THE BOND BUYER

O'Hare deal launches massive terminal rebuild

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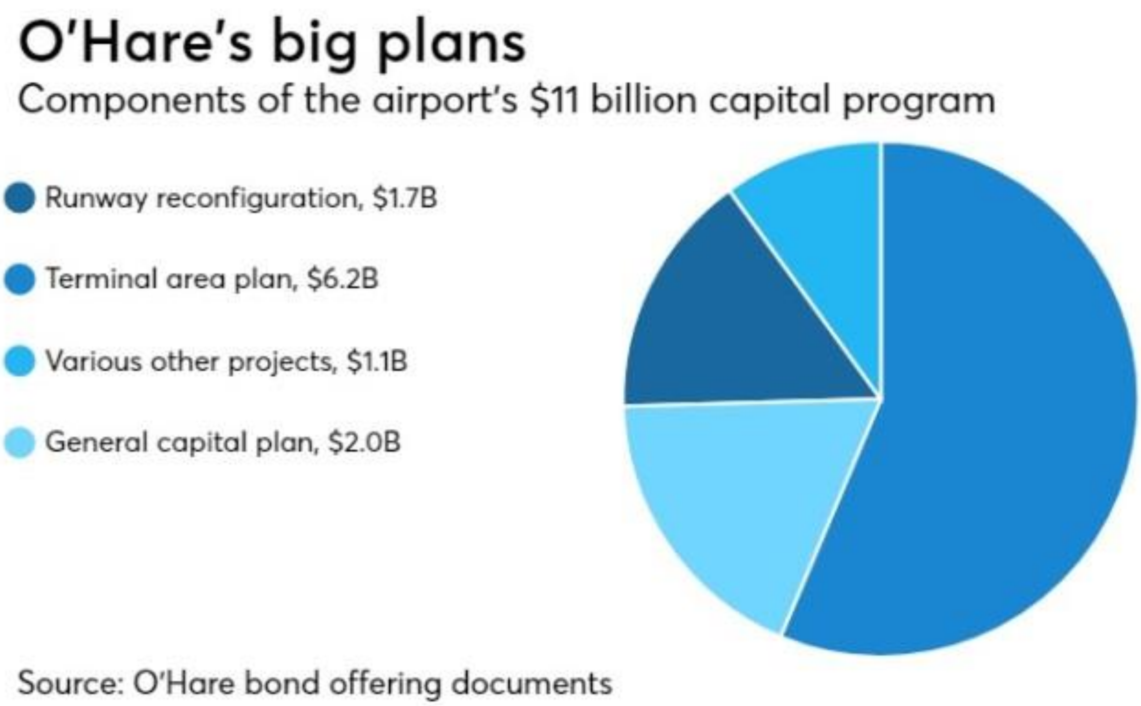
CHICAGO — Chicago will kick off its $8.5 billion, airline-approved terminal makeover of O'Hare International Airport with a $1.85 billion bond issue in early December with plans to return in the coming years with billions more.

The issue marks the city's first use of an initial $4 billion of borrowing approved by the City Council earlier this year as part of the city's new airline use and lease agreement reached with signatory airlines to paves the way for the makeover.



The expansive plan calls for the redevelopment of existing terminals, the expansion of the existing international terminal, new satellite concourses, and the demolition of one domestic terminal to replace it with another global terminal to smooth international and domestic connections.

“The agreement is designed to support airport expansion and to elevate O’Hare into a global gateway,” Chicago’s chief financial officer Carole Brown said in a recorded investor presentation. “The agreement supports the largest capital expansion in the airport’s history. As part of that expansion the city is making a series of investments in terminals and the core airport design to increase capacity, connectivity and growth to meet passenger demand.”

The deal is equally divided into a tax-exempt series of senior lien general airport revenue bonds not subject to the alternative minimum tax, a tax-exempt GARB series subject to the AMT, and a taxable GARB series. The final maturity is expected to be in 2054.

Ahead of the sale, Fitch Ratings and S&P Global Ratings affirmed their A ratings for O’Hare GARBs. Kroll Bond Rating Agency affirmed its A-plus rating. All three assign a stable outlook is stable.

GARB debt will rise to $9.2 billion after the sale with the airport’s overall debt portfolio also including $520 million of outstanding passenger facility charge backed bonds and $220 million of customer facility charge debt. Long term, management forecasts that outstanding principal will peak at $18.8 billion in fiscal 2025 when accounting for additional borrowing for capital projects, some of which are not currently authorized, according to Kroll.

The deal is slated to price Dec. 5 with investor meetings scheduled late next week in Boston and New York. JPMorgan is running the books with more than 20 firms serving rounding out the syndicate. Frasca & Associates LLC and Swap Financial Group are advisors. Mayer Brown LLP and Neal & Leroy LLC are bond counsel.

Bond proceeds will finance capital projects, retire a portion of the $223 million of debt outstanding under $600 million in commercial paper and credit lines, refund $26.6 million of 2008 bonds, and fund capitalized interest and reserve requirements.

The airport capital program totals “approximately $11 billion in escalated dollars and will be funded through the issuance of these 2018 bonds and future bonds totaling over $9 billion,” Brown said in the investor presentation. The numbers are in escalating dollars accounting for inflation.

The 15-year, $11 billion program includes $9.4 billion of projects to be funded with borrowing, grants, and passenger facility charges and $1.6 billion already funded.

The $9.4 billion figure includes the $6.2 billion first phase of the terminal area plan, referred to as TAP. The airport’s $2 billion capital improvement program that covers various gate projects and non-TAP projects are also included as are another $774 million for various gate projects and $355 million for remaining projects under the current O’Hare Modernization Program that is nearing completion. It reconfigured and expanded the airport’s runways.

The city projects $1 billion to $2 billion of debt issuance annually through 2024. The expansion is expected to raise the number of gates to 220 from the current 191.

The terminal overhaul got off to a rough start. Texas-based American Airlines, one of O'Hare's two hub carriers, initially opposed it accusing the city of favoring Chicago-based United Airlines on gate allocations. American dropped opposition after the city agreed to speed up construction of several gates that will benefit American.

A total of 17 airlines signed off on the new 15-year lease led by United and American, which together account for about 80% of flights. O'Hare operations account for 17% of United's profits and 13% for American. Another 17 airlines signed a five-year agreement. Five airlines are not signatory participants.

In addition to covering the costs of operations and debt, under the lease agreement the bond indenture is being amended to allow for an incremental increase in debt service coverage to 1.25 times by 2021 from a current 1.10 times and it establishes a supplemental reserve for operations and maintenance that grows to 25% of the operations/maintenance expenses by 2025.

The new lease gives the city more planning flexibility with a "negative majority-in-interest" veto on projects, that requires agreement from 70% of long-term signatory airlines measured either through landed weight for airfield-related projects or terminal fees and charges for terminal related projects to block a project.

"Fitch views this agreement as an essential step to allowing 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 and American," analysts wrote.

RISING DEBT SERVICE

Rising debt to fund the program will drive up maximum annual debt service to $1.4 billion in 2040 from the current $583 million.

The airport's material strengths, rating agencies say, include rising traffic levels that rose 2.4% last year to 39.8 million and the airport's significant to the national and international travel grid. They helped offset the negatives of a rising debt load that could have driven a downgrade.

Passenger traffic is projected to grow at a rate of 1.1% through 2029, hitting 41.4 million by 2025. It's up 4.9% for the first eight months of the fiscal year.

"The ratings reflect our opinion of the airport's extremely strong enterprise risk profile, adequate financial risk profile, and significant additional borrowing plans," said S&P analyst Kevin Archer. "The stable outlook reflects our expectation that ORD's enplanement trends will remain generally stable and management will maintain coverage at or above 1 times" based on S&P's calculation.

Airline costs are high at $16.63 per enplaned passenger in 2017 and are projected to rise to $42.83 in 2029.

“KBRA’s concerns regarding this elevated level are tempered by the lucrative nature of American and United routes at ORD, and the benefits of reduced airfield and terminal delays, increased national airspace capacity, and savings to the airlines. KBRA also believes this forecast is conservative," it wrote.

Fitch too said the rising debt is mitigated by “the airlines pre-approval for the overall capital program as well as the residual agreement with stronger financial covenants that will go into effect in conjunction with this bond issue.”

The threat of a Fitch downgrade tied to concern over a Puerto Rico court ruling has eased. Fitch warned that court ruling in Puerto Rico's Title III bankruptcy earlier this year that dismissed claims on repayment of Puerto Rico Highways and Transportation Authority debt could damage special revenue credits rated above a municipality's issuer rating. Fitch rates O'Hare GARBs A while it rates Chicago's general obligation debt BBB-minus.

“While the outcome of the litigation could result in modifications to Fitch's approach for certain public finance sectors, Fitch believes that bonds issued by municipalities secured by a pledge of airport revenues have particularly strong protections for bondholders under federal laws and therefore negative credit implication are unlikely,” analysts wrote in the new O’Hare review.

Moody’s Investors Service, which rates the airport debt at A2 but was not asked to rate the new deal, warned earlier this year that the higher leverage tied to the makeover could damage the airport’s competitive edge and labeled it a credit negative.

Chicago’s airport credits have fared well in the market compared the city's general obligation credit.

A March report on the airport sector from Janney reported Chicago’s spreads were at about 36 basis points to the Municipal Market Data AAA benchmark, slightly higher than the Los Angeles and Atlanta airports, which are both rated in the double-A category.

A 10-year non alternative minimum tax maturity with a 5% coupon on an O’Hare June 2017 sale for $812 million landed at 2.3%, a 44 basis point spread to the market opening Municipal Market Data’s AAA benchmark with a long 2041 non-AMT, 5% coupon maturity landing at 3.28%, a 65 bp spread.

A 10-year maturity on Chicago’s $1.1 billion O’Hare sale just after the 2016 presidential election landed at an 82 basis point spread to the MMD top benchmark. In a $1 billion sale just before the election, the 10-year landed at a spread of 58 basis points. Both were in non-AMT series.