Memorandum

CITY OF DALLAS

DATE September 1, 2022

TO Honorable Mayor and Members of the City Council

SUBJECT **S&P Global Ratings Upgrades Rating to ‘A’ from ‘A-’ and Revises Outlook to ‘Stable’ on Love Field Airport Modernization Corp. General Airport Revenue Bonds – RATING ACTION**

I am pleased to share that yesterday, S&P Global Ratings (S&P) raised its rating to 'A' from 'A-' on the Love Field Airport Modernization Corp. General Airport Revenue Bonds (GARBs) issued for Dallas Love Field Airport (DAL). The outlook was also revised from positive to stable, marking the raising of the rating. S&P reports that the upgrade reflects, “the airport's recovered enplanement levels around 94% as of July 2022, improving our view of DAL's market position and the airport's overall enterprise risk profile to strong.”

S&P previously affirmed the LFAMC rating and revised the outlook to positive on August 13, 2021. From the onset of the pandemic, DAL was the first airport in the United States wherein S&P revised the rating for the better. In today’s report, S&P notes that “enplanement levels have recovered to prepandemic levels, with May 2022 enplanements slightly higher than May 2019.” Additionally, S&P believes that “DAL’s financial profile will remain stable in the near term, supported by no near-term additional debt needs, $46 million in unspent federal stimulus relief, and additional anticipated receipts from the Bipartisan Infrastructure Law.”

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,” “very strong management and governance,” as well as, “resilient financial metrics,” as evidenced by a healthy debt-to-net revenues ratio and debt service coverage (DSC) in fiscal 2021. The report also notes potential credit weaknesses, including “significant airline concentration, with Southwest, its largest carrier, accounting for approximately 96% of total enplanements in fiscal 2021” and competition from nearby airports.

The S&P report states that, although unlikely, S&P “could raise the rating within the two-year outlook period if the airport sustains its extremely strong debt-to-net revenues ratio, supporting a very strong financial risk profile.” This is a direct reflection of the resilient financial performance of DAL as the financial risk profile has remained very strong and is near prepandemic levels when enplanements were at their highest levels ever. This is positive indicator of the future financial performance of DAL and the overall strength of the LFAMC credit profile.

Please find attached the report issued by S&P yesterday. If you have any questions or need further information, please do not hesitate to contact me.

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

S&P Global
Ratings

RatingsDirect®

Summary:

Dallas Love Field Airport Love Field Airport Modernization Corp.; Airport

Primary Credit Analyst:
Alex Louie, Centennial + 1 (303) 721 4559; alex.louie@spglobal.com

Secondary Contact:
Scott Shad, Centennial (1) 303-721-4941; scott.shad@spglobal.com

Table Of Contents

Summary:

Dallas Love Field Airport
Love Field Airport Modernization Corp.; Airport

Credit Profile		
Love Field Airport Modernization Corp gen arpt rev rfdg bnds ser 2021 (AMT) due 11/01/2040		
Unenhanced Rating	A(SPUR)/Stable	Upgraded
Love Field Airport Modernization Corp AIRPORTS		
Long Term Rating	A/Stable	Upgraded

Many issues are enhanced by bond insurance.

Credit Highlights

- S&P Global Ratings raised its rating to 'A' from 'A-' on Love Field Airport Modernization Corp. (LFAMC), Texas' general airport revenue bonds (GARBs), issued for Dallas Love Field Airport (DAL or the airport).
- The outlook is stable.
- The upgrade reflects the airport's recovered enplanement levels around 94% as of July 2022, improving our view of DAL's market position and the airport's overall enterprise risk profile to strong, which we believe will support the airport's strong financial risk profile.

Security

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 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 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.

Credit overview

The upgrade reflects an improved enterprise risk profile to strong as a result of returning the market position to our pre-pandemic view of strong based on the airport's robust enplanement recovery. We expect recovered and stabilized enplanements will support DAL's strong financial risk profile. Enplanement levels have recovered to prepandemic levels, with May 2022 enplanements slightly higher than May 2019. This recovery is slightly ahead of our updated activity estimates, which expects activity levels for airports to return to pre pandemic levels by the end of calendar year 2022. In addition, we believe that DAL's financial profile will remain stable in the near term, supported by no near-term additional debt needs, $46 million in unspent federal stimulus relief, and additional anticipated receipts from the Bipartisan Infrastructure Law.

For more information, see "Updated U.S. Transportation Infrastructure Activity Estimates Show Air Travel Normalizing And It’s A Long Road Back For Transit Operators," published July 27, 2022, and "U.S. Transportation

Infrastructure Sector Update And Medians: U.S. Airport Sector View Is Now Positive," published Nov. 10, 2021, both on RatingsDirect.

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

- Role as an important provider of air service in the expanding Dallas-Fort Worth-Arlington metropolitan statistical area (MSA), along with its position as a key component of Southwest's route system;
- Resilient financial metrics as evidenced by DSC (S&P Global Ratings calculated) of 1.56 and a debt-to-net revenues ratio of 7.30 in fiscal 2021, supported by a robust enplanement recovery and no near-term additional debt needs;
- 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:

- Competition from DFW and moderate exposure to connecting traffic; and
- Significant airline concentration, with Southwest, its largest carrier, accounting for approximately 96% of total enplanements in fiscal 2021.

Environmental, social, and governance

We analyzed DAL's risks and opportunities related to environmental, social, and governance credit factors relative to its market position, management and governance, and financial performance. Health and safety risks, which we consider a social risk factor, are abating, as reflected in DAL's enplanement recovery, but are moderately negative in our analysis of the sector, given the shock that these types of events have on air travel and mobility behavior. Long-term credit stability is supported by favorable demographic trends and economic growth within the Dallas-Fort Worth MSA, and represents a social opportunity that generates demand for the system. Governance credit factors are neutral in our credit rating analysis.

Outlook

The stable outlook reflects our expectation that DAL enplanements will at least be near pre-pandemic levels supporting financial metrics (S&P Global Ratings calculated) that are consistent with a strong financial risk profile.

Downside scenario

We could lower the rating if enplanement trends weaken materially or are unpredictable due to lingering effects of the pandemic, or if we expect financial metrics will be sustained at weaker levels inconsistent with a strong financial risk profile.

Upside scenario

Although unlikely, we could raise the rating within the two-year outlook period if the airport sustains its extremely strong debt-to-net revenues ratio, supporting a very strong financial risk profile.

Credit Opinion

Dallas owns and operates DAL, Dallas Executive Airport (a general aviation airport), and a heliport, managing them through its department of aviation. It provides air transportation services for the Dallas-Fort Worth-Arlington MSA, which is the fourth-largest in the U.S. DAL competes against Dallas Fort Worth International Airport (DFW), which serves the same MSA. 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 decline in enplanements at the onset of the pandemic. We view DAL's enplanement recovery in recent months as robust, outperforming national trends, and conservative straight-line projections suggest the airport will reach 7.6 million enplanements for fiscal 2022, or 92% of 2019. As a result, we view DAL's market position as improved and the airport's overall enterprise risk profile as strong given the robust enplanement recovery.

In our view, mitigating factors of the airport's enterprise risk profile is nearby DFW, as well as airline concentration. DAL is four miles northwest of Dallas' central business district on 1,300 acres. The airport relies on Southwest airlines, with 96% market share, followed by Delta, Alaska, and Sky West.

Our opinion of DAL's overall financial risk profile is unchanged at strong, supported by resilient financial performance and a debt-to-net revenues ratio during the pandemic and no additional near-term debt needs.

This overall financial risk profile assessment incorporates our view of DAL's:

- Strong DSC, which remained within our expectations from our previous review (1.23x) with strong fiscal 2021 performance at 1.56x. We expect coverage will remain stable given a step down in debt service from fiscal years 2022-2027.
- Very strong debt-to-net revenues ratio, based on fiscal 2021 results of 7.3x, no additional debt plans, and stabilized and recovered enplanement levels. Debt amortization will step down from 2022-2027 following DAL's 2021 refunding issue. We view DAL's capital improvement plan with a manageable $466 million planned from fiscal years 2022-2027. We note that the airport just used its commercial paper program for $52.9 million.
- The airport's liquidity position is adequate, in our view, with $39.2 million in unrestricted reserves as of June 2022 (unaudited), providing 206 days' cash on hand based on estimated fiscal 2022 figures, bolstered by an infusion of federal stimulus relief with $46.0 million unspent that DAL expects will generally deplete by fiscal 2025.

S&P Global Ratings believes that momentum will likely protect the U.S. economy from recession in 2022. Our U.S. GDP growth forecasts are 2.4% for 2022 and 1.6% for 2023 (compared with 2.4% and 2.0%, respectively, in May 2022), and while our baseline forecast signals a low-growth recession, we believe the likelihood of a contraction or technical recession is increasing, to 40% (35%-45% band). The wider band reflects increased uncertainty over the

Russia-Ukraine conflict. Supply chain disruptions, worsened by that conflict and the China slowdown, remain the largest stumbling block for the U.S. economy. As inflation expectations become more entrenched, extreme price pressures will likely last well into 2023. We expect the national unemployment rate, at 3.6% in May and slightly in excess of the pre-pandemic level, will remain near that rate until early 2023 before surpassing 4.3% by the end of 2023 and 5.0% by the end of 2025 as the economy slows. The Federal Reserve is now likely to push rates to 300 basis points by year end from zero at the beginning of the year and reach 3.50%-3.75% by mid-2023. The Fed will keep monetary policy tight until inflation decelerates and nears its target in second-quarter 2024. We expect the Fed will start to cut rates in third-quarter 2024. Our lower GDP and inflation forecasts for 2023 and 2024 reflect this more aggressive policy stance. (See "Economic Outlook U.S. Q3 2022: The Summer Of Our Discontent," published June 27, 2022.)

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022