Memorandum

CITY OF DALLAS

DATE June 20, 2019

TO Honorable Mayor and Council Members

SUBJECT **Standard and Poor's Global Ratings Affirmed 'A' Rating and Stable Outlook for Love Field Airport Modernization Corp. (LFAMC) - INFORMATION**

Today, Standard and Poor's Global Ratings (S&P) affirmed the City's 'A' credit rating and stable outlook for the Love Field Airport Modernization Corp. (LFAMC), following updated rating criteria published last year. The S&P rating considers Dallas Love Field Airport, the largest division of the Dallas Airport System, which also includes Dallas Executive Airport and Dallas Heliport.

According to the analysis report, the rating reflects S&P's "opinion of the airport's strong enterprise and financial risk profiles." The assessment of the enterprise risk profile focuses on the airport system's "strong market position," "extremely strong service area economic fundamentals," "low industry risk relative to that of other industries," and "very strong management and governance." In regard to the financial risk profile, S&P highlights the airport system's "strong financial performance," "strong debt and liabilities capacity," and "adequate liquidity and financial flexibility." With an "effective and experienced" management team, supported by revenues from the fourth-largest metropolitan statistical area (MSA) in the U.S., S&P expects that "enplanements will remain generally stable or increase, allowing the airport to maintain a strong financial profile."

With the City's support of the airport enterprise system, the LFAMC maintains a favorable rating under the new criteria. As rating criteria evolve, I look forward to continuing to represent the City of Dallas as a smart, stable, and robust investment.

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 (Interim)
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Preston Robinson, Administrative Judge
Kimberly Bizor Tolbert, Chief of Staff to the City Manager
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Love Field Airport Modernization Corp., Texas; Airport

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Love Field Airport Modernization Corp., Texas; Airport

Credit Profile		
Love Field Airport Modernization Corp AIRPORTS		
Long Term Rating	A/Stable	Affirmed

Rationale

S&P Global Ratings affirmed its 'A' long-term rating on Love Field Airport Modernization Corp. (LFAMC), Texas' general airport revenue bonds outstanding. The outlook is stable.

The rating reflects the application of S&P Global Ratings updated rating criteria, "U.S. And Canadian Not-For-Profit Transportation Infrastructure Enterprises," published March 12, 2018.

LFMAC issued the debt for Dallas, which owns and operates Dallas Love Field Airport (DAL).

The rating reflects our opinion of the airport's strong enterprise and financial risk profiles, which dominate the financials of the city's airport system, which consists of DAL, Dallas Executive Airport (a general aviation airport), and a heliport. Our enterprise risk profile assessment reflects DAL's relatively high activity levels (about 8 million enplanements) from serving a large and expanding service area, tempered by extremely high air carrier concentration, competition, and moderate exposure to connecting traffic. Our financial risk profile assessment reflects our expectation that debt service coverage (DSC) and debt capacity will be maintained within ranges we consider strong, and liquidity metrics will be maintained at levels we consider adequate.

The enterprise risk profile reflects our view of the airport system's:

- Strong market position, reflecting our expectation that DAL's enplanements will be relatively stable at about 8 million with a large and growing demand base. Tempering this is significant air carrier concentration with Southwest Airlines Co. handling about 90% of the airports' total enplanements, local competition from Dallas Fort-Worth International Airport (DFW), and moderate exposure to connecting traffic (which accounts for roughly 30% of total enplanements);
- Extremely strong service area economic fundamentals, which include favorable levels of economic activity as measured by GDP per capita, a large population base, expected population growth that is more than double the forecast national population growth rate, and below-average unemployment levels;
- Low industry risk relative to that of other industries and sectors; and
- Very strong management and governance, reflecting an effective and experienced management team that has sufficiently managed risks and operations, as the airport's steady financial and operational performance during periods of significant growth demonstrates.

The financial risk profile reflects our view of the airport system's:

- Strong financial performance, with a three-year average DSC of 1.7x, which steadily increased year-over-year from fiscal 2016-2018. We expect this will remain within a range we consider strong, despite a step-up in debt service in fiscal 2019;
- Strong debt and liabilities capacity, reflecting our expectation that debt to net revenues, per our calculations, will continue within the 10x-15x range including additional borrowings. Our calculation of debt includes the airport's revenue bond debt, pension obligation bond debt, capital lease obligations, and Southwest Airlines debt since the debt service for such debt is paid from airport revenues; and
- Adequate liquidity and financial flexibility that reflects historical fluctuations and recent spenddown in liquidity as the airport system deployed a portion of unrestricted cash for the capital improvement program (CIP).

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 funded to lesser of the IRS maximum provides additional liquidity. The corporation is authorized to issue debt pursuant to the agreement, so long as historical net revenues provide at least 1.1x DSC or projected net revenues provide at least 1.25x DSC, respectively. We consider the bond provisions credit neutral.

For our analysis, we calculated DAL's debt at about $731 million for fiscal 2018. The airport has no variable-rate debt, swaps, or direct-purchase debt. Our debt calculation includes DAL's revenue bond debt, Southwest bond debt, pension obligation bond debt, and capital lease obligations. LFAMC issued the Southwest bonds to facilitate the phased redevelopment of the airport terminal (the Love Field Modernization Plan). The bonds are secured by facilities payments the airline pays pursuant to DAL's facilities agreement with it and the city. To the extent net revenues are available, the airport reimburses Southwest for payments on debt service, which also benefit from a pledge of PFC and letter-of-intent (LOI) grant payments. The airport's payments for this debt are subordinate to the general airport revenue bonds (GARBs). Airport management budgets annually for these payments and intends to continue to make payments. As a result, our calculations of DSC, debt to net revenue, and unrestricted cash reserves to debt metric calculations include these obligations.

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 8.1 million enplanements in fiscal 2018, DFW handled 34.5 million enplanements. Nevertheless, DAL has retained a good level of demand given its closeness to downtown Dallas and significantly lower airfares.

Outlook

The stable outlook reflects our expectation that enplanements will remain generally stable or increase, allowing the airport to maintain a strong financial profile.

Upside scenario

Although unlikely, we could raise the rating in the next two years if the airport's enplanements materially increase to levels we believe are sustainable, suggesting a stronger market position.

Downside scenario

Also unlikely, we could lower the rating in the outlook period if DAL's enplanement levels drop significantly, suggesting a weaker market position, or if the airport's financial metrics erode materially.

Enterprise Risk

Our assessment of the enterprise risk profile considered LFAMC's service area economic fundamentals, industry risk, market position, and management and governance.

Economic fundamentals

The primary service area, the Dallas-Fort Worth-Arlington MSA, has extremely strong economic fundamentals due to favorable levels of economic activity as measured by estimated GDP per capita of $73,187, a large estimated population base of 7.5 million, estimated three-year population growth rate of 4.8%--more than twice the national rate (2.2%)--and below-average unemployment levels.

We consider the MSA broad and diverse. Sustained population growth and in-migration, and positive employment metrics continue to bolster Dallas' local economy and further ground the city as a major economic hub in the country. The city and greater metro area continue to be desirable for new business and recent relocations of corporate headquarters to the area. Dallas has almost 76,000 businesses and over 1.15 million jobs along with 3,489 company headquarters.

Market position

Our market position assessment reflects DAL's historically robust enplanement trends that we expect to remain generally stable in the near term despite local competition from DFW, significant air carrier concentration, and moderate exposure to connecting traffic. The airport continues to experience high growth due to ramp-up following the expiration of the Wright Amendment in 2014, which prohibited service from DAL to destinations beyond Texas and neighboring states, and resulted in enplanements increasing 40.4% to 6.5 million in fiscal 2015 from 4.4 million in fiscal 2014. Enplanement trends have remained robust the past three years, with a compound annual growth rate of 8.1% from fiscal years 2015-2018, largely attributed to expanded service from Southwest and growth in the demand base. Enplanements hit a record 8.1 million in 2018 (up 4.1%), of which 32% is connecting passengers. We expect enplanement trends to remain generally stable-to-positive due, in part, to expected regional economic growth.

We consider the airport's carrier concentration extremely high with Southwest, the leading carrier, accounting for 90.5% of fiscal 2018 enplanements. Virgin America and Alaska Airlines Inc. are the next largest carriers, accounting for 4.0% and 2.7% of enplanements, respectively. The air carrier concentration for Southwest is unique in that legislation (the Wright Amendment, expired 2014) intentionally enabled Southwest's position at DAL. However, the airport's importance to Southwest with its national headquarters located adjacent to Love Field, along with its good level of origin and destination traffic somewhat offset the risk. We consider DAL's airline cost structure moderate, with an airline cost per enplanement of $8.46 in fiscal 2018, per S&P Global Ratings' calculations.

DAL competes for air travel demand with DFW, which is 16 miles away from DAL and 20 miles from downtown Dallas and serves the same MSA. In fiscal 2018, DFW handled 34.5 million enplanements compared with DAL's 8.1 million. Although DFW is much larger than DAL, DAL has retained a good level of traffic, offering a lower-airfare alternative, especially for those traveling domestically to or from the MSA. Furthermore, DAL benefits from its proximity to downtown Dallas.

Management and governance

We consider DAL's management and governance very strong. This reflects our view of the airport's strategic positioning, risk management and financial management, and organizational effectiveness.

DAL has an effective management team that has sufficiently managed risks and operations, evidenced by the airport producing improving financial performance as it underwent a large capital project from fiscal years 2016-2018 during a period of significant demand growth. This is due, in part, to management defining financial targets, which it has consistently met or exceeded. These targets include the maintenance of no lower than 90 days' cash on hand, and an informal target to be among Southwest's lower cost-per-enplanement hubs.

We consider management's risk and financial management practices fiscally prudent. These include conservative budgeting practices; an annually updated five-year CIP; and a relatively simple capital structure that does not include variable rate debt, swaps, or direct purchase debt. DAL typically funds a portion of its CIP from its aviation fund (capped at $30 million). The city's insurance policies cover the airport. The DAL airline agreement has a hybrid rate-making model, with residual rate-making for the airline cost center covering operations and maintenance (O&M) and debt service. The airport's use and lease agreement took effect Oct. 1, 2008, and has a 20-year term. Following the completion of the Love Field Modernization Plan's first phase, a residual cost-setting methodology took place in which certain non-airline revenues are credited back to the airlines. More specifically, 75% of concession revenues and 75% of net parking revenues are credited back to the terminal building cost center in determining airline costs; the remaining 25% flows through to the aviation fund for use on airport improvements and any other lawful purposes, up to a cap of $30 million adjusted for inflation. Surplus money in this fund are credited back to the airlines.

We consider the management team effective and experienced in operating an airport such as DAL, which has experienced periods of significant growth. We also consider the airport's governance structure credit neutral, with DAL owned and operated by the city of Dallas, which has historically been supportive.

Financial Risk

Our assessment of DAL's financial risk profile considers the airport system's financial performance, debt and liabilities capacity, and liquidity and financial flexibility. Our financial profile risk assessment considers historical figures and 2019 budgeted figures, reflecting our expectation that future performance will be comparable to historical levels. Our financial profile assessment also considers the corporation's financial policies, which we consider credit neutral.

Financial performance

The financial performance assessment reflects our expectation that the airport system's DSC, per our calculations, will continue at about 1.7x, a level we consider strong, due to manageable additional debt needs and despite a step-up in debt service in fiscal 2019. Historical DSC, as per our calculations, increased to 2.1x in fiscal 2018 from 1.2x in fiscal 2016, following increased airline rates and charges to meet debt service and enplanement growth, with DSC averaging 1.7x from 2016-2018, based on audited results; and 1.78x based on budgeted 2019 figures. Our coverage calculation includes net revenues of the airport system, PFC applied to debt service, LOI grant payments, and interest income in the numerator divided by the sum of debt service on the 2015 and 2017 GARBs, capital lease obligations, pension obligation bonds, and the airport's debt-like annual reimbursements to Southwest for debt service payments on the 2010 and 2012 bonds.

If DSC is calculated per the city's GARB indenture, which allows net revenues (airport system revenues less O&M expenses) divided by GARB debt service, DSC is 17.53x in fiscal 2018 and projected at 5.14x in fiscal 2019.

We consider DAL' airline cost structure moderate at $8.46 per enplanement for fiscal 2018, as per our calculations.

Debt and liabilities

We assess the airport system's debt and liabilities capacity as strong, reflecting our expectation that the airport's debt to net revenue will continue in the 10x-15x range due to a manageable CIP and including a potential debt issuance in 2020. We expect the airport system's debt-to-net revenues, as per our calculations, to be comparable with historical levels, which averaged 12.6x from fiscal years 2016-2018. DAL's debt as of fiscal 2018, as per our calculations, totals $731 million, including the airport's GARBs, Southwest bonds, a pension obligation bond, and capital lease obligations. Net revenue, as per our calculations, include the summation of DAL's EBIDA, PFCs applied to debt service, LOI grant payments, and interest income.

We consider the airport system's CIP manageable, totaling approximately $429.4 million for 2019-2024. The airport may issue a modest amount of additional debt around 2020. Despite this, we do not expect the additional debt to materially weaken the system's debt capacity or debt per enplaned passenger given amortization of existing debt and offsetting growth in net revenues based on our expectation of generally stable enplanement trends. For fiscal 2018, DAL's debt per enplaned passenger is a moderate $81.

Liquidity and financial flexibility

The liquidity and financial flexibility assessment reflects our expectation that the airport system will maintain liquidity at levels we consider adequate given historical fluctuations and the recent spenddown in unrestricted cash. The system deployed a portion of its unrestricted cash for its CIP, resulting in a spenddown to $48.7 million, or 219 days' cash on hand, in fiscal 2017 from $113.3 million, or 781 days, in fiscal 2015. For fiscal year-end 2018, audited unrestricted cash and investment balance increased to $55.1 million, equaling approximately 268 days' cash on hand and 8.4% of debt, as per our calculations.

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