

# Memorandum



CITY OF DALLAS

DATE May 21, 2021

TO Honorable Mayor and Members of the City Council

SUBJECT **Fitch Ratings Affirms 'A' Rating and Negative Outlook for Love Field Airport Modernization Corporation (LFAMC) Outstanding Debt– RATING ACTION**

On May 19, Fitch Ratings (Fitch) affirmed its 'A' rating and Negative outlook on the outstanding Love Field Airport Modernization Corporation (LFAMC) bonds issued on behalf of the City of Dallas (City) as part of an annual review. Fitch notes that the rating "reflects [Dallas Love Field Airport] DAL's resilient and growing traffic base prior to the coronavirus pandemic within the strong Dallas metropolitan region, including the sharp increase in traffic following the expiration of the Wright Amendment," and "should DAL's recovery trajectory remain in line with or better than recent performance, a return to a Stable Outlook may be warranted in the coming months."

Fitch's analysis of LFAMC's credit profile key rating drivers includes volume revenue risk, price revenue risk, infrastructure development/renewal, debt structure, and financial profile. In terms of volume revenue risk, Fitch 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 rates the price volume risk "Stronger," detailing the solid cost recovery framework. According to the report, despite operating deficits, "surpluses generated from other non-airline revenues are more than sufficient to offset these cash flow shortfalls." Additionally, "should there be considerable service reductions or a Southwest cessation of operations, reimbursement payments for the special facility bonds would terminate in full, ensuring the airport maintains an attractively low CPE for new entrants." Fitch also states that with a well-defined capital plan, the infrastructure development/renewal are also rated "Stronger." Fitch also highlights the "Stronger" debt structure on outstanding debt and financial profile of the DAL.

While Fitch's report of the LFAMC credit profile reflects a positive rating, it also details potential rating sensitivities that could lead to a negative rating action, including "worst-case-scenario" in operation or financial performance, new debt issuances that would increase General Airport Revenue Bonds leverage to greater than 6.0 times, or volatility in post-pandemic traffic.

Despite extreme obstacles to the airline industry in the last year, the LFAMC and Dallas Love Field Airport have maintained a strong credit profile, sustained operations to the City of Dallas and the international community.

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Please find attached the report provided by Fitch. If you have any questions or need further information, please do not hesitate to contact me.



M. Elizabeth Reich  
Chief Financial Officer

[Attachment]

c: T.C. Broadnax, City Manager  
Chris Caso, City Attorney  
Mark Swann, City Auditor  
Biliera Johnson, City Secretary  
Preston Robinson, Administrative Judge  
Kimberly Bizer Tolbert, Chief of Staff to the City Manager

Majed A. Al-Ghafry, Assistant City Manager  
Jon Fortune, Assistant City Manager  
Joey Zapata, Assistant City Manager  
Dr. Eric A. Johnson, Chief of Economic Development & Neighborhood Services  
M. Elizabeth (Liz) Cedillo-Pereira, Chief of Equity and Inclusion  
Directors and Assistant Directors



## RATING ACTION COMMENTARY

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

Wed 19 May, 2021 - 3:35 PM ET

Fitch Ratings - Austin - 19 May 2021: Fitch Ratings has affirmed the 'A' rating on Love Field Airport Modernization Corporation, TX's (LFAMC) \$214 million outstanding senior lien airport revenue bonds, series 2015 and series 2017 issued on behalf of the City of Dallas (City) for the Love Field Airport (DAL). The Rating Outlook is Negative.

## RATING RATIONALE

The rating reflects DAL's resilient and growing traffic base prior to the coronavirus pandemic within the strong Dallas metropolitan region, including the sharp increase in traffic following the expiration of the Wright Amendment. The rating also reflects the operational constraints of the DAL terminal following several years of high growth. Dallas Love entered the coronavirus pandemic period with a strong financial position including modest leverage of less than 3x, though its financial strength will be tested in the near term as pandemic recovery continues. Concentration risk is acute with Southwest Airlines (BBB+/Negative) representing around 95% of enplanements and competition exists from the larger Dallas-Ft. Worth Airport (DFW) though these risks are adequately mitigated by

Southwest's long-term commitment to serving the airport, DAL's low cost-structure, and an established underlying demand that is returning as the pandemic effects ease.

The Negative Outlook reflects the substantial adverse impact on operating performance with modest recoveries to date due to the coronavirus and related containment measures, along with uncertainty around the timing and magnitude of recovery. Should DAL's recovery trajectory remain in line with or better than recent performance, a return to a Stable Outlook may be warranted in the coming months.

## KEY RATING DRIVERS

Strong Market; Carrier Concentration - Revenue Risk (Volume): Midrange

DAL is the second major domestic airport serving the economically strong Dallas-Fort Worth metropolitan region. Fiscal 2019 enplanements reached 8.3 million prior to the pandemic, but growth was levelling due to the constraint of the airport's permanent 20-gate terminal capacity. However, enplanements fell sharply in FY2020 to around 5.1 million and the timing and trajectory of recovery remain uncertain. Southwest Airlines' high concentration exposes DAL to their scheduling decisions and could affect operational performance. Air service competition with DFW remains an ongoing concern, although Fitch views DAL as a strong complementary airport for the air trade service area.

Solid Cost Recovery Framework - Revenue Risk (Price): Stronger

DAL operates under a cost-center residual use and lease agreement (AUL), with a 20-year term through 2028 that provides for sound carrier commitment and stable financial performance. Fitch notes that DAL's cost per enplanement (CPE) level is competitive at a national level for medium-hub airports and is projected to be below forecast costs at DFW. 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. Should there be considerable service reductions or a Southwest cessation of operations, reimbursement payments for the special facility bonds would terminate in full, ensuring the airport maintains an attractively low CPE for new entrants.

Well-Defined Capital Plan - Infrastructure Development/Renewal: Stronger

Key airport facilities are in good condition following the recent completion of the reconstructed terminal and new concession areas and should accommodate projected traffic levels. The restrictive gate capacity limits capital improvements to redevelopment and modernization projects. The airport's \$430 million capital improvement program for 2021-2026 is funded through federal grants, passenger facility charge (PFC) revenues, City of Dallas revenues and future debt issuances. Some projects have been delayed due to the pandemic, but none have been cancelled. A \$150 million commercial paper program has been approved for interim financing. DAL anticipates using the CP program and taking it out with long-term bonds in fiscal 2023 though the amount and timing of future debt issuances could change. Fitch's analyses currently assume this additional issuance goes forward in 2023.

### Conservative Debt Structure - Debt Structure Risk: Stronger

There are \$214 million of general airport revenue bonds (GARBs) outstanding as of fiscal year-end 2020. DAL's debt profile has all fixed-rate debt with level annual debt service requirements of approximately \$19.3 million and a final maturity in fiscal 2037. While the system's sum-sufficient rate covenant is more limited than for other airports, all other structural features are satisfactory. The 2010 special facilities bonds are callable and may be refunded under the current credit structure with forecast interest savings.

### Financial Profile

DAL's GARB lien net leverage is comparatively low at around 1.5x for FY 2020 but rises to around 3.5x by FY 2025 in the coronavirus rating case, including an assumed \$150 million of future debt issuance for the capital plan. Liquidity is modest with unrestricted cash and O&M reserve of approximately \$66 million, which equates to more than 300 days cash on hand. The 2020 debt service coverage ratio (DSCR) remained strong at 4.5x due to the residual framework, and stabilizes to a five-year average of 2.1x. CPE spiked to more than \$17 in 2020, but should level off around \$10-\$11 for FYs 2022-2025.

### PEER GROUP

Fitch-rated comps include Chicago's Midway International Airport (MDW; A/Outlook Negative) and Detroit (DTW; A/A senior/sub/Outlook Negative). MDW similarly serves a comparable strong, metropolitan market with a greater than 90% Southwest concentration and faces competition from a larger, nearby airport, but it plays more of a strategic role in the Southwest network, serving more passengers and destinations and with more daily seat

capacity than DAL. MDW and DTW share elevated leverage profiles relative to DAL, with high carrier concentration and similar coverage levels under their long-term, fully residual AULs that are lower than DAL's.

## **RATING SENSITIVITIES**

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--A return to a Stable Outlook could be likely over the next few months should LFAMC experience a sustained recovery in passenger volumes in line with or better than the Fitch Rating Case, leading to stabilization of the authority's financial profile at pre-pandemic levels.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Operational and financial performance in line with or worse than Fitch's Coronavirus Severe Downside Case;

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

--A material downshift or volatility in the post-pandemic traffic profile given the Southwest concentration.

## **BEST/WORST CASE RATING SCENARIO**

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit

<https://www.fitchratings.com/site/re/10111579>.

## CREDIT UPDATE

### Performance Update

Starting in March 2020, DAL has experienced a significant decline in passenger traffic as air travel was sharply curtailed due to the coronavirus pandemic. April 2020 saw the most severe passenger declines at -95% yoy, with September remaining -56% down yoy. For the fiscal year ending September 2020, enplaned passengers declined by -39% yoy to 5.1 million, and revenues declined -13%. Current YTD results (2.0 million enplanements for October to March 2021) indicate enplanements remained down 38% relative to 2020 levels.

The airport was approved for a commercial paper program in the amount of \$150 million to use for large projects needed for capital development; management intends to refund the CP with GARB debt in fiscal 2023. The 2010 Special Facilities Bonds were callable in November 2020. The City is ready to refund the Special Facilities Bonds under the current credit structure, at significant savings, as soon as Southwest Airlines indicates it is ready to move forward.

In response to the coronavirus pandemic, DAL delayed various capital projects, but none have been cancelled. Total capital spending during 2020 was roughly \$186 million, which contributed to construction, rehabilitation, replacement and reconstruction of various projects. From 2021 to 2026, DAL's capital plan is projected to be roughly \$1.1 billion for various airport related projects.

DAL received approximately \$53 million in CARES Act funds from the federal stimulus package in March/April 2020. As of September 2020, management indicated its intent to use \$33 million for FY19-20 needs (\$4 million for capital projects, \$10 million for debt payment, and \$19 million for O&M), allocating the remaining \$20 million of funds for debt payment in FY 2020-2021. DAL was also awarded nearly \$16 million from CRSSA grants, and will likely be the recipient of another approximately \$40 million from the ARPA grants. Because final amounts have not yet been disclosed, these second and third rounds of federal funding have not been factored into Fitch's cases at this time, but would provide positive upside to financial metrics.

## FINANCIAL ANALYSIS

## Fitch Cases

Given the current economic environment due to the coronavirus and the unlikeliness of a stable operating environment over the near term, Fitch's rating case is also considered the base case. Fitch's rating case assumes, relative to fiscal 2019, a 42% decline in enplanements in fiscal 2021, followed by declines of 20%, 15% and 5% in fiscal years 2022, 2023 and 2024, respectively. Enplanements reach full recovery in fiscal 2025. Airline payments are driven by cost recovery terms under the rate agreements and adjusted for CARES Act funding and non-aeronautical revenues are largely driven by fluctuations in passenger traffic. Under Fitch's rating case, DSCR declines to and remains around 2.0x. CPE remains slightly elevated at \$14 for 2021, but drops to roughly \$10-\$11 from fiscal 2022 through fiscal 2025. GARB leverage rises slightly with the assumed \$150 million CP takeout in 2023, but stabilizes below 4x by FY2024.

Fitch also ran a severe downside case with declines relative to 2019 of 55%, 45%, 25% and 10% in fiscal years 2021-2024, respectively, and full recovery in fiscal 2025. Under this scenario, the DSCR and leverage profiles are the same as the rating case given the fully residual AUL, but CPE is higher, reaching a maximum of almost \$21 in fiscal 2021.

## Asset Description

DAL is a medium-hub airport located approximately seven miles northwest of the City's business district serving the Dallas and Dallas Fort Worth metropolitan areas. The airport, together with Dallas Executive Airport and the Heliport, are managed and operated as an airport system by the city's aviation department. Southwest's headquarters are adjacent to the airport. Southwest has operated at DAL since 1971 and captures more than 90% of the airport's market share.

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

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

## ESG CONSIDERATIONS



Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg).

## RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR
Dallas (TX) [Love Field]		
● Dallas (TX) /Airport Revenues - Love Field/1 LT	LT A Rating Outlook Negative	Affirmed A Rating Outlook Negative

[VIEW ADDITIONAL RATING DETAILS](#)

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## **APPLICABLE CRITERIA**

[Infrastructure and Project Finance Rating Criteria \(pub. 24 Mar 2020\) \(including rating assumption sensitivity\)](#)

[Airports Rating Criteria \(pub. 22 Oct 2020\) \(including rating assumption sensitivity\)](#)

## **APPLICABLE MODELS**

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

GIG AST Model, v1.3.0 ([1](#))

## **ADDITIONAL DISCLOSURES**

[Dodd-Frank Rating Information Disclosure Form](#)

[Solicitation Status](#)

[Endorsement Policy](#)

## **ENDORSEMENT STATUS**

Love Field Airport Modernization Corporation (TX)

EU Endorsed, UK Endorsed

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