GW&K INVESTMENT MANAGEMENT

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Positive Outlook Continues for the Airport Sector

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During the last decade, the nation's airports faced a number of challenging dynamics, including airline bankruptcies, consolidations, high fuel prices and a global recession. Yet in recent years, the sector has fared quite well, reflecting the prolonged national recovery along with the essentiality of air travel in support of a global economy. Due to the cyclical nature of the industry and the extensive capital needs of airports, ratings within the sector have historically been held to the mid-A range, thereby providing an opportunity to add portfolio yield. We currently hold 16 different credits, with ratings ranging from A2 to Aa2, evenly split between origination and destination (O&D) and hub airports. We agree with Moody's assignment of a positive outlook in its November 2017 report, given the expectation for ongoing economic growth, increasing air traffic and relatively low fuel prices. (See chart for Moody's Airport Rating Distribution.)

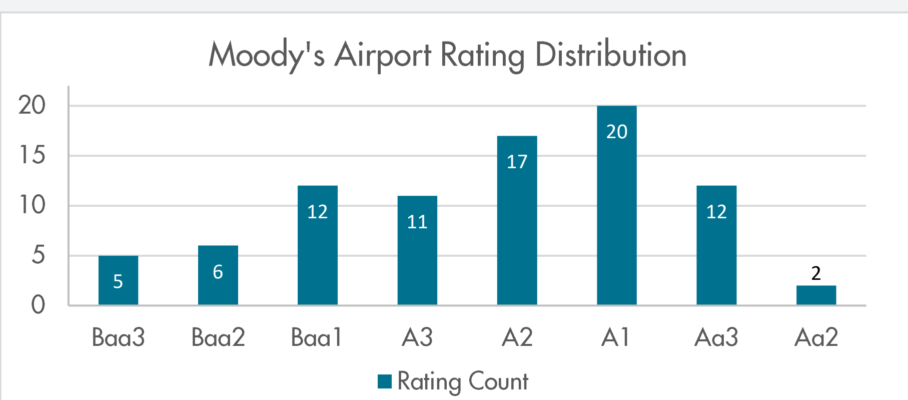
Our sector participation is primarily through the purchase of general airport revenue bonds (GARBs). Broadly speaking, GARBs are secured by net revenues of the enterprise. Airport revenues include airline terminal rentals, landing fees and non-airline revenues generated by concessionaire leases, car rental operations and parking garages. Carrier agreements are structured to provide rents and fees sufficient to cover O&M of the airport, debt service on outstanding bonds and approved capital projects after netting out non-airline concessions.

For an airport with a high percentage of O&D traffic, the depth and growth potential of the regional economy is an important credit consideration. We emphasize O&D airports that have a monopoly on air travel in economically resilient mar-kets. Our largest O&D airport holdings in-clude the Port Authority of New York & New Jersey (which controls all three major airports in the region), San Francisco In-ternational Airport and Port of Seattle. All three markets are characterized by strong underlying demand supported by robust regional economies and above-average wealth levels.

Airports with connecting traffic representing more than 30% of enplanements are generally defined as hub airports. Within the hub universe, there exists a tier structure. First-tier hubs serve the local O&D market but also act as a primary gateway for one or more major carriers that offer airlines higher yields/larger loads than other hubs. Second-tier hubs are in smaller cities and in many cases represent legacy hubs that pre-dated the prior decade of industry consolidation. There has been a shift away from second-tier cities towards first-tier hubs as carriers have rationalized routes and capacity. Recognizing this trend, we have focused on first-tier centers with steady traffic growth, such as Chicago O'Hare, Miami, Houston, and Charlotte, while avoiding mature second-tier hubs with declining enplanements, such as Philadelphia.

Our credit assessment of an airport is essentially the same for both O&D and hub airports. The primary drivers of airport credit quality are: demand, operating performance, cost competitiveness and debt load. Demand has been solid due to continued economic growth across the U.S., coupled with capacity additions by airlines, particularly the budget carriers. Op-erating performance has benefited from revenue gains, tied to increasing enplane-ments, as well as expanded retail and res-taurant (concession) offerings at many air-ports. A notable component of the sector's general concession revenues includes parking fees. Demand for airport parking has been impacted by the growing pres-ence of transportation network companies (TNCs) such as Uber and Lyft. All airports in the composite have instituted a charge on TNC services to offset the revenue slip-page from reduced parking activity. Car rental transactions also have been affected by the popularity of TNCs, yet fees associated with car rentals are often segregated to pay for rental facilities and other special projects and therefore do not factor into our analysis. Given the diversity of revenue available, we are comfortable with the ability of airports to respond to changes in transportation methods. Furthermore, the last several years of strong financial results have led to excellent liquidity across the sector, with Moody's reporting a median reserve equal to a lofty 615 days cash on hand at the end of fiscal 2016.

Looking ahead, the outlook remains positive for airports as the key industry risks of an economic slowdown and higher fuel prices appear somewhat benign. With several large enterprises in the midst of sizable capital projects, we expect new issue supply to be healthy over the intermediate term. Given the yield advantage and diversification value, we will look to add select airport names as opportunities arise.



Source: Moody's Investor Service, Sector In-Depth, 27 October 2017
Airports US, Medians: Continued economic growth underpins financial performance