumption is that it will finance the NBT project and layer in the debt, maintaining 2.2x debt service coverage at the low point of the forecast and using excess operating cash flow to fund the capital plan in combination with draw downs of current cash balances, maintaining between 370 and 450 days cash on hand at the low point of the range. Absent continued healthy growth in volumes, maintaining these metrics would require further revenue enhancements. Failure to reach increased revenues through the renewed contracts in 2016 will be an indicator that the authority will be challenged in reaching the increased revenue levels to maintain satisfactory metrics.

Debt-Related Derivatives

The authority is party to three interest rate swap agreements. In December 2005, the authority entered into a swap referencing a $26.33 million notional with counterparty Wachovia Bank N.A. and a swap referencing a $61.44 million notional with counterparty Goldman Sachs Capital Markets. The two swaps were entered into to replicate a forward refunding of the fixed-rate Series 1998B bonds, with effective dates of July 1, 2008. The authority chose not to refund the Series 1998B bonds in 2008, and due to high termination costs, entered into a third swap agreement to effectively balance the 2005 swaps. Under each of the 2005 swaps, the authority pays a fixed rate of 3.67% and receives a variable rate of 70% of one-month LIBOR. The 2008 swap referenced an initial notional of $87.8 million with Goldman Sachs Capital Markets. Under the swap, the authority receives a fixed rate of 3.5% and pays SIFMA. As of June 30, 2015, the net mark-to-market of the three swaps was $940,000 against the authority. Additional termination events for the two Goldman swaps include a downgrade of either party's rating to below Baa2 by Moody's or the equivalent by S&P.

Additional termination events for the Wachovia swap include a downgrade of either party's rating to below Baa3 by Moody's or the equivalent by S&P. Collateral posting requirements factor a threshold of $10 million at the current A1 rating level.

Pensions and OPEB

The financial impact of unfunded pension and OPEB liabilities for this issuer are minor and are not currently major factors in our assessment of the credit profile.

MANAGEMENT AND GOVERNANCE

The South Carolina State Ports Authority was created in 1942 by Act Number 626 of the South Carolina General Assembly for the general purposes of developing and improving the harbors and seaports of Charleston, Georgetown and Beaufort for the handling of waterborne commerce, and to foster and stimulate the shipment of freight and commerce through these ports. The authority owns and is responsible for the operation of six ocean terminals at the ports of Charleston and Georgetown. These facilities handle import and export containerized and breakbulk and bulk cargoes.

The authority operates as a self-supporting governmental enterprise. The authority has no stockholders or equity holders and is directed by a governing board whose members are appointed by the Governor of South Carolina for five-year terms. In addition to the nine voting members of the Board of Directors appointed by the Governor, the Act requires an additional two nonvoting board members including the Secretary of Transportation and the Secretary of Commerce. The authority's financial statements are included in the State of South Carolina general purpose financial statements as a discretely presented component unit.

METHODOLOGY SCORECARD FACTORS

- Factor 1A - Port Size: A ($196 million)

- Factor 1B - Quality of Service Area & Competition: Baa

- Factor 1C - Operational Restrictions: Aa

- Factor 2A - Financial Revenue Variation: Aaa (11.9%)

- Factor 2B - Customer Diversity: B

- Factor 3A - Complexity and Size of Capital Program: Caa

- Factor 4A - Net Revenue DSCR: Aa (3.44x)

- Factor 4B - Debt to Operating Revenues: Aa (1.5x)

OBLIGOR PROFILE

The South Carolina State Ports Authority owns and operates six cargo terminals and a cruise terminal in two seaports with more than 18,000 linear feet of berthing space, more than 1.1 million square feet of warehouse space, and over 500 acres of cargo storage yards. The authority also owns and operates a 90-acre intermodal inland port facility 200 miles northwest of Charleston.

LEGAL SECURITY

The bonds are secured by a senior lien on net revenues generated at port facilities. Additional security features include a cash-funded debt service reserve fund sized at 50% of maximum annual debt service, a rate covenant to provide 1.20x debt service and 1.0x operating expenses and all required reserve deposits, and an additional bonds test requiring the prior fiscal year or five projected fiscal years maintain 1.20x debt service coverage. The resolution also establishes a Depreciation Fund and a Capital Improvement Fund, but does not require funding. Surpluses can be used to pay debt service. Given the alignment of debt service schedules, the authority will have debt service reserve funds equivalent to approximately 66% of aggregate annual debt service for the next 10 years.

USE OF PROCEEDS

Proceeds will provide new money for the purchase of two new Super-Post-Panamax Cranes, wharf repairs and improvements, refrigerated infrastructure upgrades, and site preparation at the Navy Base Terminal. Proceeds will additionally refinance a draw on a subordinate line of credit, which will pay down and terminate the credit facility, and fund a deposit to the debt service reserve fund for the bonds.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was Public Port Revenue Bonds published in December 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

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