Memorandum

CITY OF DALLAS

DATE August 20, 2021

TO Honorable Mayor and Members of the City Council

SUBJECT **Fitch Ratings Affirmed ‘A’ Rating, Revised Outlook to Stable for Love Field Airport Modernization Corp. (LFAMC) – RATING ACTION**

On August 13, 2021, Fitch Ratings (Fitch) revised the outlook to stable from negative and affirmed its 'A' long-term rating on the Love Field Airport Modernization Corp. General Airport Revenue Bonds (GARBs) issued for Dallas Love Field Airport (DAL). Fitch’s rating also applies to the upcoming General Airport Revenue Bonds, Series 2021 (AMT).

Fitch previously deemed the outlook negative following an annual review of the credit profile in May 2021. According to Fitch, the revised outlook, “reflects the significant progression in traffic recovery, with Southwest remaining the dominant air carrier, and the airport's prudent financial and capital management throughout the pandemic, which together with robust levels of federal allocations, is expected to allow for sound financial metrics over the next several years under Fitch's rating case.”

According to the Fitch report, the rating reflects DAL’s “resilient operating profile serving the strong Dallas metropolitan region benefitting from the service expansions following the expiration of the Wright Amendment. Dallas Love entered the coronavirus pandemic period with a strong financial position including modest senior lien leverage of less than 3x and competitive airline costs for the regional market.” The assessment of the enterprise risk profile focuses on the airport system’s strong, “solid cost recovery framework,” “well-defined capital plan,” “adapting but conservative debt structure,” and service area strength revenue risk. Along with key rating drivers, Fitch’s credit update reports an increase in DAL’s enplanements which reached “8.3 million prior to the pandemic” and as of June 2021, “reached roughly 90% of 2019 levels” on a monthly basis.

Although we continue to navigate the effects of COVID-19 and air service competition with DFW remains an ongoing concern, Fitch continues to view DAL “as a strong complementary airport for the air trade service area.” Fitch’s revision to the rating outlook further reinforces the strength of DAL’s credit profile to the investing community and reflects the City’s commitment to service excellence.

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Attached is the published Fitch report. Please let me know if you need additional information.

M. Elizabeth Reich

M. Elizabeth Reich
Chief Financial Officer

[Attachment]

c: T.C. Broadnax, City Manager
Chris Caso, City Attorney
Mark Swann, City Auditor
Bilierae Johnson, City Secretary
Preston Robinson, Administrative Judge
Kimberly Bizor 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

FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Dallas Love Field Airport (TX) Senior Revs at 'A'; Outlook Revised to Stable

Fri 13 Aug, 2021 - 4:06 PM ET

Fitch Ratings - New York - 13 Aug 2021: Fitch Ratings has assigned an 'A' rating to City of Dallas' Love Field Airport (DAL), TX's approximately $247 million of series 2021 senior lien airport revenue refunding bonds issued by the Love Field Airport Modernization Corporation (LFANC).

Fitch has also affirmed the 'A' rating on LFAMC's $205.3 million outstanding parity senior lien airport revenue bonds, series 2015 and series 2017. The Rating Outlook on all outstanding bonds has been revised to Stable from Negative.

RATING RATIONALE

The Outlook revision to Stable reflects the significant progression in traffic recovery, with Southwest remaining the dominant air carrier, and the airport's prudent financial and capital management throughout the pandemic, which together with robust levels of federal allocations, is expected to allow for sound financial metrics over the next several years under Fitch's rating case.

The rating reflects DAL's resilient operating profile serving the strong Dallas metropolitan region benefitting from the service expansions following the expiration of the Wright Amendment. Dallas Love entered the coronavirus pandemic period with a strong financial position including modest senior lien leverage of less than 3x and competitive airline costs for the regional market. Concentration risk is acute with Southwest Airlines representing around 95% of enplanement market share, 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.

The debt restructuring of DAL's obligations intended with this refunding will sharply raise the leverage and lower the coverage profile for the general airport revenue credit going forward. However, the financial profile on an aggregate basis remains largely unchanged.

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 long-term growth is constrained by the airport's permanent 20-gate terminal capacity. During COVID-19, enplanements fell sharply in FY2020 to around 5.1 million, but as of June 2021, monthly enplanements reached roughly 90% of 2019 levels. Southwest Airlines (BBB+'/Negative Outlook) accounts for 95% of enplanements and their scheduling decisions could impact 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 lasting through 2028 that provides for sound carrier commitment and stable financial performance. DAL's cost per enplanement (CPE) level is competitive at a national level for medium-hub airports and is projected to be below forecasted 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 $480 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.

Adapting but Conservative Debt Structure - Debt Structure Risk: Stronger

The series 2021 issuance will lead to a phased approach to modify DAL's debt structure where all previously issued special facilities bonds, payable directly by Southwest, will be replaced into senior lien airport debt by 2022. There is currently $205 million of general airport revenue bonds (GARBs) outstanding but will rise to approximately $452 million. DAL's debt profile has all fixed-rate debt with level annual debt service requirements of approximately $16.8 million and a final maturity in fiscal 2040. 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 senior lien net leverage is comparatively low at around 2.6x for FY 2020, but with the proposed debt restructuring, this metric will rise markedly in the near term and evolve closer to under 6x by FY 2025. Liquidity is sustained at modest levels with unrestricted cash and operating reserves of approximately $66 million which equates to about Fitch-calculated 283 days cash on hand. Historical senior debt coverage remained strong, at 2.6x in fiscal 2020, due to the residual framework and the subordinated reimbursement payments to Southwest, but is expected to decline and stabilize to about 1.3x due to the effects of the transfer of debt through the refunding. Airline costs are initially forecasted to spike to $14 due to enplanement losses in 2021 but will return to around $8 by FY2025 under a full recovery scenario.

PEER GROUP

Fitch-rated peers include Chicago's Midway International Airport (MDW; A/Stable) and Detroit (DTW; A/Stable). 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 also 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 NEGATIVE RATING ACTION/DOWNGRADE:

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

--Operational and financial underperformance relative to Fitch downside case, leading to sustained leverage above 7x, would elevate the credit profile risks;

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

FACTORS THAT COULD, INDIVIDUALLY OR COLLECTIVELY, LEAD TO POSITIVE RATING ACTION/UPGRADE:

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

While positive rating action in the near term is not expected given recovery uncertainties, a trend in aggregate airport leverage below 4x could position DAL for an improving credit profile.

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.

TRANSACTION SUMMARY

The airport expects to issue approximately $247 million of series 2021 bonds to refund $310 million of the Corporation's outstanding special facilities revenue bonds, series 2010. The 2010 bonds were solely payable by Southwest Airlines but ultimately reimbursed by the airport, as funds were originally applied to defray the costs for significant terminal improvements benefitting the carrier.

This refinancing plan will shift the costs to a parity senior lien obligation of the airport, and by next year, DAL further intends to refinance the remaining series 2012 special facilities revenue bonds with parity senior bonds. Substantial debt service savings, which can be passed down to the airlines, are anticipated with this series 2021 financing plan with the expectation to level the total debt service to about $40 million per year for most years through final maturity in 2040.

CREDIT UPDATE

Performance Update

Similar to nearly all U.S. commercial airports, LFAMC had experienced a significant decline in passenger traffic as air travel was sharply curtailed due to the coronavirus pandemic. April 2020 faced the most severe passenger declines at -95% while fiscal year 2020 (ending Sept. 30) indicated enplanement declines of -39% YoY to 5.1 million. With the vaccination deployments that accelerated through the first half of 2021, DAL's enplanements have quickly rebounded and are reaching 80% to 90% recovery levels compared to similar months in 2019.

The loss in passenger traffic has adversely impacted DAL's revenues, with non-airline revenues declining by more than 30% from pre-pandemic levels. DAL was able to maintain a steady level of airline payments as a result of the airline agreement rate setting mechanisms and applied a portion of the federal aid awards towards expense reductions. DAL initially received $53.9 million in CARES Act funds and subsequently received over $70 million in two successive aid relief awards. With only $51.5

million spent to date, DAL has flexibility to apply the remaining $73 million over the next several years to offset revenue losses or reduce costs for operations or debt service.

The airport's $480 million capital program through 2026 focuses largely on airfield and roadway projects and follows past works involving the reconstructed passenger terminal and new concession areas, which should accommodate projected traffic levels. Funding sources for the capital program are federal entitlement grants, Passenger Facility Charges (PFCs), Commercial Paper and Aviation Departments funds, and future debt issuances.

FINANCIAL ANALYSIS

Fitch Cases

Fitch reviewed the sponsor's traffic and financial forecasts as inputs to establishing a rating and downside case. Fitch's rating case is also considered the base case. Fitch's rating case assumes, relative to fiscal 2019, a 32% decline in enplanements in fiscal 2021 to 5.67 million followed by additional recoveries to 2019 levels reverting the losses to 10% and 5% in fiscal 2022 and 2023, respectively. Fitch also assumes that enplanements will return to 100% of fiscal 2019 levels by fiscal 2024, growing by 2% thereafter.

Under this scenario, airport leverage peaks at 8.4x in fiscal 2021 but shifts lower to 6x or less by 2023. Debt service coverage, influenced by the combination of the airline agreement rate setting as well as uses of federal aid funds and application of passenger facility charges for debt service should remain in the 1.25x-1.3x range. Airline costs per enplanement rise to the $10-$12 range through 2023 but then begin to stabilize.

Fitch's downside case considers a slower pace of recovery, reaching 2019 levels in 2025. Under this scenario, near-term DSCR and leverage profiles are similar to the rating case; however, CPE levels would be modestly higher in each year but achieve these comparable metrics.

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

RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR

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

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Seth Lehman
Senior Director
Primary Rating Analyst
+1 212 908 0755
seth.lehman@fitchratings.com
Fitch Ratings, Inc.
Hearst Tower 300 W. 57th Street New York, NY 10019

Erik Diehl
Analyst
Secondary Rating Analyst
+1 312 205 3397
erik.diehl@fitchratings.com

Chad Lewis
Senior Director
Committee Chairperson
+1 212 908 0886
chad.lewis@fitchratings.com

MEDIA CONTACTS

Sandro Scenga
New York
+1 212 908 0278
sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

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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, v1.3.1 (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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