PIPER | SANDLER

AUGUST 30, 2023

Airport Discussion & Review

Tim Oswald
MANAGING DIRECTOR
Tel: +1 515 247-2358
Timothy.oswald@psc.com

John Coan
MANAGING DIRECTOR
Tel: +1 202 463-1966
Email: john.coan@psc.com

The Airport's request

Des Moines International Airport Authority has requested Polk County issue up to $350M of General Obligation bonds, and lend the proceeds to the Authority.

The Airport intends to repay the loan out of general airport revenues which include parking revenues, payments from various tenants including airlines, rental car companies and concessionaires

The airport currently proposes to borrow money in two or perhaps three installments – 2024 and 2025 and maybe 2026 – hopefully commensurate with when the County is otherwise selling bonds

The Airport is interested in this approach in order to allow it to borrow at much cheaper interest rates than it would otherwise borrow at, using the County's much higher credit rating

The Airport indicates that the reduced cost of borrowing will flow through to the cost per enplanement that is paid by airport customers which will allow it to remain competitive relative to other airports thereby attracting additional airline service.

Background

The Airport Authority exists under Iowa Code Chapter 330A

- One or more municipalities may create an authority
  - Created by the City of Des Moines
- Board of five members
  - Appointed by the City of Des Moines

The City cannot withdraw from the Authority if there are obligations (i.e. debt) outstanding

In creating the authority in 2011, the City provided the assets and liabilities of the City's airport department to the Authority. The assets transferred via two separate documents

- Real Estate Lease and Asset Transfer Agreement
  - Essentially leases all land ($1/yr) to Authority, including any future land acquired by the Authority (all future land and buildings must be titled in the name of the City)
  - Requires DSM police and fire protection(is Fire in the agreement) be the contract providers to the Authority
  - Terminates if the Authority dissolves, or otherwise terminates on 12/31/2110
  - Ownership of land and assets reverts to City at termination of land lease
- Assignment and Assumption Agreement
  - Creates the authority; directs the formation of the Board;
  - Transfers airport revenue, funds, balances and employees from City to Authority
  - Transfers all equipment and personal property of the Airport to the Authority

We understand that the Authority's debt obligations have been extinguished at this time

The Proposed loan terms

Proposed loan terms:

- These bonds would be the only debt of the Authority (is this a requirement or statement about current condition)
- Authority will carry a debt service reserve of at least one year's P&I owed to County; or Airport will carry cash on hand at an agreed upon level
- Authority will have restrictions on incurring additional debt consistent with standard airport revenue bond offerings
- Authority will not be allowed to offer property security interest to any other lender (i.e, mortgage its assets or offer a leasehold interest)
- No future debt will be allowed with a claim on airport revenues superior to this loan
- Subordinate debt will be allowed consistent with standard airport revenue bond offerings
- 30-year loan amortization (20-yr bond with a balloon payment in year 20)

Rates and charges will be set annually at levels that allow airport to operate, pay debt service and fund annual capital maintenance costs.

Open issues

Airport revenues must remain at the airport. An airline use and lease agreement dictates the size of the capital program. Terminal rental rates must be reasonable so building up cash is somewhat restricted.

- What to do with surplus cash of the airport
  - Authority's financing model contemplates surplus after debt and capital maintenance
    - On one hand, prepaying debt makes sense
    - However, having sufficient liquidity is helpful when unexpected expenses arise
    - However, having too much cash might cause someone to want to spend the cash in a way that the County would not be pleased with
- Whether Passenger Facility Charge (PFC) and Customer Facility Charge (CFC) debt restrictions are warranted

We will work with airport team to find approach that appropriately restricts cash, but still allows an appropriate cushion for unforeseen and downturns.

The Risks

- Markets change from time to time
  - Demand for air travel can vary over time particularly in times of economic recession (Airline utilization could change)
  - Concern over climate change could negatively affect demand for air travel (Environmental concerns could cause flight utilization to decline over the long-term)
  - Airlines may reduce seat capacity in and out of Central Iowa thereby potentially reducing operating revenues
  - General demographic trends could alter people moving to, living in or doing business in Central Iowa
  - Other unknown or unidentified risks
- If a recession, depression, pandemic or similar disruption occurs, airline travel could meaningfully decline.
- The County's GO bond rating could decline as a result of the increased debt load.
- The requested finance plan contemplates a balloon payment in year 20, which would necessitate a refinancing sometime after year 10, but before year 20, to stretch the payments out to 30 total budget years.
  - This risk could be offset by escrowing surplus cash

The impact on taxpayers if the tax has to be levied

While we recognize that the airport intends to repay the loan (no governmental U.S. airport has ever failed to make a debt service payment when due), the key risk to taxpayers of the County is if the airport is unable to generate sufficient revenues to pay for operating costs and debt service. In that event, the tax might need to be levied, in part or in full, to retire the bonds.

- A $1M tax levy is $0.0298
- Current estimated P&I on $350M is $22.5M annually, which would be $0.671 tax rate increase

Mitigating the risk

- Restrict a portion of surplus cash toward additional liquidity or retiring the Loan early
- Perhaps seek bond insurance, if available and reasonably priced, to back-stop payments from the airport under the airport loan agreement
- Perhaps seek some support from State of Iowa

Other Options the Authority has considered to finance the project

The Authority can issue General Airport Revenue Bonds on their own

- Likely have interest rates that are about 0.6% higher than County GO rates
  - About $3M annual increased cost when compared to GO bond interest rates
- Since airport intends to repay debt, this increased cost would cause cost per enplanement to be higher than the cost would be with GO bonds (airport intends to pay the debt out of user fees)
- Authority believes that cost per enplanement is a key factor for certain carriers evaluating whether they can come to, remain in or expand service in Central Iowa

What about P3 structure?

- P3 would require a third party who would operate and finance the airport (essentially take over and act as the Authority, but in a for-profit structure)
- Several airport P3's previously put in place have cancelled or terminated at this time
- Authority is already constructing project, following Iowa's public bidding laws for construction
- Airports and third-party operators realized that there isn't any meaningful savings to the operating part of the P3 structure
- In this case, it appears that the City would have a say in whether a P3 is allowed

The Financial Model

Background

The Airport operates with a cash waterfall structure as it relates to receipt of Aviation System Revenue. Under the terms of the Master resolution (that transferred the assets to the Authority) – the flow of funds is as follows:

Gross revenues incoming (excludes CFC's and PFC's)
1. Operating and maintenance expenses
2. P&I on Senior Bonds
3. Create or maintain balance in Senior Bond debt reserve fund
4. P&I on Subordinate bonds (if any)
5. Rebate fund (if IRS rebate is required for any particular reason)
6. O&M reserve fund (15% of total O&M expenses in most recent budget)
7. P&I on City-issued GO bonds
8. Surplus

We understand there are no Senior Bonds, no Subordinate Bonds and no GO bonds at this time.

The model assumes Cost Per Enplanement (CPE) of $17.79 in 2027 (the model assumes usage that is 3% annual increase over estimated 2023)
Coverage on debt is 1.8x in 2027, with the airport generating about $16M of cash surplus

If one stress tests by reducing usage by 15%, then CPE increases to $21.43 in 2027.
Using this assumption, coverage on debt is 1.56x in 2027, with the airport generating about $10M of cash surplus

At a stress test of 25% reduction, CPE is $25, coverage is 1.43x and surplus cash after debt is $8M.

How much cheaper is it for the Airport with County GO's

- We assume current interest rates for tax-exempt debt that is subject to the Alternative Minimum Tax (AMT), plus 0.5% for market timing.
- We assume that 50% of the debt would be AMT, private use; the interest cost on the balance of debt would be subject to federal taxation
- We assume debt issued $100M in 2024 and $250M in 2025
  - For the GO bond, we assume a repayment of 20 years (2044), based on an original amortization of 30 years (29 years for the 2025 bond)
  - We assume a refinancing in 2044 for 10 years of the remaining balance due on the GO bond (using same rate calculation noted above)
- For the airport revenue bond, we assume a repayment of 30 years (from 2024)
- We assume bond issuance costs
- No principal be paid on the bond until 2026 (upon project completion)
- We come up with annual P&I on the GO bond of $23.5M
- We come up with annual P&I on the airport rev bond, net of interest earnings on and the release of the debt reserve, of $26.6M
- Resulting in savings to the airport authority of $76M over 30 years, or a present value savings of $47M
- Authority calculates that every $1M reduction in annual P&I lowers enplanement costs by about $0.33.

The Airport's management letter

Management targets 6-12 months of cash on hand for operating liquidity

Coverage compliance statement (though no debt is outstanding)

Capital improvement plan projection

Discussion of key legal documents

Discussion of any management strategies or expectations

Indicates that the revenue estimate will be sufficient to cover operating costs, debt P&I and adequate cash set-aside for pay-go capital improvements

It takes about 3-6 months to complete the letter at this time

Can wait until the County is actually ready to lend money to the Authority (i.e, after the election, but prior to when County sells 2024 bonds)

Letter is completed by an Airport Financial Advisory firm and is a common practice for airports to complete prior to debt issue

Real Estate lease and other City imposed terms

City transferred airport assets to the Authority pursuant to the two previously discussed documents. Lease period terminates in 2110.

The Lease was subordinated to the 2010 bonds, but it is not clear that it is subordinated to any other debt (the 2010 bonds have been retired). Clarity as to subordination of the Lease is necessary.

The terms of the Services Agreement between the City and Authority appears to continue at this time for Police services only

At termination, real estate and buildings transfer to City (as do all obligations therein)

Careful legal review of documents on behalf of County is necessary, should the County get to the point where it is considering lending money to the Authority

Disclosures

Piper Sandler is providing the information contained in this communication for discussion purposes only, and it is not intended to be and should not be construed as "advice" within the meaning of Section 15B of the Securities and Exchange Act of 1934. Nothing contained herein is intended to and should be construed to give rise to a municipal advisory, financial advisory or fiduciary relationship. In conveying this information, and unless circumstances otherwise indicate, Piper Sandler is presumptively acting as an underwriter or placement agent, in which Piper Sandler's primary role is to purchase securities for resale to investors or arrange for the placement of securities in an arm's-length commercial transaction between the Client and Piper Sandler. As underwriter or placement agent, Piper Sandler has financial and other interests that differ from those of the Client.

The information contained herein may include hypothetical interest rates. Interest rates used herein take into consideration conditions in today's market and other factual information such as credit rating, geographic location and market sector. Interest rates described herein should not be viewed as rates that Piper Sandler expects you to achieve. Information about interest rates is based on current publicly available information. Interest rates change from time to time.

Piper Sandler Companies (NYSE: PIPR) is a leading investment bank and institutional securities firm driven to help clients Realize the Power of Partnership®. Securities brokerage and investment banking services are offered in the U.S. through Piper Sandler & Co., member SIPC and NYSE; in Europe through Piper Sandler Ltd., authorized and regulated by the U.K. Financial Conduct Authority; and in Hong Kong through Piper Sandler Hong Kong Limited, authorized and regulated by the Securities and Futures Commission. Asset management products and services are offered through separate investment advisory affiliates.

©2023 Since 1895. Piper Sandler Companies. 800 Nicollet Mall, Minneapolis, Minnesota 55402-7036