



Letter of Intent Program

January 2002

A KEY FUNDING SOURCE FOR AIRFIELD PROJECTS

Airports are extremely capital-intensive, requiring investment in facilities from all available sources, including federal grants, passenger facility charge (PFC) revenue, retained airport revenue, and revenue bonds (including general airport revenue, PFC revenue, and special facility revenue).

Airport sponsors using federal grants to help fund large-scale airfield improvement projects typically face challenges that can be addressed by receiving letters of intent (LOIs) from the Federal Aviation Administration (FAA) and leveraging the amounts to be received under an LOI:

- Discretionary grant amounts are determined annually and are not known ahead of time. LOIs specify annual grant amounts that the FAA intends to provide for specific project(s) (subject to future budget authority), usually over

a 10-year period. LOIs reduce uncertainty about the amount airport sponsors will receive.

- Project costs are usually concentrated in the near term and do not match LOI amounts that are spread over time. To address this challenge, certain airport sponsors are leveraging their LOIs, i.e. issuing debt to provide up-front funding and repaying the debt from grant funds received under the LOI.

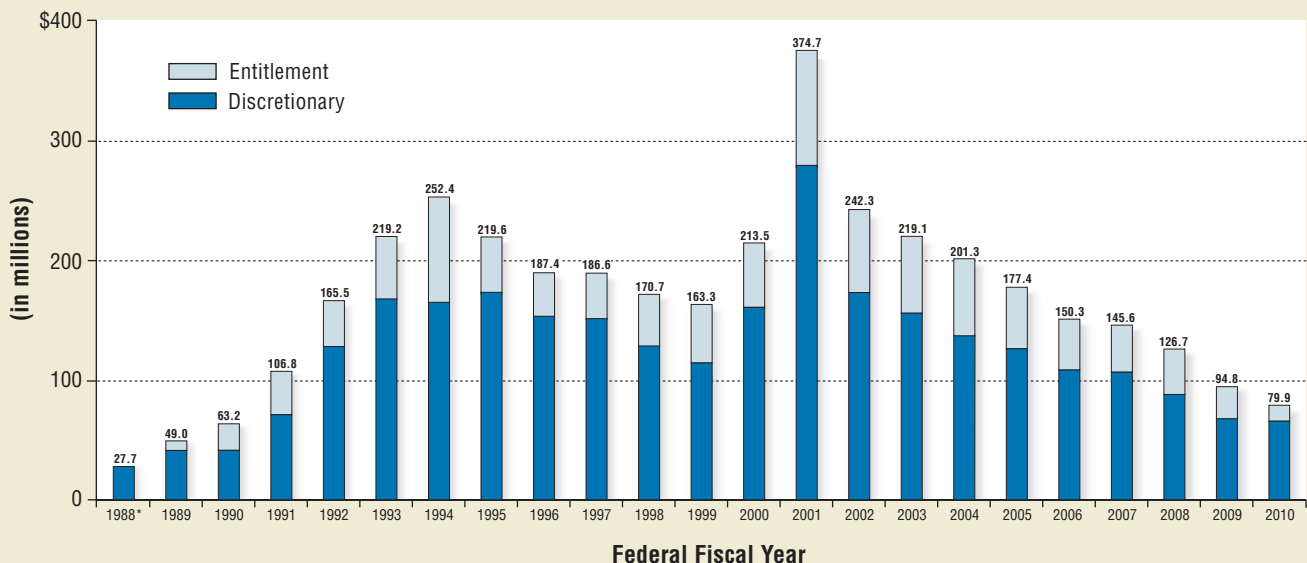
This focus piece describes the LOI program as administered by the FAA, how to apply for an LOI, why an airport sponsor might decide to leverage an LOI, and provides examples of the ways various airport sponsors have leveraged their LOIs. Credit concerns and the status of the LOI program after September 11, 2001, are also discussed.

LOIs UNDER THE AIRPORT IMPROVEMENT PROGRAM

Federal funding for airport improvements is provided to airport sponsors through the Airport Improvement Program (AIP), established by the Airport and Airway Improvement Act of 1982. AIP funds are provided annually in the form of:

1. **Entitlement funds** (also known as apportionments)—funds allocated annually by formula, based on passenger numbers and cargo airline landed weight at each airport.
2. **Small Airport Fund grants**—discretionary funds (typically described as “entitlement set-asides”), awarded to small-hub, nonhub, and noncommercial service airports. These funds come from those entitlement funds allocated for large- and medium-hub airports that are relinquished because PFCs are imposed.

LETTER OF INTENT PAYMENTS BY YEAR (FFY 1988 - FFY 2010)



* End of Federal Fiscal Year (FFY)1988 discretionary funding used to advance-fund FFY 1989 portions of LOIs.
Source: Federal Aviation Administration, October 12, 2001.

3. Discretionary funds—distributed at the FAA's discretion.

AIP funds are drawn from the Airport and Airway Trust Fund, which is supported by aviation fuel taxes and user fees. The Wendell H. Ford Aviation Investment and Reform Act for the 21st Century (AIR-21), enacted in April 2000, did not incorporate any major changes to the structure or functioning of the AIP, but did increase the amount of AIP funding available.

The FAA was given authorization to issue LOIs pursuant to legislation enacted by Congress in 1987. FAA policy was issued in 1994, and updated by draft Section 8 of the *AIP Handbook* (FAA Order 5100.38A). At primary or reliever airports, LOIs are issued only for airside development projects with significant capacity benefits. In an LOI, the FAA announces its intent to obligate AIP funds and issue grants over multiple years for a specific eligible project. The LOI sets out a multiyear schedule of AIP discretionary and entitlement grants subject to funding being made available by Congress.

The primary uncertainty that remains after the FAA approves an LOI is whether Congress will appropriate sufficient budgetary authority each year to meet the FAA's funding intentions. To minimize this risk, the FAA limits LOIs so that no more than 50% of projected available discretionary funds in any federal fiscal year (FFY) are allocated to LOI payments. The FAA uses conservative projections, so the actual percentage of discretionary funds allocated to LOIs may be much lower than projected. Statutory provisions described in the *AIP Handbook* give priority to LOI payments over annual entitlement and discretionary payments.

The chart on the previous page shows the amount of entitlement and discretionary grants paid or authorized to be paid under open LOIs.

APPLYING FOR AN LOI

An FAA Airports District Office (ADO) must approve a project for AIP funding prior to the approval and issuance of an LOI. Airside development projects with significant capacity benefits are given priority over other airside development projects. Airside projects eligible for an LOI must significantly enhance national air transportation system capacity. The decision to

LETTERS OF INTENT ISSUED IN FEDERAL FISCAL YEARS 2000 AND 2001

| Airport | Amount | Date Issued | Projects Funded | | | |
|-------------------------------------|---------------|-------------|------------------|-------------------------------|--------------------------------|---------------|
| | | | Construct Runway | Reconstruct or Extend Runways | Reconstruct or Extend Taxiways | Improve Apron |
| Bush Intercontinental/Houston | \$193,024,000 | 10/11/00 | ✓ | | | |
| Cleveland Hopkins International | 148,400,000 | 12/22/00 | ✓ | | | |
| Miami International | 101,040,000 | 4/3/00 | ✓ | | | |
| San Jose International | 81,520,000 | 4/3/00 | | ✓ | ✓ | |
| Memphis International | 75,394,000 | 11/2/00 | | ✓ | ✓ | |
| Orlando International | 73,680,000 | 4/3/00 | ✓ | | | |
| Manchester | 56,700,000 | 1/8/01 | | ✓ | | |
| Dallas/Fort Worth International | 49,640,000 | 4/3/00 | | ✓ | ✓ | ✓ |
| Baltimore/Washington International* | 38,112,571 | 2/15/01 | | | ✓ | |
| Eppley Airfield | 33,057,000 | 12/7/00 | | ✓ | ✓ | |
| Gerald R. Ford International | 31,500,000 | 12/7/00 | | ✓ | ✓ | |
| Springfield Branson Regional | 30,201,277 | 12/7/00 | | ✓ | ✓ | |
| Mammoth Yosemite** | 28,681,785 | 2/6/01 | | | | ✓ |

*LOI included funding for reconstruction of airfield ramp.

**LOI included funding for land acquisition.

Source: Federal Aviation Administration, October 12, 2001.

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approve an LOI is based primarily on a benefit-cost analysis. Projects most likely to receive approval are new airports, new runways, and major runway and taxiway extensions. The table above indicates the types of projects for which LOIs were issued in FFY 2000 and FFY 2001.

In reviewing requests for an LOI, the FAA primarily considers three factors:

- 1. Project's effect on overall national air transportation system capacity.** Projects that reduce delay nationwide and projects at airports where the number of enplaned passengers has increased or is projected to increase significantly are given priority.
- 2. Project's benefits and costs.** Federal policy requires airport sponsors to demonstrate that a project's benefits—including delay reduction, capacity enhancement, and safety and security enhancement—exceed its costs. This benefit-cost analysis must be conducted in accordance with FAA guidelines (see information provided on the final page.)
- 3. Airport operator's financial commitment, including project timing.** The FAA prefers that airport sponsors commit a portion of their future entitlement funding to the project and requires that sponsors commit sources other than the federal government, such as airport funds and state grants, before they will allocate discretionary funding.

The FAA evaluates the project and, if approved, issues a letter stating that reimbursement will be based on a given schedule as funds become available. More specific information about applying for an LOI can be obtained from any FAA ADO.

WHY LEVERAGE AN LOI?

Grants scheduled to be received under an LOI are not always received when project costs are incurred. For large-scale capital projects, a majority of the expenditures typically occur in the first few years, whereas the duration of an LOI is usually between 5 to 10 years. As an example, the difference between cash flow requirements and LOI grant receipts for the runway expansion and reconstruction project at Manchester Airport is shown in the graph to the right.

To address the resulting cash-flow shortage in the initial years, some airport sponsors have leveraged grants scheduled to be received in an LOI to obtain upfront funding.

APPROACHES TO LEVERAGING AN LOI

- Bonds.** Airport sponsors have long used LOI grants to pay debt service on outstanding bonds, although few have actually pledged the funds as security for the bonds. Two examples are the Airport Authority of Washoe County's (Reno,

Nevada) Revenue Improvement (Letter of Intent) Bonds and the City of St. Louis' Letter of Intent Double Barrel Revenue Bonds (see table at the right).

- Commercial Paper.** The Minneapolis-St. Paul Metropolitan Airports Commission issued \$75 million of subordinated commercial paper notes in October 2000. The commercial paper is to be repaid by LOI grants received over the next 10 years. The Commission considered issuing LOI-secured debt, but decided instead to pledge general airport revenues. If LOI receipts do not materialize, the commercial paper would be repaid from subordinated airport revenues.
- American Association of Airport Executives (AAAE) Airport Capital Projects Loan Program.** This program provides flexible, low-cost loans to eligible airport sponsors to finance improvements and equipment that constitute "governmental use" projects under federal tax law. Any projects eligible for AIP funding meet these conditions. Loans may be repaid from LOI or normal AIP grant receipts. More information regarding the program can be obtained from AAAE's web site (<http://www.airportnet.org/aaabonds/>).

BONDS SECURED BY LETTERS OF INTENT

The Airport Authority of Washoe County was the first airport sponsor to issue LOI-secured bonds and took a conservative approach in the financing. The City of St. Louis wanted the greatest flexibility possible to develop an overall master financing plan and was limited in what it could use for backup security.

| | Airport Authority of Washoe County Series 1993A | City of St. Louis Missouri Series 2000 |
|-------------------------------------|---|---|
| Par Amount of Bonds | \$71,000,000 | \$87,165,000 |
| Total LOI Funding | \$71,000,000 | \$141,433,000 |
| Application of LOI Payments | Principal only | Principal and interest |
| Secondary Pledge | General Airport Revenues | Airport Development Fund |
| Enplaned Passenger Forecasts | No increase assumed over term of LOI | 2% annual growth assumed over term of LOI |
| Bond Insurer | MBIA | Not insured |
| | Ratings | |
| Moody's | Aaa | Baa3 |
| Standard & Poor's | AAA | BBB- |
| Fitch | AAA | Not rated |

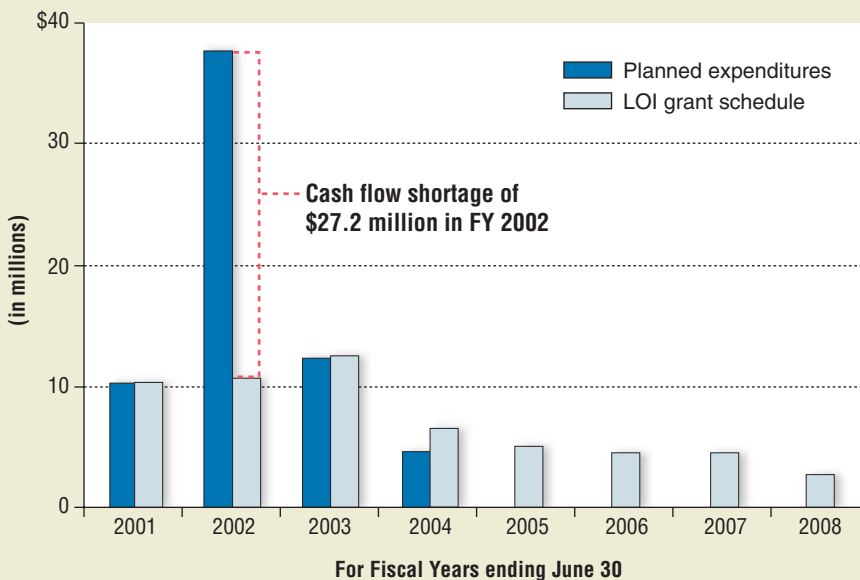
CREDIT CONCERNS

The investment community has identified credit concerns related to pledging future LOI grants as security for debt. As a result of these concerns, LOI-backed instruments are typically supported by a secondary pledge of other funds. The FAA has never

failed to fulfill its LOI commitments. Nevertheless some risk is involved.

- An LOI is not a binding agreement.** An LOI is not an obligation of the U.S. government and is not deemed to be a commitment for funding. An LOI evidences only the FAA's current intent to provide grant funding to the airport sponsor for certain projects.
- LOI entitlement payments are dependent upon airport enplanements.** The entitlement grant component of an LOI will vary according to future passenger enplanements at the airport and total AIP appropriations. The FAA states in LOIs that, if the enplanement-based entitlement in a given year is lower than indicated in the LOI, the corresponding discretionary component will not be increased automatically. Airport sponsors can apply to the FAA to amend an LOI to increase the discretionary component or to include entitlement grant amounts in future years. If the FAA approves the amendment, the length of the term of the LOI is typically extended.
- LOI payments are dependent upon actual expenditures.** An LOI indicates the FAA's intent to reimburse the airport sponsor for eligible expenditures on approved projects and the FAA will

MANCHESTER AIRPORT RUNWAY PROJECT
Planned Expenditures versus LOI Grant Schedule



only make payments equal to actual expenditures. An amendment may be requested to include any unexpended funds in future years of the LOI, which is subject to negotiation.

- **LOI payments may decrease with a change in hub status or PFC amount.** Annual entitlement funding at medium-hub or large-hub airports where a \$3.00 PFC is charged is reduced by 50% and at airports where a \$4.00 or \$4.50 PFC is charged is reduced by 75%. Entitlement funding for sponsors of small-hub and nonhub airports is not reduced if a PFC is imposed. If, during the term of the LOI, an airport were to change status from a small hub to a medium hub, its entitlement amounts would be reduced by either 50% or 75%, depending on the PFC imposed. The annual entitlement amounts in an LOI can also be reduced if the airport sponsor increases its PFC to \$4.00 or \$4.50. In the past, airport sponsors have been able to amend their LOIs to increase discretionary funding and compensate for the reduction in entitlement funding. However, there is no guarantee that the FAA will approve such amendments in the future.
- **Appropriations by Congress.** Congress might reduce the future AIP appropriations. Congress has not guaranteed any FAA funding level in the future.

LOI PROGRAM AFTER SEPTEMBER 11, 2001

As a result of the decrease in nationwide airline traffic and the increased priority given to security projects by the FAA after September 11, some policy changes will affect the LOI program.

Reprioritization of Security Projects—The Aviation and Transportation Security Act (ATSA), enacted on November 19, 2001, requires airport security projects to receive the highest priority for AIP funding. ATSA also permits airport sponsors to use AIP funds for additional security-related operating expenses incurred between September 12, 2001, and September 30, 2002. These ATSA provisions, coupled with the security-related projects airport sponsors will need to pursue in the post-September 11 environment, could limit the amount of AIP funding that the FAA is willing to commit via LOIs.

Potential Increases in AIP Funding—In ATSA, Congress has authorized, but not appropriated, an additional \$1.5 billion for the AIP in FFY 2002 and 2003. These authorized funds can only be used to cover direct costs incurred by airport sponsors and other parties as a result of heightened security requirements imposed after September 11 and will not be available directly for LOI-funded capacity enhancement projects. However, authorized funds that would otherwise have been allocated to security projects may now be available, indirectly increasing the money available for LOIs.

Lower Enplanements Reduce the Entitlement Component of LOI Grants—Entitlement grants in any given year have historically been based on the number of enplaned passengers at the airport 2 years prior. With reductions in passengers following the events of September 11, the entitlement funding included in an LOI may now be lower than projected. The FAA has stated that entitlement grants for FFY 2003 will be based on the greater of either 2000 or 2001 enplanements, thus mitigating the risk that LOI amounts will be reduced. However, it is not known whether or how any continued decreases in enplanements will be addressed.

Project Postponement—Many airport sponsors have decided to postpone or defer projects following the events of September 11 and uncertainties regarding air travel demand. LOI payments are reliant upon eligible expenditures by the airport sponsor; however, any unused portion of the LOI is available for payment in future years. While LOI payments would not increase to account for the costs of delaying a project, the total amount allocated under an LOI would still be available to the airport sponsor, subject to an approved LOI amendment from the FAA.

Additional information:

"Policy for Letter of Intent Approvals under the Airport Improvement Program," Federal Register, October 31, 1994, http://www.access.gpo.gov/su_docs/index.html

"Policy and Guidance Regarding Benefit-Cost Analysis for Airport Capacity Projects Requesting Discretionary Airport Improvement Program Grant Awards and Letters of Intent," Federal Register, June 24, 1997, http://www.access.gpo.gov/su_docs/aces/aces140.html

"FAA Benefit-Cost Analysis Guidance," FAA Office of Aviation Policy and Plans, December 15, 1999, <http://api.hq.faa.gov/pubs.asp>

"Letter of Intent - National Summary and Detail Data by Location," October 12, 2000, <http://www.faa.gov/arp/pdf/aips16.pdf>

Directory of FAA Regions and District Offices, <http://www.faa.gov/arp/us01.htm>

Leigh Fisher Associates has prepared LOI applications for numerous airport sponsors to fund capital projects, including sponsors of the airports in Grand Rapids, Indianapolis, Manchester (New Hampshire), Memphis, and Seattle.

Please contact Cindy Nichol, Principal, for additional information.

Leigh Fisher Associates has offices in the San Francisco Bay Area and the Washington, D.C. area. LFA employs 60 consultants with extensive practical experience in all of the disciplines necessary for the planning and management of airports, including facilities planning and design, ground transportation planning, financial analyses and planning, economics and air traffic forecasting, commercial and concession planning, airport management and operation, and noise and other environmental analyses. The consulting staff is supported by dedicated staff who provide computer-aided design, simulation modeling, editing, and administrative services.

Leigh Fisher Associates
Post Office Box 8007
San Francisco International Airport
San Francisco, California 94128-8007
Nicholas Davidson, Principal-in-Charge

Please contact us for more information:
telephone: (650) 571-7722
fax: (650) 571-5220
email: inquiry@leighfisher.com
www.leighfisher.com