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PART II: A TALE OF 3 AIRPORTS

Lino Del Signore, Eagle Consulting
Bill A. Matz, The S-A-P Group

Editors note: CDIAC presents this article to its readers in its continuing efforts to offer information on the broad spectrum of specialty areas within the municipal market.

In last month's edition of *DEBT LINE,* we discussed the impact several supply and demand factors have had recently on activity levels at the San Francisco Bay Area's three primary airports. We analyzed why traffic at Oakland International Airport (OAK) has increased and why it has decreased at San Francisco International Airport (SFO) and Norman Y. Mineta San José International Airport (SJC).

In this month's *DEBT LINE,* we will

- highlight the traffic trends at each airport immediately prior to and after September 11th,
- examine the impact these trends may have on the implementation of capital improvement programs (CIPs) and timing of bond issues, and
- present a near term outlook.

SAN FRANCISCO INTERNATIONAL AIRPORT (SFO)

SFO is the Bay Area's primary airport for long-haul and international flights and serves as a major connecting hub for United Airlines' domestic and international services. In 2000, it was ranked the world's ninth busiest airport in terms of passengers. In FY 2000, 20.2 million passengers departed from the airport, accounting for approximately 65 percent of all passengers departing from Bay Area airports.

From FY 1996 to FY 2001, passenger enplanements at SFO increased modestly from 18.6 million in 1996 to 19.4 million in 2001. Average annual increases of approximately 5 percent in international enplanements were offset by decreases in domestic enplanements. In FY 1998 and FY 1999, slowing economies in the Pacific—leading to reduced inbound tourism from Asian countries—also affected annual rates of growth.

Between February 2001 and August 2001, SFO reported year-over-year declines in monthly passenger levels ranging from–5 percent to–13 percent, the result of the regional recession and weak business demand. Between September 2001 and December 2001 declines in monthly passenger levels ranged from –25 percent to –38 percent, the result of the events of September 11th and subsequent reductions in airline service.

In 2001, the availability of low-fare service at the Airport decreased when Southwest Airlines discontinued its flights and United Airlines eliminated its United Shuttle brand. By December 2001, low-fare carriers provided only 10 percent of the 260 daily domestic flights at SFO.

Impact on Capital Improvement Program.

On December 10, 2000, SFO opened the new International Terminal Complex, the largest international terminal building in the United States. On June 3, 2001, the San Francisco International Airport Commission approved a $1.1 billion, 5-year capital improvement plan. According to FitchRatings (a recognized national rating agency),*(U.S. Airport Debt—The Sky's the Limit*, February 9, 2001), SFO planned four bond issues from 2001 to 2004, totaling $982 million.

In response to decreased passenger levels following September 11th, the Airport Commission has put on hold the implementation of its current capital improvement plan and has cancelled or postponed all projects not currently underway or related to safety and security. Such projects include development of an on-airport hotel and reconfiguration of the former international terminal for domestic use.

Using Capital Improvement Programs

The implementation of a CIP and the issuance of General Airport Revenue Bonds (GARBs) are usually shaped by negotiations between airport management and airlines. In a political sense, a CIP is a bargaining outcome in which airport management has succeeded in convincing the airlines to accept higher payments. GARBs are secured by airline payments to the airport (landing fees and terminal rents) as well as non-airline revenue streams (parking, rental cars, and retail concessions). Since additional debt service means higher airline payments, it can be difficult for management to move forward on implementing and funding a CIP during an economic downturn.

In return for approving a CIP and acquiescing to higher payments, airlines often receive assurances that payment increases will not exceed a threshold of reasonableness, or that phases of the CIP will not be implemented until a certain level of traffic is reached. They also examine the CIP plan of finance. Airlines generally demand that airport management design funding plans that reduce required airport debt levels by committing to available federal grants.

Outlook.
Kurt Forsgren, an analyst with Standard & Poor's, recently noted that "although the airport is prudently taking all the right steps," SFO's situation will not return to normal "in the near and intermediate term." These steps include raising aircraft landing fees, securing performance bonds from airlines, and ending the grace period for reduced rents provided to airport concessionaires after September 11th.

John F. Brown Company, Inc. forecasts that "recovery"—defined as FY 2001 activity levels—will not be attained until FY 2004 in SFO's most recent financial feasibility study (February 28, 2001).

METROPOLITAN OAKLAND INTERNATIONAL AIRPORT (OAK)

OAK is currently the fastest growing airport in the Bay Area. In 2000, the Airport served 5.3 million departing passengers, flying primarily on short- and medium-haul domestic routes. In 1999, Southwest Airlines accounted for 67 percent of all passenger enplanements at the airport.

OAK is experiencing strong growth, especially from the introduction of new airlines and routes at the airport. JetBlue, a New York-based, low-fare carrier, has stimulated the transcontinental market by introducing nonstop flights to John F. Kennedy International Airport in New York and Washington-Dulles International Airport. New medium-haul and transcontinental flights have also been introduced by American Airlines, Continental Airlines, Delta Air Lines, and Southwest Airlines.

Changes in Activity.
In the early to mid-1990's Southwest Airlines and United Airlines expanded service and initiated a phase of dramatic growth. Enplaned passengers increased 20.5 percent in fiscal year 1995. Enplanements decreased in 1997 and 1998 as United Airlines and Delta Airlines reduced their level of service. A new growth phase started in early 2001, as Southwest Airlines increased its number of flights.

In the months prior to September 11th, OAK continued to experience strong growth levels. From January 2001 to August 2001, monthly passenger enplanements increased over prior year levels by 5 percent to 20 percent.

Soon after September 11th, airlines continued to increase flight levels. Southwest maintained its growth strategy at the airport. SunTrips and Aloha Airlines have added services to vacation destinations in Mexico and Hawaii. American Airlines, Delta Air Lines, JetBlue, and United Airlines have either introduced new scheduled flights or announced their intentions to do so.

Impact on Capital Improvement Program.
The events of September 11, 2001 and the Bay Area recession have not delayed implementation of the airport's $1.6 billion development program. The program includes construction of a new, two-level terminal complex with 12 additional gates, new rental car facilities, a multi-level parking garage and an improved terminal access roadway system. Work on access roadways has already begun. Work on the terminal complex may begin in early 2003.

According to the FitchRatings' April 11, 2002 report titled *U.S. Airport Debt 2002-2006: A Post September 11 Survey,* the development program will be funded with:

- $176 million in airport funds
- $155 million in federal grants
- $163 million with Passenger Facility Charges (a $3.00 user fee paid by each enplaning passenger) on a pay-as-you-go basis
- $148 million in commercial paper
- $261 with bonds secured by Passenger Facility Charges
- $640 million with Port Authority revenue bonds.

The Port expects to issue debt in late FY 2002 or early FY 2003, then, possibly, every other year through 2009.

Outlook.
Airport management anticipates that passenger enplanements will exceed 6.0 million in 2002, an attainable target given that enplanements were 5.7 million in 2001. In addition to positive airline supply side trends, some economic fundamentals are also in Oakland Airport's favor. Analysts forecast that the share of Bay Area residents who live and work closest to OAK (and SJC) will continue to increase. In addition, Alameda County has experienced only slight job losses recently, relative to losses in San Francisco and Santa Clara counties.

Standard & Poors recently removed OAK from CreditWatch, where it was placed along with all North American airports on September 20, 2001. Citing the essentially uninterrupted service provided by Southwest, good demand recovery, and the airport's high percentage of origin and destination travel (95 percent), Standard & Poors affirmed its underlying rating of 'A+' on Oakland Airport's revenue bonds and defined the outlook as "stable".

NORMAN Y. MINETA SAN JOSÉ INTERNATIONAL AIRPORT (SJC)

From FY 1995 to FY 2000, SJC was the fastest growing airport in the Bay Area. An average annual rate of growth for passenger enplanements of 8.9 percent reflected the economic dynamism of the Silicon Valley. In FY 2000, the airport served 6.1 million departing passengers.

In FY 2001, American Airlines accounted for 36.2 percent of total airport enplanements, while Southwest Airlines accounted for 30.1 percent.

Changes in Activity.
In FY 2001, American Airlines continued to increase its service and replaced Southwest Airlines as the dominant carrier at the airport. Between January 2001 and August 2001, monthly passenger enplanement levels increased 7 percent to 17 percent over prior year levels.

In the months immediately after September 11th, however, passenger enplanements have decreased at rates greater than those nationally. SJC decreases reflect a combination of factors, including:

- Reductions in service by American Airlines, part of the airline's nationwide reduction in seat capacity following September's events.
- General declines in business (and leisure) travel that are driven by Silicon Valley.

In December 2001, SJC passenger levels were 23.2 percent lower than those of the prior year and well below the average nationwide decrease at medium hubs of -10.5 percent (Standard and Poor's, *Operational and Financial Difficulties Confront North American Airport Sector,* February 7, 2002).

Impact on Capital Improvement Program.
SJC is engaged in planning efforts to address capacity constraints, expansion needs, and local transportation requirements while mitigating the impact on the community. It is in the process of completing extensive airfield work, including the opening of a second air carrier length runway. The extension of the original air carrier length runway is scheduled for 2003. The 1997 Master Plan calls for the construction of a consolidated terminal facility parking and garage facilities, and roadway improvements. A City Council Airport Implementation Program ordinance mandates that the terminal not exceed 40 gates and that parking spaces not exceed 12,700. A City Council Airport Traffic Relief Act ordinance requires that certain work be undertaken only when identified ground transportation projects, including a "people mover," are within two years of completion.

Outlook.
It has not yet been determined whether the events of September 11th and the recession may delay the completion dates of the new terminal and other key Master Plan projects. However, unless activity returns to pre-September 11th levels in the near-term, the airport may need to increase the share of project costs funded with bond debt and decrease the equity share funded with airport discretionary revenue and activity-based user fees.

Standard & Poors recently removed SJC from CreditWatch, affirmed the underlying rating of 'A' on the airport's revenue bonds, and defined the outlook as "stable". While noting in the credit profile that SJC traffic levels have rebounded more slowly than other airports' on average, Standard & Poors based its rating affirmation on SJC's strong liquidity, low-cost structure, high debt service coverage and positive management measures such as reducing expenses and adjusting the capital improvement program.

About the Authors
Lino Del Signore (eagld@att.net) serves as a Technical Advisory Committee member for the California Debt and Investment Advisory Commission. Mr. Del Signore is also the Founder and President of Eagle Consulting, a San Francisco-based consulting firm that provides financial planning assistance to small- and medium-size airports in the United States.

Bill A. Matz (bill.matz@thesapgroup.com) is the Founder and Managing Director of The S-A-P Group, a San Francisco-based airport consulting firm that provides financial and strategic planning services for major international airports around the world. Mr. Matz has led several successful privatization projects at airports outside the U.S.

This Offprint was previously published in DEBT LINE, a monthly publication of the California Debt and Investment Advisory Commission (CDIAC). CDIAC was created in 1981 to provide information, education, and technical assistance on public debt and investment to state and local public officials and public finance officers. DEBT LINE serves as a vehicle to reach CDIAC's constituents, providing news and information pertaining to the California municipal finance market. In addition to topical articles, DEBT LINE contains a listing of the proposed and final sales of public debt provided to CDIAC pursuant to Section 8855(g) of the California Government Code. Questions concerning the Commission should be directed to CDIAC at (916) 653-3269 or, by e-mail, at cdiac@treasurer.ca.gov. For a full listing of CDIAC publications, please visit our website at http://www.treasurer.ca.gov/cdiac.