Financial Planning in Uncertain Times

September 2008

Managing uncertainty in this high fuel price and slow economic environment presents challenges for airport operators, including challenges similar to those confronted after September 11, 2001, and new ones unique to today's high oil prices. This focus piece summarizes some of the measures that airport operators took after September 11 in an effort to inform today's airport operators.

Since 2007, world oil prices have more than doubled, reaching a peak of $147 per barrel in July 2008 and triggering unprecedented changes in the airline industry. Airlines have redefined business models, increased available cash on hand, expanded fuel hedges, instituted a la carte fees, retired fuel inefficient aircraft, and announced significant schedule reductions in order to operate in a high-fuel-price environment and increase their pricing power. At the same time, airport operators have been preparing downside scenario plans and anticipating how all of these changes will affect their operations. Notwithstanding predictions by many analysts that world oil prices would soon reach $200 per barrel, prices fell to less than $100 per barrel in September 2008, lower, in some cases, than the fuel hedging positions that airlines recently put in place. Although the recent drop in oil prices provides a welcome respite to the airline industry, it is unclear whether or not prices will remain at these levels. The uncertainty over oil prices is further compounded by the current crisis in U.S. and world financial markets, which threatens to further slow economic activity, decrease disposable income, and reduce the propensity to travel.

> **"The industry is facing uncharted waters. Airlines are feeling it now and airports are next."**
>
> David Cush, *CEO,* Virgin America, *Aviation Daily*, June 10, 2008

Airport operators are also feeling the effects of the current crisis in the U.S. and world financial markets. Recent downgrades on bond insurers required the immediate refinancing of auction-rate securities, some variable rate debt, and debt service reserve sureties. Because of the limited number of AAA-rated insurers, bond insurance may no longer provide economic savings for the issuing party. In addition, a reduction in line-of-credit providers limits access to commercial paper and variable rate debt. Many airport operators with commercial paper programs are finding that they cannot extend or replace expiring credit facilities and letters of credit, and are instead accessing local banks for lines of credit. Airport operators are also contemplating potential action following the recent bankruptcy and consolidations in the investment banking industry with regard to interest rate swaps and other financing instruments.

AIRPORT MEASURES TAKEN AFTER SEPTEMBER 11, 2001

Operations
- Reviewed operating budgets and reduced nonessential spending
- Closed concourses due to reduced activity
- Closed fire stations at reliever airports
- Reduced shuttle bus headways
- Implemented purchasing initiatives to maximize discounts
- Deactivated moving walkways and escalators during off peak hours
- Adjusted terminal temperature settings to reduce energy use
- Closed commercial departure curb during off-peak hours
- Reduced professional services expenses

Staffing
- Reduced staff, sometimes by as much as 10%, through layoffs, attrition, and early retirement
- Implemented hiring freezes
- Froze employee compensation
- Changed work schedules
- Reduced employee health benefits

Revenues
- Increased public parking rates
- Recovered larger shares of rental car revenues when operator agreements expired
- Levied rental car customer facility charges for consolidated rental car facility improvements
- Improved and expanded terminal concessions
- Expanded advertising programs
- Developed land for nonaeronautical uses

Airline Rates and Charges
- Suspended or reduced airline rates and charges for a period of time
- Under-recovered costs otherwise allowable under the airline agreement
- Contributed discretionary cash flow to reduce airline charges (compensatory)
- Adjusted the net income sharing formula to increase airline share (hybrid)

Capital
- Deferred significant portions of airport capital plans or suspended major programs
- Deferred major maintenance projects
- Refunded debt at lower interest rates to reduce annual debt service costs
- Restructured interest mode and term or extended selected maturities to reduce debt service costs
- Capitalized bond interest on eligible interest expense that had previously been paid from revenues
- Redirected PFC revenues from future capital projects to pay existing debt service

Other
- Applied for reimbursement from the Transportation Security Administration for security costs
- Maximized use of contract security to reduce more expensive police services
- Evaluated petitions for rent relief from concessionaires.
- Re-evaluated insurance policies and, in some cases, reduced coverage to offset extraordinary increases in annual premiums

The table on page one presents measures taken by airport operators following September 11 to preserve fiscal stability, meet financial covenants, reassure the public and investment communities of their ability to maintain operations and meet financial obligations, and adjust to decreased airline traffic. Not all of these measures were widely implemented.

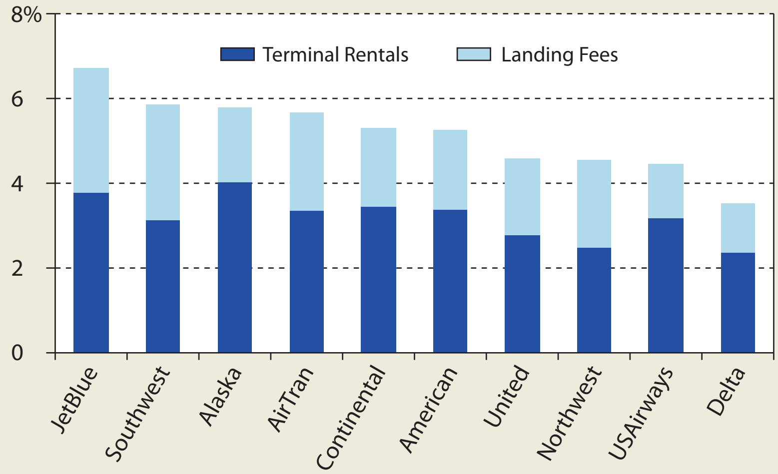
Many of the measures listed allowed airport financial officers to increase the cash position or "liquidity" of their airports to levels that provided financial stability immediately after September 11 as well as the years following.

During this period of oil price uncertainty, airport operators should attempt to preserve liquidity as the duration of this current economic downturn may not be short-lived. At most airports, passenger-related revenues will decrease with decreases in enplaned passengers, which could put increased pressure on airport cash flow. In preserving airport cash flow and cash balances and to meet today's challenges, several airport operators have taken or are planning to take actions that are, in some cases, unprecedented compared with actions taken following September 11.

- At Pittsburgh International Airport, the ends of two concourses were closed after US Airways gave back 30 of its 40 leased gates in bankruptcy.
- The Dallas/Fort Worth International Airport Board froze its operating budget for the first time in history, is considering closing portions of a terminal, and is rethinking future expansion plans.

AIRPORT RATES AND CHARGES AS A PERCENT OF TOTAL OPERATING EXPENSES

12 Months Ended December 31, 2007



Source: U.S. DOT, Form 41.

- Capital programs at some airports have been slashed – Oakland International's third terminal and parking garage are on indefinite hold; the Las Vegas airport's 5-year CIP was cut by 20%.
- Others are considering the deferral of projects (at the Cleveland airport, the connection of Concourse D to the landside terminal was put on hold) and scope reductions (the San Luis Obispo airport operator is revisiting its $60 million terminal expansion after American and Delta left the market this summer).
- Several airport operators (e.g., in San Juan, New York (Stewart), Myrtle Beach) are offering rates and charges waivers to attract lost service.

Airport rates and charges have historically represented between 4% and 6% of airline fare revenues (except for the first few years after September 11). In contrast, fuel costs, as a share of airline fare revenue, have varied significantly—from a low of about 11% in 1998 to nearly 35% in 2007. As shown in the graph above, airlines pay varying levels of landing fees and terminal building rentals, which are largely influenced by their business models—e.g., high or low frequency of service and operational needs in terminal buildings. Any rates and charges waiver or reduction program will have different financial benefits to the airlines depending on the mix of airlines serving a particular airport and their business models.

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