Memorandum

CITY OF DALLAS

DATE October 10, 2019

TO Honorable Mayor and Council Members

SUBJECT **Fitch Ratings Affirmed 'A' Rating and Stable Outlook for Love Field Airport Modernization Corporation (LFAMC) - INFORMATION**

Today, Fitch Ratings (Fitch) affirmed the City's 'A' credit rating and stable outlook for the Love Field Airport Modernization Corporation (LFAMC), following an annual surveillance review of outstanding LFAMC debt. The Fitch report considers Dallas Love Field Airport (DAL), the largest division of the Dallas Airport System, as well as Dallas Executive Airport and the Dallas Heliport.

According to the analysis report, the rating reflects "DAL's resilient and growing traffic base within the strong Dallas metropolitan region." The assessment of the enterprise risk profile focuses on the airport system's strong, "solid cost recovery framework," "well-defined capital plan," "conservative debt structure," and "midrange" service area strength revenue risk. Along with key rating drivers, Fitch's credit update reports DAL's enplanements reached "8.1 million in fiscal 2018, a 4.1% increase over fiscal 2017," and that "operating revenues grew by 22% in fiscal 2018 primarily from higher rental fees for terminal buildings."

Under Fitch's stress test model, the report asserts that, "Fitch views DAL as a strong complementary airport for the air trade service area," and the "airport's solid cost recovery framework should provide for continued stable financial performance." With Council support of prudent policies and judicious financial management, the outlook on the Dallas Airport System continues to be strong and stable.

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)
Bilierae Johnson, City Secretary
Preston Robinson, Administrative Judge
Kimberly Bizor Tolbert, Chief of Staff to the City Manager
Jon Fortune, Assistant City Manager
Majed A. Al-Ghafry, Assistant City Manager
Joey Zapata, Assistant City Manager
Nadia Chandler Hardy, Assistant City Manager and Chief Resilience Officer
Michael Mendoza, Chief of Economic Development and Neighborhood Services
Liz Cedillo-Pereira, Chief of Equity and Inclusion
Laila Alequresh, Chief Innovation Officer
Directors and Assistant Directors

FitchRatings

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

Fitch Ratings - New York - 10 October 2019:

Fitch Ratings has affirmed the 'A' rating on Love Field Airport Modernization Corporation, TX's (LFAMC) $222 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 Stable.

KEY RATING DRIVERS

Summary: The rating reflects DAL's resilient and growing traffic base within the strong Dallas metropolitan region. The rating also incorporates the sharp increase in traffic following the October 2014 expiration of the Wright Amendment capacity restrictions. After several years of high growth, enplanements have stabilized due to the operational constraints of DAL's terminal. The concentration risk from Southwest Airline's domination of service (92% enplanement market share in fiscal 2018) and competition from the larger Dallas-Ft. Worth Airport (DFW) airport are adequately mitigated by Southwest's long-term commitment to serving the airport, low costs, and established underlying demand. Senior lien leverage is low at 3.5x in fiscal 2018 and decreases in the rating case to 2.4x in fiscal 2023, not including any debt issuances for the capital plan. The airport's solid cost recovery framework should provide for continued stable financial performance.

Carrier Concentration Hinders Service Area Strength - Revenue Risk (Volume): Midrange

DAL is the second major domestic airport serving the economically strong Dallas-Fort Worth metropolitan region. In fiscal 2018 enplanement levels reached 8.1 million, up 4.1% from fiscal 2017. Growth is levelling due to the constraint of the airport's permanent 20-gate terminal capacity. Southwest Airlines (A-/Stable Outlook) accounts for 92% 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. Fiscal 2018 airline costs are low for a medium-hub airport at approximately $6.98 per enplanement but are expected to rise moderately over the forecast period to approximately $11 by fiscal 2023 in Fitch's rating case. Fitch notes that this cost per enplanement (CPE) level will be 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 should well accommodate projected traffic levels. The restrictive gate capacity limits capital improvements to redevelopment and modernization projects. The airport's $423 million capital improvement program for 2019-2024 is funded through federal grants, passenger facility charge (PFC) revenues, City of Dallas revenues, and future debt issuances. The amount and timing of future debt issuances is still being determined and depends on available cash and PFCs.

Conservative Debt Structure - Debt Structure Risk: Stronger

There is $222 million of general airport revenue bonds (GARBs) outstanding as of fiscal year end 2019. DAL's debt profile has all fixed-rate debt with level debt service requirements, a maximum annual debt service (MADS) of $19 million on outstanding bonds in fiscal 2020, 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.

Financial Profile

DAL's senior lien net leverage steadily declines to 2.4x in fiscal 2023 in the rating case not including future debt issuances for the capital plan. Liquidity is modest with unrestricted cash of $44.5 million or approximately 200 days cash on hand at the end of fiscal 2018. Fitch's rating case incorporates a 15% decline in enplanements assuming a recessionary environment in fiscal 2021 followed by steady recovery of 5% growth in the subsequent two years. In the rating case, the average debt service coverage ratio (DSCR) is strong at 2.4x and senior leverage averages below 3.0x throughout the forecast period. CPE is also projected to remain under $11 throughout the forecast period. The airport is in the process of determining funding sources for its capital plan and the financial profile could weaken if outsized new debt issuances are pursued.

PEER GROUP

Fitch-rated comps include Chicago's Midway Airport (subordinate lien rated A/Stable Outlook) and Detroit (DTW; A/A senior/sub/Outlook Stable). MDW serves a comparably strong, metropolitan market with a greater than 90% Southwest concentration and faces competition from a larger, nearby airport. MDW has a higher leverage profile but plays a more strategic role in the Southwest network, serving more passengers and destinations and with more daily seat capacity. DTW has a more elevated leverage profile but lower carrier concentration, no competition from a larger, nearby airport, and is not subject to gate constraints.

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Negative Rating Action: --New debt issuances that increase net GARB leverage to greater than 6.0x on a sustained basis; --A material downshift or volatility in the traffic profile given the Southwest concentration. Developments That May, Individually or Collectively, Lead to Positive Rating Action: --Positive rating action is not likely given the traffic limitations and the extremely high service exposure to Southwest.

CREDIT UPDATE

Performance Update

DAL's enplanements reached 8.1 million in fiscal 2018, a 4.1% increase over fiscal 2017. Further growth is constrained by the limitation of having only 20 gates at the airport. The airport estimates modest growth in enplanements at a compound annual growth rate (CAGR) of approximately 0.8% through fiscal 2023 based on improvements in boarding load factors and increases in the average number of seats per aircraft.

Southwest dominates services at DAL with 92% of enplanements in fiscal 2018 and full use of 18 out of the airport's 20 gates. Delta has been operating at the airport since 2009 and accounted for 2% of enplanements in fiscal 2018, currently operating on one gate it shares with Southwest. Virgin America (acquired by Alaska Airlines) started operating at the airport in 2014 and utilizes the two remaining gates. Both Alaska Airlines and Virgin accounted for 6% of enplanements during fiscal 2018.

Operating revenues grew by 22% in fiscal 2018 primarily from higher rental fees for terminal buildings. Greater fees supported the increase in debt service after the expiry of the capitalized interest periods for the 2015 and 2017 GARBs. Operating expenses declined by less than 1% in fiscal 2018. CPE currently remains low at $6.98 but has risen from $4.74 fiscal 2017 due to higher debt service requirements.

FINANCIAL ANALYSIS

Fitch Cases

The base case utilizes the forecast provided by management, which includes the 2019 and 2020 budget. From 2018 through 2023, traffic and revenue increase at CAGRs of 0.8% and 5% respectively. Operations and maintenance (O&M) expenses follow conservative budget estimates with approximately 12% growth in fiscal 2019 and fiscal 2020, followed by an inflationary growth rate of approximately 2% from fiscal 2021 to 2023. Under this scenario, leverage declines from 3.5x in fiscal 2018 to 2.4x in fiscal 2023 and the average DSCR is 2.6x.

The Fitch rating case assumes a 15% decline in enplanements in fiscal 2021 to model a recession as well as a decline in Southwest's operations, followed by 5% annual traffic growth until enplanements recover. Non-airline revenues such as parking, ground transportation, and concessions track enplanement growth rates. O&M expenses decline by 0.5% in fiscal 2021 when there is a decrease in enplanements and grow by 4% in subsequent years. Leverage decreases to 2.4x by fiscal 2023 and the average DSCR is 2.4x. CPE increases to approximately $11 in 2021 in this stressed scenario as airline revenues increase to compensate for the decline in non-airline revenues.

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.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3 -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 our ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

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

Additional information is available on www.fitchratings.com

Applicable Criteria

Airports Rating Criteria (pub. 23 Feb 2018)
Rating Criteria for Infrastructure and Project Finance (pub. 27 Jul 2018)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Policy

DISCLAIMER

COPYRIGHT

services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001
Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

Endorsement Policy

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

Fitch Updates Terms of Use & Privacy Policy