

FITCH UPGRADES DALLAS-FORT WORTH AIRPORT, TX'S JOINT REV BONDS TO 'A+'; OUTLOOK STABLE

Fitch Ratings-New York-31 May 2018: Fitch Ratings upgrades to 'A+' from 'A' its rating to approximately \$5.8 billion in outstanding joint improvement revenue bonds, issued by the cities of Dallas and Fort Worth, Texas for Dallas - Fort Worth International Airport (DFW). The Rating Outlook is Stable.

DFW has also issued approximately \$583 million in parity joint improvement revenue bonds in 2016 and 2017, sold in private placements. These debt obligations are not rated by Fitch.

KEY RATING DRIVERS

The rating upgrade reflects DFW's favourable operating and financial performance, supported by an expanding regional economy and a strengthening American Airlines hub positioning for continued growth. The airport's leverage position has declined in recent years and the airline agreement should enable the airport to maintain a stable leverage profile on a sustained basis even as they proceed with a sizable medium term capital program (still in negotiation). Airline costs are expected to remain competitive to other major U.S. hubs.

The 'A+' rating reflects the strong demand for global air travel in an expanding market, the strategic location of Dallas-Fort Worth to serve as a hub, low overall volatility in passenger traffic, competitive airline costs for a major hub, and stable coverage metrics. While metrics are expected to continue to improve longer term, the high degree of single carrier exposure, ongoing large capital programs to modernize airport infrastructure, and elevated borrowing levels may constrain the rating from the 'AA' category.

Sizable, Concentrated Traffic Base - Revenue Risk (Volume): Stronger

The stronger volume assessment reflects the positive developments from both an economic perspective within the DFW service area as well as the airport's steady expansion of passengers and operations, which collectively more than compensate for elevated carrier concentration and connecting exposures. DFW is the primary airport serving the Dallas-Fort Worth metroplex benefitting from expanding demand for air service with a current base of 33.1 million total enplanements, of which 13.7 million are categorized as origination/destination. Further, DFW's favorable central geographic location provides for a well-balanced traffic profile for both domestic and international passengers, with both components are showing expansion. DFW is primarily served by American Airlines (85% of enplanements); however, American's (Issuer Default Rating: BB+/Stable) presence has been notably stable and overall traffic has not been adversely impacted in recent years by American bankruptcy, the subsequent U.S. Airways merger, or Wright Amendment expiration at nearby Love Field airport.

Strong Rate Setting Mechanism - Revenue Risk (Price): Stronger

The current airline use agreement (which runs through 2020) allows for timely recovery of costs within all airline cost centers. The agreement also provides for adequate cash flow generation to meet all funding requirements under the bond documents as well as funding for renewal and replacement. Airline costs are currently moderate for a large-hub airport at \$11.32. However, they are projected to steadily increase to over \$15 under Fitch's base and rating cases within the next five years as airport capital spending is funded, even under conditions of modest traffic growth.

Large CIP; Additional Borrowings - Infrastructure Renewal and Development: Midrange

DFW is nearly complete with its nearly \$1.9 billion terminal renewal and improvement program (TRIP) and is transitioning to a recently developed \$3.4 billion 10-year capital plan focusing on airfield and other infrastructure redevelopment. Funding for this program includes future borrowings for 60% of the total program costs. Over the longer term, DFW will still need additional investments for its terminal facilities, a process still under negotiation with its leading carriers, in order to sustain its strong position as modern hub facility.

Fixed Rate, Conservative Structure - Debt Structure: Stronger

All of DFW's debt is issued in fixed rate mode with generally conservative debt amortization. Bond covenants and reserves are viewed as standard for a large hub airport. The airport has taken steps in recent years to amortize debt in a more accelerated schedule, providing flexibility for phasing in future borrowings as the capital program moves forward.

Financial Profile

Debt service coverage and liquidity metrics have been stable in recent years and should remain healthy for the next several years under the current airline agreement and favorable traffic performance. In fiscal 2017 (ended Sept. 30), debt coverage was 1.5x combined (including the use of rollover coverage funds) supplemented with a strong level above 700 days cash on hand. Airport leverage at 10.3x is somewhat elevated for a large-hub airport, but has steadily evolved downward from higher levels in prior years, and is anticipated to remain below 10x taking into consideration the principal amortization of existing debt and future borrowings to fund the capital program.

PEER GROUP

DFW's peers include other major hub airports with similar market and hubbing characteristics, such as Chicago O'Hare (A/Stable) and Miami (A/Stable). DFW's higher rating in part reflects its improving forward-looking leverage metrics at under 9x, which compare favourably to these two airports, where leverage is expected to remain above 10x through the forecast period. Miami's future capital needs are expected to be lower in scale relative to both DFW and Chicago, and therefore airline costs will not be facing similar upward pressures over the next decade.

RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action:

- Increases to capital spending and borrowings that result in leverage metrics remaining over 10x on a sustained basis.
- Material losses or increased volatility in aviation activity, considering the particular exposure to the operations of American Airlines.
- Changes to airline rate-setting that weaken overall cost recovery mechanisms.

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action:

- Expansion of the traffic base and carrier mix diversification.
- Development of longer term capital commitments and financing plans that indicate continued cost flexibility and leverage metrics that can still evolve below 8x on a sustained basis.

CREDIT UPDATE

Performance Update

Fitch views DFW as an airport with an important role in the national aviation system and a favorable geographic location to support its standing as a Midwestern transportation hub. Fiscal 2017 operating data indicated positive trends in enplanements (33.1 million), up 0.9% over the prior year, supported by growth in both domestic and international passengers. Connecting passengers remain the dominant component of traffic, representing nearly 59% of total passengers.

For the first six months of fiscal 2018, the airport has realized a strengthening growth rate of 4.3% while updated forecasts from DFW management indicate a robust 10% total growth by 2019. The overall performance trends is a collective indication of local economic strength, American Airlines network expansion for DFW, and the apparent limited competitive effects from the 2014 Wright Amendment expiration from nearby Dallas Love Field. Love Field has physical limitations for growth and focuses on domestic operations and therefore would continue to act as complementary airport in the greater DFW air trade service area.

American Airlines currently accounts for an 85% market share of traffic. American continues to demonstrate a strong commitment to the Dallas-Ft Worth market and is expected to remain a vital hub for its global network. DFW is American's largest hub operation, with about 800 daily departures and has historically been supported by a favorable, high average passenger yield. The current rating level assumes the combined carrier will maintain a comparable level of operation at DFW.

DFW is nearly complete with its multi-year TRIP plan with an updated overall cost of approximately \$1.9 billion at three existing terminals built in the 1970s. The airport's Terminal C facility is currently not part of the TRIP budget and DFW will likely need to make additional investments at its terminals for years to come to maintain its status as a modern hub facility. Negotiations with the airport's leading carriers are underway and these investments will likely tie into a refreshed airline agreement (currently expires in 2020).

A recently developed 10-year capital program, sized at \$3.4 billion, is moving ahead to cover airfield projects and other general airport infrastructure needs. Additional projects also cover modest terminal upgrades to add more gates to serve American's planned expansions for the next several years. Debt borrowings are expected to cover almost 60% of program costs; however, total airport debt levels should trend higher but only at a modest scale relative to the outstanding \$6.4 billion balance as accelerated debt amortization will offset a portion of future borrowings.

Financial performance under the current airline agreement is healthy evidenced by stable debt service coverage levels, competitive airline costs, and strong reserve balances. Debt service coverage (including rolling coverage accounts) has averaged about in the 1.4x-1.5x range over the past several fiscal years. Airline costs has begun to increase to \$11.28 level in fiscal 2017, and will likely exceed \$13 for fiscal 2018, but remains competitive for a large-hub international gateway airport. Airport fund balances are robust at \$858 million of unrestricted cash, translating to a very strong 715 days cash on hand. Historical airport leverage was among the highest for a U.S. airport given the debt borrowings since 2010, but has been trending downward in the more recent fiscal periods to about 10.3x is high. Fitch expects leverage to hold remain at a more steadier profile consistent with the current rating level.

Fitch Cases

Fitch's base case assumes 2.3% average enplanement growth through 2022, recognizing a higher rate of growth expectations through 2019 followed by a 1.5% average growth rate thereafter. Total revenues are expected to grow at 5.7% driven by higher charges to airlines while operating expenses are forecasted to grow at 4.5% annually through the forecast period. Under this scenario, the cost per enplanement (CPE) is likely to reach to the \$14-\$15 range from the \$11.28 level in fiscal 2017. Similarly, net debt to cashflow is now elevated, even for a major airport, at 10.3x, but will evolve to the 8x-9x range over the next several years. Under this base case, debt service coverage levels are expected to remain stable in the 1.4x-1.5x range (including the use of rollover coverage funds).

Fitch's rating case assumes a weaker -0.6% average enplanement growth through 2022, taking into account an approximately 11% aggregate loss in fiscal 2019 by assuming reductions in O&D

and connecting passengers followed by modest recovery in future years. Operating revenues are expected to grow at 6% per year while annual operating expenses are forecasted to grow by approximately 5% annually through 2022. Under this scenario, the CPE is likely to reach the \$18-\$19 range and net debt to cashflow will slowly evolve downward to just under 9x which is moderately higher than Fitch's base case forecast. Under Fitch's rating case, debt service coverage levels are expected to average above 1.4x.

SECURITY

The bonds are secured by a senior lien pledge of the airport's net revenues.

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Applicable Criteria

Airports Rating Criteria (pub. 23 Feb 2018)

<https://www.fitchratings.com/site/re/10021613>

Rating Criteria for Infrastructure and Project Finance (pub. 24 Aug 2017)

<https://www.fitchratings.com/site/re/902689>

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