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Fitch: Chicago O'Hare Airport Inks New Airline Agreement.

Fitch Ratings-New York-11 April 2018: The City of Chicago and the leading carriers serving O'Hare International Airport will begin to operate under a new airline use and lease agreement (AUL) starting in May 2018, which Fitch Ratings views as an essential step to allow the airport to address both the modernization and the expansion of the airport to serve long-term growth for domestic and international service, as well as hub activities for United Airlines and American Airlines.

The underlying long-term capital plan working in tandem with this airline agreement is substantial in size at $8.5 billion and will take nearly a decade to complete. Given the limitations of external funding resources, O'Hare will likely assume a considerable addition of future borrowings, resulting in elevated leverage and airline costs for many years. Further, a capital program of this size will carry considerable cost and execution risks as the budget could evolve upward. Still, the leading domestic and foreign-flag carriers have approved the new lease, including the associated capital plan, and therefore recognize both the value and the cost implications to maintain service in a strong Chicago market.

The new AUL, which replaces a legacy 35-year agreement, will extend through December 2033 and will continue to utilize credit supportive residual rate setting mechanisms. Airport costs will be recovered primarily through the landing fees and terminal rents at a sufficient level to meet all bond indenture requirements. At this time, Fitch has not reviewed any new financial or cost forecasts associated with the new AUL and the approved capital plan. Excluding the newly approved capital plan, O'Hare's airline cost per enplanement (CPE) was already forecast to rise from the current $15 level to over $25 in approximately five years under Fitch's rating case scenario. The new capital plan will only exacerbate the degree of cost increases and likely place O'Hare as one of highest cost airports in the U.S. and a much higher cost level versus the city's Midway Airport. Fitch notes that a number of other international gateway airports, including those serving the New York, Los Angeles, and San Francisco regions, are facing steep increases to airport costs but have not experienced adverse demand shifts as a result given the market strength.

Key financial-related modifications covered under the new AUL include gradual increases to the minimum annual debt service coverage levels from 1.10x to 1.25x by 2021. Further, the airport will add a supplemental operating and maintenance reserve fund reaching a funding level of 25% of annual operating costs by 2025. As O'Hare's cost base rises in conjunction with potential service growth and the capital spending under the approved plan, Fitch views these revisions as a prudent development since they collectively provide additional financial cushion in case of adverse operating developments.

Leverage related risks have been a key consideration in the 'A' rating of O'Hare airport. Even ahead of the new capital expansion plan, O'Hare already had an elevated leverage position of nearly 10x net debt to cashflow available for debt service, reflecting the approximately $7.3 billion of existing debt. Airport debt has increased sizably over the past decade to defray the capital costs for the reconfiguration of the airfield with new and extended runways. Additional debt to fund this capital plan will likely keep overall airport leverage above the current 10x level for many years. The 'A' rating could be pressured to the extent there is a sustained upward shift in leverage.

The upcoming transition to a capital program focused on the airport terminals is a logical next step for the overall airport infrastructure. Terminal-related capacity constraints exist at O'Hare given the lack of meaningful gate expansion for some time coupled with the limitations of exclusive-use gate leasing under the prior agreement. The approved terminal area plan, with a current estimate of $6.1 billion, will ultimately result in a dramatically reconfigured layout of the terminals, including new concourses and approximately 25% more gate capacity. The new airline agreement will lease gates to the carriers under preferential and common use terms, a more common practice at many of the other U.S. large-hub airports, which provides more control to the city to ensure higher utilization as well as to support service opportunities for new entrants.

In Fitch's view, the new terms under the updated airline agreement are fundamental to the airport's modernization plans while operating under a partnership approach with the airlines. The overall financial integrity of the airport should remain sound given the provisions to boost coverage levels and operating reserves. Effective implementation and successful delivery of a capital program of this size will be among the greatest challenges while airport leverage will be sustained at relatively high levels.

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