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South Carolina State Ports Authority; Ports/Port Authorities

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Credit Profile

US\$162.74 mil taxable rev rfdg bnds ser 2019D due 07/01/2039

<i>Long Term Rating</i>	A+/Stable	New
South Carolina St Ports Auth		
<i>Long Term Rating</i>	A+/Stable	Affirmed
South Carolina St Ports Auth (AGM)		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Affirmed
South Carolina St Ports Auth (AGM)		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings assigned its 'A+' long-term rating to the South Carolina State Ports Authority's (SCSPA) estimated \$162.7 million series 2019D taxable revenue refunding bonds. At the same time, S&P Global Ratings affirmed its 'A+' rating on the authority's revenue bonds outstanding. The outlook is stable.

The rating reflects our opinion of the port's very strong enterprise risk profile and strong financial risk profile.

Our enterprise risk profile is based on our market position assessment of the Port of Charleston (the port), which dominates the SCSPA's finances. The very strong enterprise risk profile reflects our favorable view of the port's prospects. More specifically, the authority's harbor-deepening project, in our opinion, will further enhance the port's capabilities, enabling it to accommodate increasingly large vessels used by shipping companies. Our enterprise profile assessment also reflects the port's strong market position. The Port of Charleston is the ninth-largest container port in North America, as measured by 20-foot equivalent unit (TEU) volumes, and the second-largest port in the South Atlantic. We also consider the port's importance to the regional economy as an import and export hub for manufacturers and other businesses in South Carolina and neighboring states. Tempering this assessment is the port's exposure to volatility in activity levels related to fluctuations in economic conditions and international trade.

The financial risk profile reflects our expectation that SCSPA will maintain strong debt service coverage (DSC), debt and liabilities capacity, and liquidity and financial flexibility as it funds its sizable \$1.5 billion, demand-driven, 10-year capital improvement plan (CIP), despite escalating debt service from a rising debt burden and plans to draw down a portion of its unrestricted reserves to fund the CIP. We have incorporated the effects of SCSPA's proposed series 2019D refinancing bonds, recent bond issuances, additional borrowing plans for its CIP, and plans to draw down a portion of its unrestricted reserves by considering pro forma metrics.

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

- Strong market position, which is reflective of the Port of Charleston's access to deep waters in the harbor and channel that enable it to handle a relatively high volume of large ships, as well as its proximity to the open ocean, good rail access, and relatively quick transit times for goods flowing to and from the port. Although we believe the port benefits from a robust demand base for import and export activity, in our opinion 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 port service area economic fundamentals, with high estimated GDP per capita, estimated unemployment rates comparable with national rates, 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 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 1.5x, as revenue growth partially offsets a substantial increase in annual debt service obligations from recent bond issuances and additional debt plans--although we note the effect of the series 2019D bond refinancing provides upfront annual debt service savings;
- Strong debt and liabilities capacity, with debt-to-net revenues that we expect will remain within a range of 10x-15x, including the effects of the proposed series 2019D bonds, recent bond issuances, and additional borrowings for its CIP, although we note a substantial portion of the CIP is devoted to revenue-producing assets, which partially offsets the significant amount of additional debt; and
- 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 the authority deploys a portion of its unrestricted reserves to fund capital projects in the near term. We expect SCSPA will maintain strong liquidity, with at least 270 days' cash on hand beyond fiscal 2019, per our calculations.

Bond proceeds will refund a portion of the authority's series 2015 bonds outstanding for interest rate savings, and pay costs of issuance.

SCSPA's net revenues secure the bonds. Following the issuance of the series 2019D bonds, the authority will have approximately \$1.32 billion in total debt outstanding. This figure comprises \$1.04 billion in senior-lien revenue bonds, including the series 2019D refinancing bonds; \$272 million in subordinate-lien loans; and an \$8 million obligation due to the state, related to construction of the Cooper River Bridge.

The authority operates two seaports and two inland ports. The Port of Georgetown, a 45-acre facility approximately 60 miles northeast of Charleston, 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 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 authority staff operating all container cranes and container-handling equipment. In fiscal 2019, the authority had total operating revenues of \$294 million.

Outlook

The stable outlook reflects our view that the Port of Charleston 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 the port's container volumes consistently trend negatively, indicating a weaker enterprise risk profile.

Enterprise Risk

Our assessment of SCSPA's enterprise risk profile considers the port's service area economic fundamentals, industry risk, market position, and the authority's management and governance.

Economic fundamentals

In our view, the port's primary service area (the state of South Carolina) maintains extremely strong economic fundamentals. This is exemplified by the state's estimated GDP per capita of approximately \$45,382, estimated unemployment rate of 3.8% (comparable with the national rate of 3.9%), and a projected three-year growth rate for its population (approximately 5.1 million) that, at 2.8%, is above the U.S. rate of 2.2%.

Market position

We consider the Port of Charleston's overall market position to be strong. We believe the port benefits from a robust demand base composed primarily of the state of South Carolina, with additional demand from import and export activity associated with firms and customers in the surrounding states. The port is the ninth-largest container port in North America, as measured by TEU volumes, and is the second-largest port in the South Atlantic. In 2018, according to the American Association of Port Authorities, the port handled 28% of South Atlantic port container volumes, a modest increase from 26% in 2010.

The port handles a diverse array of cargo. In calendar 2018, forest products were the authority's largest export commodity (25% of the total), followed by chemicals (14%), and foodstuffs and agricultural products (12%). Top import commodities in calendar 2018 included vehicles, boats, and aircraft (13% of total imports); textiles (11%); and

machinery parts (11%). In fiscal 2019, imports represented 44% of the port's total TEU volume, while exports accounted for 33% and empty containers 23%.

Shipping containers handled at the port represent the bulk of SCSPA's operating revenues, net of insurance recoveries. In fiscal 2019, containers accounted for 80% of total operating revenue, followed by breakbulk and roll-on/roll-off cargo (8%), inland port activity (7%), cruise ship activity (4%), and other (about 1%). Although they 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, Dillon, opened in April 2018.

In our view, SCSPA'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 and 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, portions of which are expected to be completed in 2021. The local share of the project, already funded fully by the state, is estimated at \$270 million. The authority has received \$108 million from the federal government, and an additional \$138 million in funds included in the 2020 federal budget is pending senate approval. These additional federal funds will fully fund the project. 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 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, with construction in three phases. All major construction contracts are underway for phase 1 (\$986 million), the largest component of the project, which is scheduled for completion in 2021. At full build-out, the new terminal will increase the port's container capacity by 2.4 million TEUs, with over 5.4 million TEUs in total capacity following completion of phase 3 of the CIP. The total project cost, including all three phases, is approximately \$1.8 billion, and will be funded primarily by a combination of port funds and revenue bonds. Timing of phases 2 and 3 of the Leatherman Terminal will be demand-driven. In our view, the authority's ability to add capacity will likely translate to revenue growth, which we consider important to offset the rising debt burden.

Management and governance

Our management and governance assessment reflects our view of SCSPA's strategic positioning, risk management and financial management, and organizational effectiveness. Our assessment also considers the SCSPA's governance structure, which we consider credit neutral.

SCSPA's management annually reviews and updates long-range capital plans, which are largely modular and demand-driven, an approach we consider prudent, particularly given the exposure of ports to fluctuating economic conditions and trends in international trade, which can affect demand levels. More specifically, the authority is using a modular and demand-driven approach in developing the Leatherman Terminal, allowing it to postpone or defer components of the project if the port experiences declining container levels. We believe management is experienced and has strong knowledge of the markets and industry in which it operates. Furthermore, management maintains both

formal and informal financial targets, including an informal policy of maintaining 1.5x all-in DSC and at least 270 days' cash on hand, which the authority has consistently met or exceeded.

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 considers its financial performance, debt and liabilities capacity, and liquidity and financial flexibility. Our financial risk profile assessment considers the authority's historic performance and pro forma figures that reflect the effects of the series 2019D refinancing bonds, recent bond issuances, and SCSPA's additional debt plans, including plans to draw down a portion of its unrestricted reserves to fund its CIP. The pro forma figures we evaluated are based on a financial forecast that was prepared in connection with the series 2019ABC bond issue, which closed in October 2019 and is still up to date. We consider the forecast assumptions reasonable, including multiple additional borrowings, increasing annual debt service requirements, and steady, although modest, increases in demand and related net revenue growth. Our financial risk 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 the authority's DSC, per our calculations, will decline, but remain at or above 1.5x as a result of escalating debt service, although we note the effect of the series 2019D bond refinancing provides upfront annual debt service savings. A rising debt burden is translating to rising annual debt service obligations, and this contributed to declines in DSC in fiscal years 2017 and 2018 to 2.7x, respectively, from stronger levels of 4.0x in fiscal 2016 and 3.5x in fiscal 2015. Although DSC improved to 3.0x, per our calculations, in fiscal 2019, driven primarily by growth in container volume and inland ports activity, we expect annual debt service obligations will rise steadily over the next 10 years, and that DSC will be pressured, declining to at or above 1.5x, per our calculations. However, we note that a substantial portion of SCSPA's capital plan is devoted to assets with significant revenue-generating capabilities, and we therefore expect DSC will remain at strong levels throughout the forecast period.

Debt and liabilities capacity

We assess SCSPA's debt and liabilities capacity as strong, with debt-to-net revenues expected to remain within a range of 10x-15x, per our calculations, including the effects of the proposed series 2019D refinancing bonds, recent series 2019ABC bond issuance, and additional debt in fiscal 2022, although this is somewhat offset by anticipated revenue growth. Net revenues include the authority's operating revenues plus interest income. SCSPA had about \$955 million in total debt outstanding at fiscal year-end 2019, including senior-lien revenue bonds, subordinate loans, and an obligation due to the state. The subordinate loans contain acceleration provisions; however, we consider contingent liquidity risk to be low, given our view that the probability of events of default, as defined, is remote. Unhedged

variable-rate debt represented 1.3% of this total, and the authority's variable-rate debt does not pose material credit risk, in our view. The fiscal 2019 debt load equaled 9.5x the authority's net revenues; however, we expect the debt burden to peak at about \$1.35 billion by fiscal 2022 (including subordinate obligations), with debt-to-net revenues increasing to 12.3x.

SCSPA's 10-year CIP calls for approximately \$1.5 billion in authority funding. The authority anticipates funding 43% of the CIP with cash, 27% with future bond proceeds and equipment leases (\$215 million in senior-lien debt and \$195 in subordinate-lien debt), 26% from the recently issued debt, and 4% with proceeds from the sale of assets. The largest projects include phases 1 and 2 of the Leatherman Terminal project, and upgrades to the Wando Welch Terminal at the Port of Charleston. Although we consider the CIP very large, we believe its demand-driven and modular nature, which enables the authority to defer or cancel certain projects, and the revenue-generating nature of the assets within the CIP, somewhat mitigate credit risk related to its size and funding requirements.

Liquidity and financial flexibility

We assess SCSPA's liquidity and financial flexibility as strong, based on our expectation that the authority will maintain unrestricted cash and cash equivalents of at least 270 days' cash on hand, or 16% of total debt, as it deploys a portion of its liquidity to fund its CIP. The authority's unrestricted reserves declined to \$219 million, or about 391 days' cash on hand and 23% of total debt, in fiscal 2019, following a planned spend-down to fund its CIP, from \$283 million at fiscal year-end 2018. We understand the authority accumulated its substantial cash reserves to contribute toward funding its CIP, and we expect the authority to draw down its liquidity position further to about 270 days' cash on hand--the informal minimum targeted liquidity threshold.

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