

Memorandum



CITY OF DALLAS

DATE December 1, 2023

TO Honorable Mayor and Members of the City Council

SUBJECT **Fitch Ratings Affirms 'A' Rating and Stable Outlook for Love Field Airport Modernization Corporation (LFAMC) Outstanding Debt - Information**

On November 17, 2023, Fitch Ratings (Fitch) affirmed its 'A' rating and stable outlook on the Love Field Airport Modernization Corp. (LFAMC) outstanding debt issued on behalf of the City for Love Field Airport (DAL), as part of an annual review. Per the Fitch report, "the rating reflects DAL's resilient traffic base within the strong Dallas metropolitan region," additionally, "the airport's full cost recovery framework provides for continued stable financial performance."

In Fitch's analysis of the key rating drivers of the LFAMC credit profile, the report notes the strong market and carrier concentration with DAL as "the second major domestic airport serving the economically strong Dallas-Fort Worth metropolitan region," and stronger full cost recovery framework, well-defined capital plan, and conservative debt structure. According to Fitch, DAL operates under a use and lease agreement that, "provides for long-term carrier commitment and stable financial performance," noting that "DAL's cost per enplanement (CPE) level is competitive at a national level for medium-hub airports and it remains lower than DFW's CPE." The report also highlights that, "key airport facilities are in good condition following the recent completion of the reconstructed terminal," and "new concession areas provide adequate capacity for traffic levels."

The affirmed rating reflects DAL's continued demonstration of service excellence and overall strong credit profile. Attached is the published report for your review. Please let me know if you need additional information.

A handwritten signature in blue ink that reads "Jack Ireland".

Jack Ireland
Chief Financial Officer

c: T.C. Broadnax, City Manager
Tammy Palomino, City Attorney
Mark Swann, City Auditor
Biliera Johnson, City Secretary
Preston Robinson, Administrative Judge
Kimberly Bizzor Tolbert, Deputy City Manager
Jon Fortune, Deputy City Manager

Majed A. Al-Ghafry, Assistant City Manager
M. Elizabeth (Liz) Cedillo-Pereira, Assistant City Manager
Dr. Robert Perez, Assistant City Manager
Carl Simpson, Assistant City Manager
Genesis D. Gavino, Chief of Staff to the City Manager
Directors and Assistant Directors

RATING ACTION COMMENTARY

Fitch Affirms Love Field Airport Modernization Corp (TX) Senior Revs at 'A'; Outlook Stable

Fri 17 Nov, 2023 - 4:27 PM ET

Fitch Ratings - Austin - 17 Nov 2023: Fitch Ratings has affirmed at 'A' the rating on Love Field Airport Modernization Corporation, TX's (LFAMC) \$416 million outstanding senior lien general airport revenue bonds (GARBs), series 2015, series 2017, and series 2021 issued on behalf of the city of Dallas (City) for the Love Field Airport (DAL). The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕	PRIOR ↕		
Dallas (TX) [Love Field]				
Dallas (TX) /Airport Revenues - First Lien/1 LT	LT	A Rating Outlook Stable	Affirmed	A Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

RATING RATIONALE

The rating reflects DAL's resilient traffic base within the strong Dallas metropolitan region.

The airport's full cost recovery framework provides for continued stable financial performance, as evidenced by low rating case senior lien leverage of 2.4x in fiscal 2028.

KEY RATING DRIVERS

Revenue Risk - Volume - High Midrange

Strong Market; Carrier Concentration

Fitch has revised its assessment of Revenue Risk (Volume) to 'High Midrange' from 'Midrange' following the publication of its new Transportation Infrastructure Rating Criteria, which assesses volume risk on a five-point scale.

DAL is the second major domestic airport serving the economically strong Dallas-Fort Worth metropolitan region. DAL consistently ranks as one of the busiest medium hub airports in the United States in terms of total passengers, with an enplanement base of over eight million. However, long-term growth is constrained by the airport's permanent 20-gate terminal capacity. Southwest Airlines (BBB+/Stable) accounts for 95% of enplanements and its scheduling decisions could affect operational performance if flights are reduced. Fitch views DAL as a strong complementary airport to its competitor, Dallas Fort-Worth Airport, to meet high demand in the regional air trade service area.

Revenue Risk - Price - Stronger

Full Cost Recovery Framework

DAL operates under a cost-center residual use and lease agreement (AUL), with a 20-year term lasting through 2028 that provides for long-term carrier commitment and stable financial performance. DAL's cost per enplanement (CPE) level is competitive at a national level for medium-hub airports and it remains lower than DFW's CPE in Fitch's cases. DAL is exposed to operating deficits at the city-owned executive airport and heliport. However, surpluses generated from other non-airline revenues are more than sufficient to offset these cash flow shortfalls.

If Southwest substantially reduced service or ceased operations, reimbursement payments

Infrastructure Dev. & Renewal - Stronger

Well-Defined Capital Plan

Key airport facilities are in good condition following the recent completion of the reconstructed terminal. New concession areas provide adequate capacity for traffic levels. The restrictive gate capacity limits capital improvements to redevelopment and modernization projects. The airport's \$680 million capital improvement program for 2023 to 2027 is funded through federal grants, passenger facility charge (PFC) revenues, city of Dallas revenues, and commercial paper.

Debt Structure - 1 - Stronger

Conservative Debt Structure

DAL's debt is all fixed-rate debt with level annual debt service requirements through fiscal 2036 followed by a step-down in payments as debt matures. The system's sum-sufficient rate covenant is weaker compared to peers but all other structural features are standard. In 2021 DAL began a phased approach to modify its debt structure by replacing previously issued special facilities bonds, payable directly by Southwest, with senior lien airport debt. DAL will continue to look for cost savings opportunities to replace the outstanding series 2012 subordinate special facilities bonds with senior lien GARBs. The special facility bonds will fully mature in 2028 if not refunded.

Financial Profile

DAL's senior lien net leverage increased following the 2021 GARB issuance, but quickly returned to historical levels due to increased liquidity from pandemic-related federal funding. Net debt to cash flow available for debt service in Fitch's rating case decreases to under 3x in fiscal 2027 as debt matures and cash reserves remain robust. DAL has substantial liquidity of 843 days cash on hand including unrestricted cash and operating reserves as of fiscal 2022.

Senior debt service coverage was 4.2 in fiscal 2022, well above the 1.25x rate covenant. Fitch expects coverage will decline to an average of approximately 1.3x from 2024 to 2028

Fitch-rated peers include Chicago's Midway International Airport (MDW; A/Stable) and Detroit (DTW; A/Stable). All three airports have high carrier concentration and fully residual AULs. MDW similarly serves a strong metropolitan market, has about 90% Southwest concentration and faces competition from a larger nearby airport. However, MDW is a larger component of the Southwest network, serving more passengers and destinations and with more daily seat capacity than DAL. Year five leverage is under 7x for Detroit and approximately 8x for Midway, which is above that of DAL's low year five leverage of 2.4x. Although DAL's leverage is lower than its peers, the rating is constrained by its high carrier concentration and expansion limitations.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--New debt issuances that increase net GARB leverage to greater than 6.0x on a sustained basis;

--A material downshift or volatility in the traffic profile.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--Positive rating action is not likely given the traffic limitations and the extremely high service exposure to Southwest.

CREDIT UPDATE

DAL's enplanements surpassed pre-pandemic levels in fiscal 2023, up 4% over 2019, and reached an all-time high of 8.7 million. Enplanements exceeded Fitch's prior rating case expectations of recovery by 10.2% and 9.7% in 2022 and 2023 respectively. LFMAC forecasts enplanements will exceed 10 million in fiscal 2024 mainly due to Southwest Airlines (BBB+/Stable) increasing the size of its fleet and Delta Airlines being awarded one full gate, allowing the airlines to increase flights from two a day to six a day to major markets like Atlanta.

Southwest continues to dominate services at DAL with 95% of enplanements in fiscal 2023 and full use of 18 out of the airport's 20 gates. Delta has been operating at the airport since

The Aviation Department's \$680 million five-year capital improvement program (2023 to 2027) is intended to maintain existing key airport facilities in good condition following the recent completion of the reconstructed terminal and new concession areas. Landside capital projects include an alternate entry way, airport roadway improvements, loading bridge replacement, and general aviation facilities. The capital program is funded by federal entitlement grants, PFCs, commercial paper and aviation department funds. There are no plans for new debt issuance in the near term.

With the issuance of the 2021 refunding bonds to transfer debt from special facility bonds to senior lien GARBs, LFMAC's outstanding debt is comprised of \$451 million of GARBs and \$79 million for the special facilities bonds

FINANCIAL ANALYSIS

Enplanements grow by 9% in 2024 as Southwest transitions to larger aircrafts. Annual traffic growth tapers off to 1% thereafter. From 2023 through 2028, revenue increases at compound annual growth rate (CAGR) of 1.8%, with non-airline revenues growing with enplanements. Operating expenses grow at a 2.7% CAGR following a conservative increase of approximately 12% in fiscal 2024 with the increase in enplanements. Under this scenario, CPE remains below \$11.25 and leverage declines from 3.5x in fiscal 2023 to 2.2x in fiscal 2028. Senior debt service coverage ratio (DSCR) averages 1.5x.

The Fitch rating case assumes a 10% decline in enplanements in fiscal 2025 to model a hypothetical recession followed by approximately 4% annual growth until enplanements recover. Non-airline revenues including parking, ground transportation, and concessions track enplanement growth rates. O&M expenses are held flat in fiscal 2025 when there is a decrease in enplanements and grow by 50 basis points above the base case in subsequent years. Leverage and coverage metrics remain similar to the base case due to the strong cost recovery under the AUL. Senior lien DSCR averages 1.4x from 2024 to 2028 and leverage reaches 2.4x by 2028. CPE peaks at approximately \$11.70 in 2025 in the rating case as airline revenues increase to compensate for the decline in non-airline revenues.

SECURITY

The senior lien GARBs are secured by a pledge of the net revenues generated at the airport on a senior basis.

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit

<https://www.fitchratings.com/topics/esg/products#esg-relevance-scores>.

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APPLICABLE CRITERIA

Transportation Infrastructure Rating Criteria (pub. 16 May 2022) (including rating assumption sensitivity)

Infrastructure & Project Finance Rating Criteria (pub. 17 May 2023) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

GIG AST Model, v1.3.1 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Love Field Airport Modernization Corporation (TX)

EU Endorsed, UK Endorsed

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