FitchRatings

RATING ACTION COMMENTARY

Fitch Rates LAX Airport, CA's Sub Rev Bonds 'AA-'; Outlook Stable

Mon 20 Mar, 2023 - 1:40 PM ET

Fitch Ratings - Austin - 20 Mar 2023: Fitch Ratings has assigned a 'AA-' rating to the Department of Airports of the city of Los Angeles' (LAX) approximately $304 million of subordinate refunding revenue bonds series 2023 series A and B. The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
Los Angeles International Airport (CA) [Airport]			
Los Angeles International Airport (CA) /Airport Revenues - Subordinate Revenues/1 LT	LT	AA- Rating Outlook Stable Affirmed	AA- Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

RATING RATIONALE

The rating reflects LAX's superior credit characteristics, including a strong underlying air trade service area, significant operational activity supported by a diverse mix of domestic and foreign-flag carriers, favorable rate agreements with airlines and very strong financial metrics over time consistent with the 'AA' rating category. The airport continues to recover from the pandemic's impact, but ongoing management actions on revenues and costs coupled with LAX's sound liquidity position bolstered in part by federal assistance grant funds, have preserved its fiscal profile.

The scale of the next capital program is significant at $15 billion through fiscal 2029, and additional borrowings will be required to provide portions of the funding. While airline costs will increase measurably, intermediate-term leverage and coverage metrics are projected to remain strong and consistent with current rating levels.

KEY RATING DRIVERS

LARGE GATEWAY AIRPORT: Revenue Risk - Volume: High Stronger

Extremely strong market economics reflect LAX's status as the nation's largest origination and destination (O&D) airport as well as one of the largest U.S. international gateway airports. The airport benefits from a strong and well- developed diversity of domestic and foreign-flag air carriers. While passenger traffic and carrier expansion trends have been particularly favorable in recent years, the coronavirus pandemic has adversely impacted traffic activity and a complete recovery may still take a few years.

SOUND RATE AGREEMENTS: Revenue Risk - Price: Stronger

LAX's carrier rate agreements employ compensatory methodologies and a successor agreement extends the term for signatory carriers through June 30, 2033. While core rate setting methodologies are similar, certain additional features such as a minimum 1.40x coverage test under an extraordinary coverage protection charge, inclusive of debt service and capital availability payments as well as revenue sharing credits, collectively enhance the pricing framework.

Airline cost per enplanement (CPE) was higher than historical norms in fiscal years 2020-2022 and is expected to continue to spike given the next capital program. However, costs should remain competitive for an international gateway airport with modernized facilities and attractive yields and provide LAX needed financial flexibility during periods of volatility.

LARGE-SCALE CAPITAL PROGRAM: Infrastructure Development/Renewal - Midrange

The airport is well underway on an ambitious $12.1 billion Existing Capital Program through fiscal 2026 with a leading focus on terminal redevelopment and access improvements as well as additional airfield and terminal projects. The series 2022GHI bonds completed the funding of the existing program and the program will be two-thirds completed by the end of 2023. Recent projects have been delivered successfully despite the complex nature of works, and public private partnerships have been a component for projects related to a new car rental center and automated people mover system.

In addition to the existing plan, LAX announced the Next Capital Program, which could commence as soon as fiscal 2023 and be completed by the end of fiscal 2029. The preliminary cost estimate for these projects is approximately $15 billion with a primary focus on terminal improvements, providing new gates that would replace the outdated American Eagle terminal and most of the remote gates and improve passenger experience at LAX. Fitch's analysis assumes funding an additional $11.4 billion of future bond proceeds to fund the next program.

CONSERVATIVE CAPITAL STRUCTURE: Debt Structure: Midrange (subordinate)

All of the existing senior and subordinated long-term airport debt is fixed-rate, minimizing the risk for fluctuations in debt interest costs. Future debt issues are expected to remain in this mode. Covenants for rates and additional borrowings are relatively standard for the sector, while all of the debt service reserves are cash funded.

The pandemic led to some restructuring of debt payments, resulting in short-term savings, but to higher costs in later years in anticipation of more normalized activity performance. The availability payments for the APM and consolidated car rental center (CONRAC) projects are bifurcated for the operating and capital components and structured to support the debt financing through final maturity tied to the projects.

Financial Profile

Financial metrics such as debt service coverage, leverage and liquidity have historically been favorable but have softened with the pandemic-led traffic decline and recovery and will likely remain below historic norms over the medium-term given future borrowing needs. Under normal operating conditions, airport leverage is not particularly elevated for a large-hub airport (under 7x in most years) and over 500 days cash on hand support LAX's financial profile, but metrics could be pressured over the next few years depending on traffic performance and the timing of additional issuances. CPE is expected to more than double by fiscal 2028 according to LAX's forecast.

PEER GROUP

Comparable Fitch-rated peers include Massachusetts-Boston (AA/Stable) and San Francisco (SFO; A+/Stable) airports. Both are either international gateway or large-hub facilities with similarly strong revenue risk profiles supported by large enplanement levels and competitive airline costs coupled with sound financial metrics. LAX has stronger coverage levels and lower leverage compared with SFO, but metrics are slightly weaker compared with Boston, which has a very low debt burden for a large hub airport enterprise.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Material changes to the airport's current forecast for cost structure, cash reserve position, and/or additional indebtedness that leads to overall sustained leverage above 8x.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Given the 'AA' category rating, coupled with its large capital plan and associated borrowings, a positive rating action is not expected at this time.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

TRANSACTION SUMMARY

The proposed refunding transaction includes approximately $255 million series 2023A and $49 million series 2023B fixed rate subordinate lien bonds. The series 2023A bonds will refund $85 million in commercial paper and, together with other available moneys, the remaining senior lien series 2013A bonds. The series 2023B bonds will, together with other available moneys, refund the remaining subordinate lien series 2013B bonds.

Projected annual debt service savings increase to nearly $900,000 for fiscal years 2024-2038 from around $500,000 in fiscal 2023 before falling to $300,000 for fiscal years 2039-2043. Overall NPV savings are estimated at around $16.6 million or 7% of refunded par and the final maturity is not extended.

CREDIT UPDATE

LAX is a nationally and globally leading airport with a pre-pandemic enplanement base over 44 million. Fiscal 2021 airport traffic (YE June 30) was down 67% when compared to the same period in fiscal 2019; however, fiscal 2022 recovered to be down 31% relative to fiscal 2019. Management expects recovery to be down 19% for fiscal 2023 based on YTD traffic and forward-looking flight schedules. Domestic traffic continues to perform stronger, estimated to recover to more than 82% of fiscal 2019 for fiscal 2023, but international traffic is closing the gap, estimated to recover to nearly 77% of fiscal 2019 for fiscal 2023.

LAX's recovery level slightly lags national trends, but is generally consistent with other US international gateway airports and Fitch still views LAX as an airport with an important role in the national aviation system and a leading international gateway hub. LAX is served by a diverse mix of domestic and foreign-flag passenger carriers, and cargo operations continues to remain a strong component of aviation performance. The largest passenger carrier, Delta Air Lines, accounts for less than 21% of the airport's total enplanements.

LAX's Existing Capital Program, which spans fiscal years 2016-2026, is significant at approximately $12.1 billion and is predominantly focused on terminal expansion and redevelopment ($6.7 billion, 55%) with the next largest cost center being the APM at $1.7 billion (15%). Positively, the series 2022GHI bonds completed the funding for the existing capital plan and approximately $7.4 billion has been expended through fiscal 2022.

LAX is making considerable progress with many projects, such as the midfield satellite concourse-north, terminal 1.5, and economy parking facility open and more set to come online over the next few years as the program will be two-thirds completed by the end of 2023. Notable undertakings include new airport access and car rental center projects, both using public-private partnership approaches.

In addition to the Existing Capital Program, the department is finalizing future capital improvements at LAX that are not included in the Existing Capital Program, but are expected to be completed by fiscal 2029. These new projects could include, among others, an eight gate South Midfield Satellite Concourse, a new concourse connected to the existing Terminal 1 containing up to nine new gates, a new terminal that would contain up to 12 gates and be located on the southeast side of LAX, and various roadway and airfield improvements.

The projects in the Next Capital Program could commence as soon as fiscal 2023 and be completed by the end of fiscal 2029. The preliminary estimated cost of the projects included in the Next Capital Program is approximately $15 billion. Funding is assumed to be predominantly bond funded ($11.4 billion of proceeds), with the remainder coming from airport cash and federal grants.

LAX's past financial performance has been largely stable with high coverage ratios of total debt service coupled with robust cash reserves and moderate leverage. This accomplishment has been seen even during the past three fiscal periods where the pandemic has adversely influenced traffic and revenues. Fiscal 2022 indenture-based total debt service coverage was 2.2x (and 1.8x under Fitch's calculation of coverage, treating PFC receipts as revenue rather than debt service offsets) demonstrating a superior cushion of net cashflows, though leverage did increase to nearly 11x given additional borrowings. This elevated level is expected to be temporary and return to a level more consistent with the 'AA' category in fiscal 2023.

The overall level of coronavirus relief grants totaled $699.7 million of which $46 million remains to pay operating or debt service costs into future fiscal periods.

FINANCIAL ANALYSIS

Fitch Cases

Given that LAX's enplanement volume has not yet recovered to historical levels, Fitch's rating case is also considered the base case. The airport consultant's latest forecasts developed for LAX's series 2022GHI bond issuance and supplemented for the series 2023AB bonds, in Fitch's view, assume a conservative approach of traffic activity over the next few years and is viewed as consistent with the Fitch rating case.

Under the rating case, LAX's passenger volumes reach a near full recovery in fiscal 2024, when compared to 2019 actuals, and achieve modest annual growth of less than 2% thereafter. Fitch-calculated total coverage levels through 2030 average about 1.8x, while airline costs rise to almost $56. Sustained leverage remains at or below 7x after peaking briefly at 7.4x in fiscal 2024.

Fitch also ran a downside scenario, showing a slower pace of recovery to 82% and 94% for fiscal years 2023-2024, respectively, relative to 2019 before achieving a full recovery in fiscal 2025 with modest annual growth thereafter, similar to the rating case at less than 2%. Under this scenario, the debt service coverage ratio and leverage profile (averaging 6.9x) are modestly weaker relative to the rating case and CPE levels would be nominally higher in each year to generate these results.

Fitch also assessed the airport's overall coverage metrics, considering the AP payments for the public-private partnership APM and CONRAC financings where such payments are expected to now begin in fiscal 2023. Under both the rating and downside cases, Fitch anticipates the overall coverage levels to remain in the 1.5x-1.7x range. This should allow for ample annual contributions for pay-go capital spending. Both cases also include bond funding an additional $11.4 billion of proceeds through fiscal 2029.

DATE OF RELEVANT COMMITTEE

18 July 2022

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means 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 Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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APPLICABLE CRITERIA

Infrastructure and Project Finance Rating Criteria – Effective Aug. 23, 2021–July 20, 2022 (pub. 23 Aug 2021) (including rating assumption sensitivity)

Transportation Infrastructure Rating Criteria (pub. 16 May 2022) (including rating assumption sensitivity)

Infrastructure & Project Finance Rating Criteria (pub. 20 Jul 2022) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

GIG AST Model, v1.3.1 (23 Aug 2021, 20 Jul 2022)

ADDITIONAL DISCLOSURES

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Los Angeles Department of Airports (CA)	EU Endorsed, UK Endorsed

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