National Federation of Municipal Analysts – Advanced Seminar on Bankruptcy and Workouts

Impact of Airline Bankruptcies on Airports

David Y. Bannard

Foley & Lardner LLP

FOLEY

FOLEY & LARDNER LLP

Background

- Initial Contractual Model – Long Term Residual Use and Lease Agreements – Airports “Borrow” Airline Credit
- Impact of Bankruptcies After Deregulation
  - Differential impact on O&D vs. hub airports
  - Airport assets tied up in bankruptcy court
  - Airports emerge as stand-alone credits
- Evolving Trends in Contractual Model:
  - Compensatory or hybrid model
  - Shorter term agreements
  - Licenses or other agreements
- Contrast: General Airport Revenue Bonds (“GARBs”) vs. Special Facilities Revenue Bonds vs. PFC Revenue Bonds

Airline Bankruptcies - Concerns

Issues of Concern to Airports

- Unpaid rent, landing fees, etc.
- Status of airline going forward – assume or reject lease?
- Impact on rate base
- Airline obligations with respect to special facilities bonds
- Airport obligations with respect to annual “true up”
- Status of PFCs

Airline Bankruptcies - Remedies

Remedies Available to Airports

- Security deposit; active monitoring of accounts
- Amendments to Bankruptcy Code – shorten period to assume or reject; limited extensions
- Use of financial tools - - amortize bad debt; PFCs; subsidy from concessions
- Use of rejected facilities – before and after plan confirmation
- Treatment of “true up”
- Recent amendments clarify PFCs held in trust

Airline Bankruptcies – Keys to Restructuring

- Application of Federal Aviation Law - - Grant Assurances
  - Economic nondiscrimination (Assurance No. 22)
  - Exclusive rights (Assurance No. 23)
- Leverage
  - Demand for service at airport
  - Availability of gates and related facilities
  - Ability to recover space from bankrupt airline

Recent Lessons Learned

United Air Lines Cases

- Lease vs. agreement – DIA vs. SFO/LAX model – re-characterization as "disguised financing"
- Value of collateral remains critical – see recent settlement at LAX

Structure

- Importance of DSRF in special facilities revenue bonds
- Pros and cons of Project Finance model

See also Airport Cooperative Research Program – Legal Research Digest 6 – The Impact of Airline Bankruptcies on Airports (www.trb.org/ACRP)

Case Study: Boston - Logan Terminal A

Background

- August 2001 –
  - Massport and Delta enter into lease
    - Delta will redevelop Terminal A
    - Title transfers to Massport upon completion
    - Delta will lease Terminal A airline space for 5 years plus 20 automatic one year extensions
  - Massport, Delta, Trustee and Ambac enter into bond documents
    - $497,565,000 of Special Facilities Revenue Bonds issued
    - Proceeds of bonds applied to Terminal A redevelopment
    - Security for bonds is Delta Lease “Facilities Rent”, including Massport reletting obligation

Case Study: Boston - Logan Terminal A

Background

- Post 9/11 – Terminal undergoes significant redesign
- March 2005 – DBO
- September 2005 – Delta files for bankruptcy protection
- December 2005 – Massport accepts Terminal A project
- December 2006 – Massport, Delta, Ambac and Trustee enter into Settlement Agreement
  - Delta will assume amended and restated lease as of July 1, 2006 of only a portion of Terminal A ;
  - Delta pays pre-petition amounts due Massport, Ambac and Trustee;
  - Trust Agreement amended, but bonds remain outstanding, secured by portion of Terminal A rents and Ambac insurance
- February 2007 – Bankruptcy Court approves settlement

Case Study: Boston - Logan Terminal A

Goals

- Delta
  - Reduce costs
    - Reduce rented area, including back office and club space
    - Reduce service/frequencies
  - Take debt off balance sheet
  - Retain flexibility
    - Ability to recover or give back gates
  - Retain ability to operate at Terminal A
- Trustee
  - Ensure uninterrupted payments of debt service
  - Maintain security for bonds, including Ambac insurance

Case Study: Boston - Logan Terminal A

Goals

- Massport
  - Maintain debt off balance sheet
  - Cover operating expenses and debt service
  - Obtain flexibility with respect to gate/space use
  - Retain Ambac insurance
- Ambac
  - Minimize/eliminate payments under bond insurance policy
  - Recover amounts paid to date
  - Ensure stable rental stream to cover debt service
  - Provide for recovery of any insurance payments going forward

Case Study: Boston - Logan Terminal A

Solutions:

- Bonds remain special facility debt; Delta no longer obligor; true "project finance" model.
- Debt service uninterrupted.
- Delta rationalizes space leased; Continental and Northwest lease remaining gates. Some back office space empty.
- Gates vacated by NWA leased to Southwest (new entrant).
- Gates vacated by Continental leased to Jet Blue (expanded service).
- Small shortfall in Facilities Rent covered by DSRF
- Ambac insurance remains in place.

Conclusions

- Airport ratings does not correlate to airline ratings.
- Trend is to compensatory/hybrid rate setting and shorter term agreements
  - Requires active airport financial management
- Airports should monitor airline financial status and manage accounts
  - Keep accounts current
  - Maintain security deposits
- True project finance model for special facilities debt is viable

Thank you

David Y. Bannard

Partner

Foley & Lardner LLP

111 Huntington Avenue

Boston, MA 02199

Tel: 617.342.4033

Email: dbannard@foley.com