Memorandum

CITY OF DALLAS

DATE August 13, 2021

TO Honorable Mayor and Members of the City Council

SUBJECT **S&P Global Ratings Revises Outlook to 'Positive' on Love Field Airport Modernization Corp. General Airport Revenue Bonds – RATING ACTION**

On August 13, 2021, S&P Global Ratings (S&P) revised the outlook to positive from stable 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). S&P's rating also applies to the upcoming General Airport Revenue Bonds, Series 2021 (AMT). DAL is the first airport in the United States for which S&P has revised the rating for the better, since the beginning of the pandemic.

S&P previously downgraded the long-term rating on the GARBs and deemed the outlook negative, following the initial impacts of COVID-19. The outlook was later revised to stable in April 2021. According to S&P, the revised positive outlook, "reflects our view that we could raise the rating within the next two years if we believe DAL's enplanement recovery is sustainable, supporting an improved market position assessment."

In the report, S&P states, "we believe the favorable enplanement levels, supplemented by the use of federal stimulus aid during the recovery, demonstrates the potential for DAL to achieve sustainable and balanced financial operations to support credit quality. Nevertheless, risks remain, including the threat of coronavirus variants or weakening consumer confidence that could slow, stall, or reverse the recovery for air travel." According to the report, DAL's key credit strengths remain in its "role as an important provider of air service in the expanding Dallas-Fort Worth-Arlington MSA," "large and economically vibrant service area, which encompasses the Dallas-Fort Worth-Arlington MSA," and "very strong management and governance, reflecting an effective and experienced management team that has sufficiently managed risks and operations, as demonstrated by steady financial and operational performance during periods of significant growth." The report also notes potential credit weaknesses, including "exposure to potentially unpredictable enplanement levels as a result of COVID-19 and additional coronavirus variants along with lingering associated effects," "potential for continued hampered cash-flow-generation ability," and competition from nearby airports.

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Please find attached the report provided by S&P. This action is a direct reflection of the financial strength of the airport and an optimistic indicator of what is to come. I look forward to continuing to share positive news. 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
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

S&P Global
Ratings

RatingsDirect®

Summary:

Love Field Airport Modernization Corp., Texas; Airport

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Summary:

Love Field Airport Modernization Corp., Texas; Airport

Credit Profile		
US$246.7 mil gen arpt rev rfdg bnds ser 2021 (AMT) due 11/01/2040		
Long Term Rating	A-/Positive	New
Love Field Airport Modernization Corp AIRPORTS		
Long Term Rating	A-/Positive	Affirmed

Rating Action

S&P Global Ratings revised the outlook to positive from stable and affirmed its 'A-' long-term rating on Love Field Airport Modernization Corp. (LFAMC), Texas' general airport revenue bonds (GARBs) issued for Dallas Love Field Airport (DAL or the airport). At the same time, S&P Global Ratings assigned its 'A-' long-term rating, with a positive outlook, to the airport's estimated $246.7 million series 2021 general airport revenue refunding bonds, issued for DAL.

The outlook revision reflects our view that we could raise the rating within the next two years if we believe DAL's enplanement recovery is sustainable, supporting an improved market position assessment. In addition, we will evaluate if the airport's ability to maintain financial metrics is achievable and consistent with its strong financial risk profile. The positive outlook further reflects our expectation that the recovery in enplanement levels combined with the deployment of federal stimulus aid will support the airport's credit quality over the outlook period.

Net airport system revenues, as made available by the city under a project financing agreement with the LFAMC, secure the bonds. A debt service reserve fund (DSRF provides additional liquidity to bondholders. A rate covenant (1.25x debt service coverage [DSC] based on average annual debt service) is in effect, as is an additional bonds test requiring that historical net revenues, including passenger facility charges (PFC) applied as a debt service offset, provide at least 1.1x DSC or projected net revenues provide at least 1.25x DSC, respectively. We consider the bond provisions credit neutral.

The series 2021 bond proceeds will be used to refund the series 2010 special facilities revenue bonds for interest rate savings; and pay costs of issuance. A DSRF or surety policy will be funded by DAL, instead of bond proceeds. The refunding will front-load debt service, increasing annual debt service requirements upfront from fiscal years 2022-2028, providing material annual savings from fiscal years 2029-2040, which coupled with an anticipated series 2022 bond refinancing, will provide more level overall debt service requirements.

Post issuance, DAL will have approximately $614.2 million in total debt outstanding, which includes $540.7 million in GARBs and special facilities revenue bonds, $69.4 million in capital leases that we view as debt-like, and $4.1 million in pension obligation bonds. All debt is fixed rate with no swaps, variable-rate debt, or direct-purchase debt outstanding.

Credit overview

The 'A-' long-term rating reflects our opinion of DAL's adequate enterprise risk profile and strong financial risk profile, and the outlook revision reflects our view that the airport's enplanement recovery from the pandemic, if sustained on its current trajectory near pre-pandemic enplanement levels, could result in an improved market position assessment, supporting a strong enterprise risk profile. Enplanement levels have generally recovered to near 2019 monthly pre-pandemic levels this summer. Overall, we believe the favorable enplanement levels, supplemented by the use of federal stimulus aid during the recovery, demonstrates the potential for DAL to achieve sustainable and balanced financial operations to support credit quality. Nevertheless, risks remain, including the threat of coronavirus variants or weakening consumer confidence that could slow, stall, or reverse the recovery for air travel.

DAL entered the pandemic operationally and financially strong, with enplanements at their highest level ever (8.31 million enplaned passengers for the fiscal year ending Sept. 30, 2019), historically strong DSC levels, and adequate overall liquidity position. However, enplaned passenger levels declined 39.1% to 5.06 million in fiscal 2020 (ended Sept. 30), following a sharp and rapid decline in enplanements at the onset of the pandemic. We view DAL's enplanement recovery in recent months as robust, outperforming national trends, with May, June, and July (estimated) 2021 monthly enplanements at 84%, 90%, and 95% (estimated), respectively compared with pre-pandemic levels, and up materially from peak declines experienced in April and May 2020. Furthermore, we view the combination of vaccine progress, easing mobility restrictions, strong economic growth, and pent-up demand as bolstering air travel demand and promoting a continued recovery in air travel demand, although ongoing threats from coronavirus variants expose DAL to risks that could slow or stall the recovery. For additional information, see "Updated Activity Estimates For U.S. Transportation Infrastructure Show Recovery For Air Travel Demand Accelerating And Public Transit Lagging," published July 29, 2021, on RatingsDirect.

The city of Dallas owns and operates DAL, Dallas Executive Airport (a general aviation airport), and a heliport, managing them through its department of aviation. DAL is four miles northwest of Dallas' central business district on 1,300 acres. It provides air transportation services for the Dallas-Fort Worth-Arlington metropolitan statistical area (MSA), which is the fourth-largest MSA in the U.S. DAL competes against Dallas Fort Worth International Airport (DFW), which serves the same MSA. While DAL handled 8.3 million enplanements in fiscal 2019, DFW handled 36.6 million enplanements. Nevertheless, DAL historically retained a good level of demand prior to the pandemic given its proximity to downtown Dallas and its important role in the Southwest Airlines route network.

As a result of weakened activity levels and continued exposure to unpredictable activity levels due to the pandemic and its lingering effects that are outside of management control, we continue to view DAL's market position as weakened, resulting in an overall adequate enterprise risk profile assessment. However, we view the airport's favorable enplanement recovery as promising, and believe if sustained on its current trajectory near pre-pandemic enplanement levels, we could improve DAL's market position assessment within our two-year outlook period, revising the airport's enterprise risk profile to strong. Furthermore, our market position assessment also considered DAL's relative importance to Southwest as the airline's headquarters, focus city, and one of the airlines busiest U.S. hubs based on enplanements. In particular, DAL serves as an important provider of air service in the expanding Dallas-Fort Worth-Arlington MSA, along with its position as a key component of Southwest's route system with strong historical enplanement growth prior to the COVID-19 pandemic. Tempering our assessment is significant air carrier

concentration (95% in fiscal 2020), competition from DFW, and moderate exposure to connecting traffic (33% in fiscal 2020).

Our opinion of DAL's overall financial risk profile is unchanged at strong, despite our expectation for improved debt and liabilities capacity following the series 2021 bond refinancing and the airport's limited additional debt needs, as we evaluate management's strategy and the shape of the traffic recovery along with the anticipated effect on metrics during this transitory period. Within our overall financial risk profile, we consider such factors as financial performance or DSC (55% weight), debt and liabilities capacity (35%), and liquidity and financial flexibility (10%). This overall financial risk profile assessment incorporates DAL's:

- Strong financial performance, reflecting our expectation that DSC (S&P Global Ratings-calculated) will decline but remain at levels we consider strong (near 1.25x) following the issuance of the proposed series 2021 bonds and an additional expected bond refinancing in fiscal 2022, given a step-up in debt service from fiscal years 2022-2027, although we note to the extent DSC is sustained at weaker levels below 1.25x, we would worsen our assessment;
- Very strong debt-to-net revenues, based on our expectation that debt-to-net revenues will generally be sustained below 10x following the series 2021 bond refinancing, expected bond refinancing in fiscal 2022, and continued enplanement recovery. DAL's expected bond refinancings will generate significant premium, moderately reducing debt outstanding, which combined with additional debt amortization, limited additional debt needs, and a manageable capital improvement plan totaling $480.8 million from fiscal years 2021-2026 support our improved assessment; and
- Adequate liquidity position, with $58.5 million in unrestricted reserves as of July 2021 (unaudited), providing 225 days' cash on hand based on estimated fiscal 2021 figures, bolstered by an infusion of federal stimulus relief with $73.1 million unspent that DAL expects to generally deplete by fiscal 2025.

Two financial forecasts were prepared in connection with this bond issue. One was based on a base-case enplanement scenario and the other was based on a low-enplanement scenario through 2030. The base-case scenario assumes enplanements of 5.7 million in fiscal 2021 (68% of fiscal 2019), a recovery in passenger levels above pre-pandemic levels to 8.3 million by fiscal 2022, 8.7 million in enplanements in fiscal 2023, followed by enplanement growth of about 1% from fiscal years 2024-2030. The low-enplanement scenario assumes the same level of enplanements in fiscal 2021 as the base-case forecast, followed by a slower recovery at which point enplanements recover to fiscal 2019 levels by fiscal 2023.

We view DAL's base-case forecast as reasonable given the recovery thus far in fiscal 2021--notably given enplanements recovered to 84% and 90% for the months of May and June, respectively, and an estimated 95% for July 2021 compared with 2019 monthly enplanements. Year-to-date enplanement levels are about 47% below pre-pandemic 2019 levels through July 2021 with two months remaining in the fiscal year. Furthermore, we consider the continued enplanement recovery as promising given the potential for increased air travel demand due to vaccine progress, less onerous mobility and COVID-19 restrictions within Texas, strong economic growth, a resumption of business travel as more employees return to work, and pent-up demand.

Per the base-case forecast, we expect DSC (S&P Global Ratings-calculated) to be insufficient in fiscal 2021 (although DSC of 2.2x as per the indenture), then gradually recover to levels we consider strong near 1.25x by fiscal 2024. Our

DSC calculation includes net revenues of the airport system, PFC applied to debt service, letter of intent grant payments, and interest income in the numerator divided debt service including GARBS, capital lease obligations, pension obligation bonds, and the airport's debt-like annual reimbursements to Southwest for debt service payments. We exclude the application of federal stimulus aid, which DAL expects to utilize in the near term to offset revenue losses related to the pandemic, because of its nonrecurring nature.

Overall, we view near-term financial results as transitory, and not indicative of where we generally expect longer-term financial results will be sustained, particularly given federal stimulus aid to bridge the gap for near-term expected revenue losses as enplanement levels recover. However, to the extent financial metrics, including DSC and debt-to-net revenues, are pressured due to weaker revenue performance without a commensurate reduction in fixed costs, we could weaken our assessment of the financial risk profile.

As of August 2021, the airport has received $124.6 million in federal stimulus aid in response to the COVID-19 pandemic, including $53.9 million from the CARES Act, $13.7 million from Coronavirus Response & Relief Supplemental Appropriations Act (CRRSA), and $57 million from American Rescue Plan Act of 2021 (ARP). The airport has deployed $51.5 million thus far, and expects to deploy the remaining unspent balance of $73.1 million through fiscal 2025. An estimated $10.1 million is expected to be applied in fiscal 2021, and $3.6 million in fiscal 2022 with the amounts expected to be applied in fiscal years 2023-2025 indeterminate.

Key credit strengths, in our opinion, are DAL's:

- Role as an important provider of air service in the expanding Dallas-Fort Worth-Arlington MSA, along with its position as a key component of Southwest's route system with strong historical enplanement growth prior to the COVID-19 pandemic;
- Large and economically vibrant service area, which encompasses the Dallas-Fort Worth-Arlington MSA (the fourth-largest MSA in the U.S.), supported by a large and growing population base, good economic activity as measured by GDP per capita, and ample employment opportunities; and
- Very strong management and governance, reflecting an effective and experienced management team that has sufficiently managed risks and operations, as demonstrated by steady financial and operational performance during periods of significant growth.

Key credit weaknesses, in our opinion, are DAL's:

- Exposure to potentially unpredictable enplanement levels as a result of COVID-19 and additional coronavirus variants along with lingering associated effects (shifting travel restrictions or behavioral changes with respect to air travel, particularly business travel);
- Potential for continued hampered cash-flow-generation ability, particularly cash flow derived from activity-based revenue sources, and a weakened rate-setting environment; and
- Competition from DFW and moderate exposure to connecting traffic along with significant airline concentration, with Southwest, its largest carrier, accounting for approximately 95% of total enplanements in fiscal 2020.

Environmental, social, and governance (ESG) factors

We analyzed DAL's risks and opportunities related to ESG credit factors relative to its market position, management and governance, and financial performance. While conditions are improving, the airport has been, and remains, exposed to health and safety social risks associated with the pandemic and weaker traffic levels that resulted in significant operating and financial pressures. We analyzed the airport's risks related to environmental and governance factors and consider them to be in line with our view of the standard for the airport sector. We will continue to evaluate these risks as the situation evolves.

Positive Outlook

Upside scenario

We could raise the rating within the next 12 months if we believe DAL's enplanement recovery is sustainable, supporting an improved market position assessment and strong overall enterprise risk profile. When making this assessment, we will also evaluate if the airport's ability to maintain financial metrics is achievable, sustainable, and consistent with its current strong financial risk profile.

Return to stable scenario

We could revise the outlook to stable if DAL's enplanement trends weaken materially or remain unpredictable due to lingering effects of the pandemic, or if financial metrics, particularly DSC and debt-to-net revenues, are expected to be sustained at weaker levels inconsistent with the current rating.

Credit Opinion

S&P Global Ratings expects U.S. economic activity and growth will accelerate in 2021 as public health conditions continue to improve. The steady pace of vaccination in the U.S. has allowed for the easing of capacity restrictions, with most state and local governments fully or partially lifting mask mandates. Vaccination progress is part of our assessment of U.S. economic and credit implications across public finance (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

A better vaccination outlook this summer, a faster reopening schedule, and $2.8 trillion from two stimulus packages have turbocharged the U.S. economic recovery this year and the next, following the pandemic-induced slump. S&P Global Economics' current forecasts anticipate ending 2021 at a 6.7% real GDP growth rate in 2021 and rebounding to a slower growth phase heading into 2022, with 3.7% estimated for next year. Our risk for recession over the next 12 months is now 10%-15%, down sharply from the 20%-25% range in January and around the U.S. economy's long-term unconditional recession risk average of 13%. The U.S. unemployment rate in May fell to 5.8%, and we expect the national unemployment rate will likely reach its pre-pandemic level of less than 4% by first-quarter 2023. For more information, see "Economic Outlook U.S. Q3 2021: Sun, Sun, Sun, Here It Comes," June 24, 2021.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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