South Carolina State Ports Authority; Ports/Port Authorities

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Rationale

S&P Global Ratings assigned its 'A+' long-term rating to the South Carolina State Port Authority's (SCSPA) $293 million series 2018 revenue bonds. At the same time, we affirmed our 'A+' long-term rating on the port's outstanding revenue bonds. The outlook is stable.

The rating reflects the application of S&P Global Ratings updated rating criteria, "U.S. And Canadian Not-For-Profit Transportation Infrastructure Enterprises: Methodologies And Assumptions", published March 12, 2018.

The ratings reflect our opinion of the port's very strong enterprise risk profile and strong financial risk profile. The very strong enterprise risk profile reflects the port's strong market position, which is bolstered by the Port of Charleston's competitive position and its importance to the regional economy as an import/export hub for manufacturers and other businesses in South Carolina and neighboring states. This is partly offset by our view that the port authority is exposed to volatility in activity levels related to fluctuations in economic conditions and international trade.

The strong financial risk profile reflects SCSPA's debt service coverage (DSC) metrics, which we expect will consistently fall within a range we consider to be strong as the authority's debt burden rises according to the funding plan for a large, demand-driven capital improvement plan (CIP). Similarly, although we expect SCSPA's debt burden will rise substantially from current levels, we expect revenue growth will mitigate the rising debt burden, enabling the authority to maintain what we view as very strong debt and liabilities capacity.

The very strong enterprise risk profile reflects our view of the port's:

• Strong market position due to the port's competitive advantages related to deep waters in the Port of Charleston's harbor and channel that enable it to handle a relatively high volume of post-Panamax ships, in addition to our expectation that a harbor deepening project will further enhance the port, and thereby the authority's, competitive position, enabling it to accommodate the increasingly large vessels used by shipping companies. Though we believe the authority benefits from a robust demand base for import and export activity, we believe the market position's strength is tempered by the volatility in activity levels that is inherent for an operating port, as a result of its exposure to economic cycles and international trade flows.

• Extremely strong service area economic fundamentals, with high GDP per capita, slightly below-average unemployment, and a projected population growth rate above the national projected growth rate.
Low industry risk relative to that of other industries and sectors; and

Very strong management and governance, with an experienced management team that we believe demonstrates a very strong grasp of industry and market conditions and trends, and that has established a track record of successfully managing and operating its port facilities.

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

- **DSC (S&P Global Ratings-calculated)** that we expect will be consistently strong, at or above 1.6x as revenue growth partially offsets a substantial increase in annual debt service obligations related to recent and additional borrowings over the next five-10 fiscal years;

- **Very strong debt and liabilities capacity.** Although we expect SCSPA's debt burden will rise as it issues additional debt to fund its large CIP, we note a substantial portion of the CIP is devoted to revenue-producing assets, and we expect steady revenue growth will likely offset the additional debt sufficiently to enable SCSPA to maintain its very strong debt and liabilities capacity, with no more than 10x debt to net revenues.

- **Strong liquidity and financial flexibility.** In planning to fund its large, demand-driven CIP, SCSPA has accumulated extremely strong cash balances. However, we expect cash balances will be drawn down materially, as SCSPA will deploy a portion of its unrestricted reserves to fund capital projects in the near-term. We expect SCSPA will maintain strong liquidity, with around 270-300 days' cash on hand beyond fiscal 2019, per our calculations.

The series 2018 bonds, with a pro forma par amount of $293 million, include approximately $158 million in new money and $135 million in funds that will serve to reimburse the authority for prior capital expenditures. The new money proceeds will be applied to finance portions of phase 1 of the Hugh K. Leatherman, Sr., Terminal, to various projects related to modernizing the authority's Wando Welch Terminal, and to other capital projects. Prior to issuing the series 2018 bonds, the authority will deploy cash reserves to defease its series 2010 bonds.

The bonds are secured by SCSPA's net revenues. At fiscal year-end 2018, SCSPA will have approximately $780 million in total debt outstanding. This figure includes $614 million in senior lien revenue bonds, $157 million in subordinate lien bank loans, and a $10 million obligation due to the state, related to construction of the Cooper River Bridge. The $780 million figure also includes the series 2018 bonds and an $80 million subordinate lien bank loan the authority plans to close on in May 2018.

The authority operates two seaports and two inland ports. The Port of Georgetown is a 45-acre facility approximately 60 miles northeast of Charleston and is limited by its harbor depth. The Port of Charleston is much larger, consisting of five terminals, each of which offers deepwater berthing for the loading and unloading of cargo ships. The Port of Charleston's access to railroads, highways, and relatively short travel time to the open ocean are important characteristics that bolster its competitive position. The Port of Charleston also includes a cruise facility. Its two inland port facilities provide inland hubs for the transfer of import and export containers and cargo. Unlike many U.S. ports, which serve primarily as landlord ports with no significant role in cargo handling and processing, SCSPA serves as terminal operator across its facilities, with SCSPA staff operating all container cranes and container-handling equipment.
Outlook

The stable outlook reflects our view that SCSPA will maintain a strong market position with a stable or improving competitive position relative to other ports in the south Atlantic, and that demand levels will remain generally stable or modestly improve. It further reflects our view that the authority will manage its large CIP, maintaining financial metrics that are consistent with the financial forecast.

Upside scenario
We do not expect to raise the rating, given SCSPA's large CIP and additional borrowing plans, which we believe will likely preclude material improvement in the authority's financial profile.

Downside scenario
We could lower the rating if container volumes trend negatively on a consistent basis, reflecting a weakening competitive position.

Enterprise Risk

Our assessment of SCSPA's enterprise risk profile as very strong reflects its extremely strong economic fundamentals, low industry risk, strong market position, and very strong management and governance.

Economic fundamentals
In our view, SCSPA's primary service area (the state of South Carolina) maintains extremely strong economic fundamentals. This is exemplified by the state's GDP per capita of approximately $43,600, its 2017 unemployment rate of 4.1% compared to a national rate of 4.4%, and a projected three-year growth rate for its population (approximately 5 million) that, at 3.3% is above the U.S. rate of 2.4%.

Market position
We consider SCSPA's overall market position as strong. We believe the authority benefits from a robust demand base comprised primarily of the state of South Carolina with additional demand from import/export activity associated with firms and customers in the surrounding states. The Port of Charleston is the ninth-largest container port in North America, as measured by 20-foot equivalent (TEU) volumes, and is the second-largest port in the South Atlantic. In 2017, according to the American Association of Port Authorities (AAPA), the Port of Charleston handled 28.7% of the South Atlantic port container volumes, up modestly from 25.7% in 2010.

SCSPA handles a diverse array of cargo. In 2017, forest products were the authority's largest export commodity (26% of the total), followed by foodstuffs and agricultural products (12%), and vehicles, boats and aircraft (12%). Top import commodities in 2017 included vehicles, boats, and aircraft (13% of total imports), textiles (11%), and machinery parts (11%). In fiscal 2017, imports represented 44% of SCSPA's total TEU volume, while exports were 37% of the total, and empty containers were 19%.

Shipping containers represent the bulk of SCSPA's operating revenues. In fiscal 2017, containers comprised 79% of total operating revenue, followed by breakbulk and roll-on/roll-off cargo (10%), cruise ship activity (5%), inland port
activity (5%), and other (1%). Though its inland ports continue to represent a small share of total revenue, we note that revenues from inland ports have increased substantially in recent years, and this will likely continue, the authority's second inland port opened in April 2018.

In our view, SCSAPA’s market position is enhanced by competitive advantages related to its naturally deep waterways, its rail access and inland port facilities that contribute to relatively quick transit times for goods flowing to/from the port of Charleston, and its available capacity for expansion to accommodate demand growth.

Deep waterways are important because they enable ports to handle the increasingly large vessels used by shipping companies. Charleston's harbor depth currently sits at 45 feet at low-tide. In early 2018, the authority began construction on a harbor deepening project that will deepen the inner harbor to 52 feet upon its expected completion in 2021. The local share of the project, already funded fully by the state, is estimated at $270 million. The authority has requested the remainder of funds from federal government. Upon completion, the Port of Charleston is expected to be the deepest port on the East Coast.

In addition to deepening its harbor at the Port of Charleston, the authority is proceeding with development of its Leatherman Terminal, which we understand is currently the only permitted, new container terminal under construction on the east coast. The authority is developing the 286-acre site on a modular and demand-driven basis. At full build-out, the terminal will increase the port's container capacity by over 40%. The total project cost of approximately $1.4 billion will be funded primarily by a combination of port funds and revenue bonds. In our view, the authority's ability to add capacity will likely translate to revenue growth, which we consider important to offset the authority's rising debt burden. Furthermore, we believe the authority's modular and demand-driven approach to developing the Leatherman Terminal is prudent, mitigating somewhat the risk that a downturn in demand would translate to fiscal distress during a time of increasing leverage.

Management and governance
The authority's managerial and governance, in our view, is very strong. This reflects our view of SCSPA's strategic positioning; risk management and financial management; and organizational effectiveness.

SCSPA’s management annually reviews and updates long-range capital plans, which are largely modular and demand-driven, an approach we consider prudent given, in particular, the exposure of ports to fluctuating economic conditions and trends in international trade that can affect demand levels. We believe management is experienced and has strong knowledge of the markets and industry in which it operates. Management is focused on enhancing the port's competitive position through capital investment. Although this entails substantial additional borrowings, we note management's track record of successfully operating the port facilities and managing the authority's finances, and we expect management will be able to successfully manage its current CIP. In addition to enhancing its competitive position, SCSPA maintains business interruption, property, and liability insurance to protect against loss.

Financial Risk
Our assessment of SCSPA's financial risk profile as very strong reflects the authority's strong financial performance, very strong debt and liabilities capacity, and strong liquidity and financial flexibility. In addition to the authority's
historic performance, our financial profile risk assessment considered pro forma figures, which are based on management's long-term financial forecast. The forecast, which we believe is based on reasonable assumptions, includes multiple additional borrowings, reflects the anticipated rising annual debt service obligations, and assumes steady though modest increases in demand and related net revenue growth. Our financial profile assessment also considered the authority's financial policies, which we consider credit neutral.

Financial performance
The strong financial performance assessment reflects our expectation that DSC, per our calculations, will decline to around 1.6x over the next four to five fiscal years. A rising debt burden is translating to rising annual debt service obligations, and this contributed to a decline in DSC in fiscal 2017 to 2.7x from stronger levels of 4.0x in fiscal 2016 and 3.5x in fiscal 2015. Though we expect DSC will be steady in fiscal 2018 compared to the prior year, we expect annual debt service obligations will rise steadily over the next ten years, and that DSC will be pressured as a result. However, we note that a substantial portion of SCSPA's capital plan is devoted to assets with significant revenue-generating capabilities, and as such we expect DSC will remain at strong levels through the forecast period.

Debt and liabilities capacity
We assess SCSPA's debt and liabilities capacity as very strong. This assessment is based on our expectation that revenue growth will somewhat offset the rising debt burden and translate to debt to EBIDA metrics around or under 10x. SCSPA had about $541 million in total debt outstanding at fiscal year-end 2017, including senior lien revenue bonds, subordinated bank loans, and an obligation due to the state. Unhedged variable rated debt represented less than 3% of this total and the authority’s variable rate debt does not pose material credit risk, in our view. The fiscal 2017 debt load equaled 6x the authority's net revenues. As the debt burden rises to a projected $1.0 billion by fiscal 2021 (including subordinate obligations), we expect revenue growth will enable SCSPA to maintain its very strong debt and liabilities capacity.

SCSPA’s 10-year CIP calls for approximately $1.5 billion in authority funding. Currently, the authority anticipates funding 44% of the CIP with cash, 41% with senior lien port revenue bonds, 14% with subordinated lien debt, and 2% with proceeds from the sale of assets. The largest projects include phases one and two of the Leatherman Terminal project, and upgrades to the Wando Welch Terminal at the Port of Charleston. Though we consider the CIP very large, we believe the demand-driven and modular nature of the CIP, which enables certain projects to be deferred or canceled, in addition to the revenue-generating nature of the assets within the CIP, somewhat mitigate credit risk related to the size and funding requirements of the CIP.

Liquidity and financial flexibility
We assess SCSPA's liquidity and financial flexibility as strong. Although the authority built up extremely strong cash reserves, with $413 million in unrestricted cash and cash equivalents, or nearly 1,000 days' cash on hand at fiscal year-end 2017, we understand the authority accumulated its substantial cash reserves to contribute towards funding its CIP. Thus, we expect liquidity levels will moderate, falling to around 270-300 days' cash on hand, throughout the forecast period. We understand management maintains a minimum targeted liquidity threshold of 270 days' cash on hand.