FitchRatings

FITCH RATES DENVER, CO'S $341MM SERIES 2011A AIRPORT SYSTEM REVENUE BONDS 'A+'; OUTLOOK STABLE

Fitch Ratings-New York-31 March 2011: Fitch Ratings assigns an 'A+' rating to the City and County of Denver, Colorado's $341 million series 2011A airport system revenue bonds issued on behalf of the Department of Aviation (DIA). Fitch also affirms the 'A+' rating on approximately $4 billion of parity bonds. The Rating Outlook is Stable.

The 'A+' rating reflects the following credit characteristics:

--DIA is the primary airport for a large air trade service area and serves as a major hub for United and Frontier. In addition, Southwest has increased its presence at the airport in recent years offsetting reductions by other carriers. The origination/destination (O&D) share represents 56% of total traffic. Despite continued volatility in the aviation industry and capacity trimming by carriers, traffic performance at DIA has been more resilient than most other large-hub airports with enplanements declining a modest 2% in 2009 followed by a positive rebound of 4% in 2010. The airport has an elevated level of service dependence from three carriers (United Continental, Southwest, and Frontier) that together accounts for over 80% of enplanements, leaving DIA vulnerable to ongoing airline scheduling decisions.

--Strong total cost recovery terms that are provided for based on a hybrid use and lease agreements which is compensatory in the terminal and residual on the airfield. The agreements include provision for sharing of surplus revenues with the airlines as well as a 'safety net' for coverage purposes. The use agreement with United runs through 2025 while the agreements with the other major carriers are currently on a one-year extension through December 2011. Airport cost per enplanement (CPE) has been stable in recent years and was $11.24 in fiscal year (FY) 2010. Fitch recognizes DIA's use of passenger facility charges (PFCs) to stabilize airline costs and views the CPE levels to be competitive with many other large hub airports.

--DIA has one of the highest debt burdens for a U.S. airport with aggregate debt outstanding of approximately $4 billion with potential for additional issuance of approximately $900 million expected under the current capital improvement program (CIP). The high debt level is partially mitigated by growing enplanement levels which produce a debt per total enplanement ratio of $152. Cash flow available for debt service to net debt of 7.37 also consistent with a large hub airport in this rating category.

--Approximately 23% of the outstanding debt is variable rate most of which is hedged via a series of swap transactions which provides some exposure to counterparty and renewal risk as well as debt interest cost stability.

--The current CIP requires close to $900 million in additional borrowing through 2016 which could reduce financial flexibility and result in higher airline rates and charges at current traffic levels. Fitch notes the capital program has measurably increased since Fitch's last review in February 2010. Portions of the proposed CIP funding are for projects that may not generate new revenues or have higher risk features, such as the planned on-site hotel. Management has represented to Fitch its plans to issue the majority of the new debt on a subordinate basis. Deviations from this financing plan may have credit implications.

KEY RATING DRIVERS:

Future rating actions are likely to be influenced by the following:

--Traffic performance that is largely driven by the service of DIA's three dominant air carriers.

--Continued commitment to use a substantial portion of the PFC revenues for the repayment of debt service beyond current authorizations that end in 2013.

--Ability to maintain healthy financial coverage and cost metrics despite the current plans to issue up to $900 million in additional debt using both the senior lien and potentially a new subordinate lien.

SECURITY:

The outstanding bonds are secured by a senior lien on the net revenues of DIA.

CREDIT SUMMARY:

The airport system's use and lease agreements utilize a strong compensatory methodology for setting fees and charges in the terminals and residual methodology at the airfield facilities, which together have resulted in sound financial operations during years of traffic expansion. The rate setting structure has allowed the airport to build sound debt service coverage levels on all debt in excess of 1.60 times (x) while similarly providing annual credits to the signatory carrier charges of up to $40 million per year. However, Fitch notes that over 50% of total operating revenues are derived from airline payments, a level generally above average for a large-hub airport. Such proportional share of airline contribution will continue in future years due to the airport's high fixed costs. Concession revenues also contribute nearly 30% of airport revenues while annual PFC collections in excess of $95 million are applied to offset debt service payments. Calculating debt coverage using PFCs as revenue, not as an offset, would adjust coverage down closer to 1.40x.

Taking into account the large growth trends in passengers since the early part of the decade, the CPE has trended downward. The fiscal 2010 CPE is estimated at $11.24 as compared to over $15 in 2002. Fitch notes the updated $933 million CIP will be largely debt financed and could pressure CPEs at the current enplanement level. However, the consultant's forecast, based on both low traffic growth rate assumptions and issuance of nearly $900 million of additional debt obligations indicate the CPE below $14 through 2018. Any unanticipated or sustained declines in traffic given the current market conditions could either exacerbate the increases in CPE or lead to tighter financial flexibility.

Nearly half of the cost for the proposed CIP is related to the airport's South Terminal Redevelopment Program, which consists of a DIA Rail Station with public circulation space and two RTD tracks. The South Terminal Redevelopment Program also includes a 500 room full service hotel above the DIA rail station. DIA plans to finance the debt portion of the CIP using both its existing senior lien and a proposed subordinate lien. Fitch notes that the South Terminal projects may not be financially accretive to the airport's net margins and could result in ratings pressure should actual performance not meet expected cash-flow projections.

The airport serves not only as the primary commercial airport for the Denver metropolitan area, but for the entire eastern Rocky Mountain area in general, providing natural regional connecting traffic to complement the national hubbing operation of United. Overall, the scheduled carriers provide non-stop service to a relatively large 168 domestic and international destinations. The airport served a record 26.1 million enplaned passengers in 2010 up 4% from 2009. Originating passengers accounted for approximately 54% of total enplanements, representing an adequate local component of overall traffic for a major connecting hub facility.

United remains the airport's largest carrier, although its aggregate share of enplaned passengers declined to 44% in 2010 versus 59% in 2004. While United's dominance continues to diminish, the airline still represents the largest contributor to airline-based operating revenues, thus its scheduling decisions could significantly influence the overall financial operations of the airport. United closed on its merger with Continental on Oct. 1, 2010; in the United and Continental airlines system DIA ranks as the fourth busiest airport in terms of 2009 enplaned passengers. Airport management does not expect the merger to have a material impact on operations at DIA. To date, United's service reductions at DIA have not been as severe as UAL's overall system cutback in operations.

Denver-based Frontier has steadily increased its share of passengers at DIA to over 21% in 2010 up from 16.7% in 2004 and serves to offset the dominance of United. Frontier was acquired by Republic Airways Holdings in October 2009 following Frontier's Chapter 11 bankruptcy filing in 2008. Frontier assumed its lease at DIA during its Chapter 11 bankruptcy and has maintained a market share of over 20%. The number of passengers enplaned by Frontier at DIA declined 11.5% and 1.8% in 2009 and 2010 respectively. The reduction is partially the result of the economic recession as well as seating capacity reductions by Frontier at DIA. Although Frontier is expected to retain its large presence at Denver, the level of service and business strategy may be subject to changes as result of the Republic acquisition.

The airport's third largest carrier, Southwest Airlines, also continues to aggressively grow its market share at the airport. After resuming service at the airport in January 2006 following a 20 year hiatus, Southwest provided 18.1% of total enplanements in 2010, up from just 5.3% in 2007. Fitch expects Southwest to at least maintain its current service level at DIA although capacity reductions are a possibility given the current challenges in the aviation sector.

Following the issuance of the series 2011A bonds, the airport's capital structure will include $904.7 million in variable rate exposure which translates to approximately 23% of the nearly $4 billion in total revenue debt. Much of the variable rate bonds have associated interest rate swaps for purposes of hedging interest costs. Fitch notes that the debt restructuring actions taken by the airport since 2008 to address weakening counterparty credit have provided greater stability with regards to interest rate resets for the outstanding debt. Still, the large balance of variable rate exposure and swaps agreements could lend to future rate volatility and ongoing risks to counterparty performance. Thus, management of the debt portfolio will remain an important consideration to the airport's credit.

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Applicable Criteria and Related Research:
--'Rating Criteria for Infrastructure and Project Finance,' (Aug. 16, 2010);
--'Rating Criteria for Airports,' (Nov. 29, 2010).

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http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=548345
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