

**North America
Special Report****U.S. Transportation Assets: Facing
a Temporary Decline or a
Permanent Change?****Analysts**

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Related Research

- *Global Infrastructure & Project Finance Outlook 2008: Balancing Government and Capital Market Needs, March 3, 2008*

Who is the Least Hurt?

Given the persistence of higher fuel prices, the slide of the U.S. dollar and a sluggish U.S. economy, there have been varying impacts on transit systems, seaports, airports and toll roads, with the latter two asset classes facing a more difficult operating environment than the former; therefore, the focus of this report is on airports and toll roads. At this point in time, the outlook for transit systems and ports remains stable. However, Fitch Ratings is in the process of analyzing sector and asset-specific trends for transit systems and seaports, and will be providing a more detailed analysis in October. In the interim, a brief overview follows.

For U.S. transit systems, the conditions described above have led to an increase in ridership and political support for the expansion of transit services. However, the increase in ridership is being offset by higher propulsion costs, slower growth or declines in sales and other tax revenue and significant cost increases in commodity prices. Given the reduction seen in vehicle miles traveled and toll road traffic, there has been a shift toward transit. However, transit systems are caught between enhancing service and expanding the network and a constrained revenue profile given the dependence upon tax revenue to cover operating and capital expenses. Changes in the federal allocation between highways and transit could help, but long-term changes may be a long way off. In the interim, most transit systems will likely meet the current demands by scaling back large capital plans.

In the case of U.S. seaports, it is also a mixed bag, with imports declining but exports growing. While exports are not providing a one-for-one offset, this does help mitigate the impacts of the current environment, especially for ports that have a more even split between imports and exports. More narrowly focused ports that provide access to cruise ships or are highly dependent upon imports could face more pressure. However, many ports do have a combination of short, medium, and longer-term leases that can provide some stability in a weak economic environment. Ports that entered into large expansion projects to attract inbound container traffic could face some pressure, as container volume has slowed from recent record volumes.

U.S. Airport and Toll Road Outlook

For U.S. airports and toll roads, Fitch Ratings is revising the outlook for these sectors to negative from stable based on continued weakness in enplanements and toll-paying traffic volumes that are being adversely affected by more than seven months of volatile fuel prices, economic weakness and inflationary pressures. In March of 2008, Fitch issued a special report entitled "Global Infrastructure & Project Finance Outlook 2008: Balancing Government and Capital Markets Needs," which indicated that the outlook for both airports and toll roads was stable, with an expectation for pressure on airports given airline labor and fuel pressure, and lower toll road credit quality in the future given the potential for significant leverage on existing facilities. At that time, many U.S. airports were still experiencing growth in enplanements, and a number of toll roads were still showing flat to positive traffic growth. Given continued economic weakness,

coupled with an approximately 33% increase in gasoline prices and a 52% increase in jet fuel prices from 2007, U.S. airports and toll roads are now experiencing declines in enplaned passengers and toll paying traffic of as much as 19% and 16%, respectively, in certain instances.

Enplanement and traffic reductions do vary significantly across the gamut of U.S. airports and toll roads, given the varying economic strength and other competitive characteristics that exist in the airport and toll road sectors. To date, large hubs with an international component and expressway systems have fared slightly better than other categories of airports and toll roads, and the overall trend by region shows that the economic situation in the Southeast for both airports and toll roads appears to be the most challenging. Despite the variances, most airports and toll roads are now experiencing throughput declines in the low single digits, and the macroeconomic trends described above cannot be ignored. Fitch recognizes that each facility is uniquely positioned within the larger transportation network and possesses its own economic characteristics relative to competitors and that management at each asset has the ability to respond and manage relative credit quality. That said, the current trends affecting both air and highway travel warrant some concern. Credit Outlooks for individual securities are being evaluated on a case-by-case basis, and Outlooks and ratings will be adjusted as appropriate over the course of the next year.

On the airport side, many issuers are facing high-single-digit to low-double-digit declines in enplaned passengers from the same month in 2007, and these declines do not reflect further capacity reductions announced by several domestic carriers, which have ranged from 6% to 14%. Likewise, most toll roads are facing traffic declines of between 2% to 10% over the same month last year, with most experiencing declines of between negative 3% and negative 6%. In terms of mitigating the impact on credit quality, the options for management are limited, with the largest impact likely coming in the form of deferred capital plans and passing along higher costs to airlines and drivers alike in the form of increased terminal and airfield rates and charges and higher tolls. Passing along higher costs could well prove to be difficult given the operating pressures faced by both airlines and individuals, which are facing higher fuel prices, inflationary pressures, a weak economy and pressure on the credit front as well.

Fitch's ratings for airports and toll roads reflect the relative ability of each credit to deal with some volatility in revenue and the expectation that management will take appropriate actions to deal with such developments. The question is whether the current trend will continue for a longer period. While fuel prices have begun to stabilize and even drop from recent highs, the U.S. economy has remained vulnerable, and credit markets remain challenging. In addition, there are signs of economic stress in Europe and other parts of the world as well. Given the significant lag in the movement of food and commodity prices relative to fuel, and the resulting impact on the economy, it is Fitch's view that challenging conditions will persist over the next one to two years.

For both airports and toll roads, previous declines have been limited to durations of one to two years. In all likelihood there will be some "sharing" of pain with airports and toll roads passing along only a portion of the increases needed to prevent revenue loss, potentially reducing financial flexibility from current levels. Prudent management will also attempt to limit the growth in operating expenses, but a large portion are salary and fuel related and could prove difficult to control, especially for public authorities that have labor unions. Public and private airport and toll road operators will no doubt try to control expenses, and it remains to be seen if one model will prove more effective than the other.

Fitch will continue to monitor the actions taken by airport and toll road asset managers to deal with the environment and is working on a more detailed analysis of the airport and road sectors to highlight those credits that have fewer options and are therefore more at risk. These reports will be released late in September. Fitch will also continue to monitor travel patterns in the air and surface transportation sectors for signs of larger shifts. In Fitch's view, if the underlying pressures continue unabated over the next several years, there is the potential for more fundamental change in airline route selection, capacity planning and pricing that could sustain the capacity reductions planned for the third and fourth quarters of 2008 through the next three to five years, thus taking out roughly 10% of total capacity for an extended period.

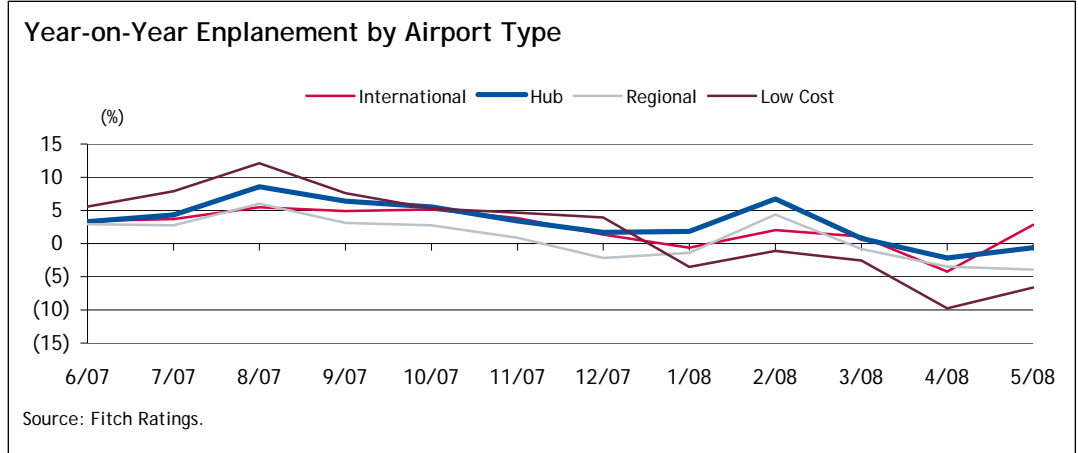
On the surface side, continued pressure could result in the federal government providing a larger increase in funding for transit, with more limited growth for highways. In addition, we could also see a longer-term shift in population trends with growth accelerating in the urban core and slowing in suburban areas, where driving in congestion is currently a part of daily life. The combination of policy and demographic shifts could have a significant impact for toll road credits over the longer term, as they will likely take a much longer time to develop. If they do materialize, prospects for roads dependent upon sustained long-term growth could be impacted.

U.S. Airports

In the case of U.S. airports, enplanement data through May reviewed by Fitch indicate that airports with a large international component and hub airports are holding up better than regional airports, indicating that major airlines are focusing their efforts here and highlighting the importance of such airports in the system. With respect to the last quarter of 2008, preliminary scheduling data indicates that overall domestic seat capacity could be down by nearly 8% from the fourth quarter of 2007, with large hubs down by more than 6%, medium hubs down by nearly 11% and small hubs down by more than 9%, again indicating the relative economic strength between the larger hubs and the medium and small hubs. While many airports have seen reductions of as much as 8% in the first and second quarters of 2008, many could very well see significant further declines, as the overall scheduling numbers for large, medium and small hubs mask significant variance, with much larger reductions in some places and much more limited reductions in others. Notably, the expected increasing capacity at certain airports is primarily due to Southwest Airlines' continued network expansion, albeit at a slower rate than the previous year.

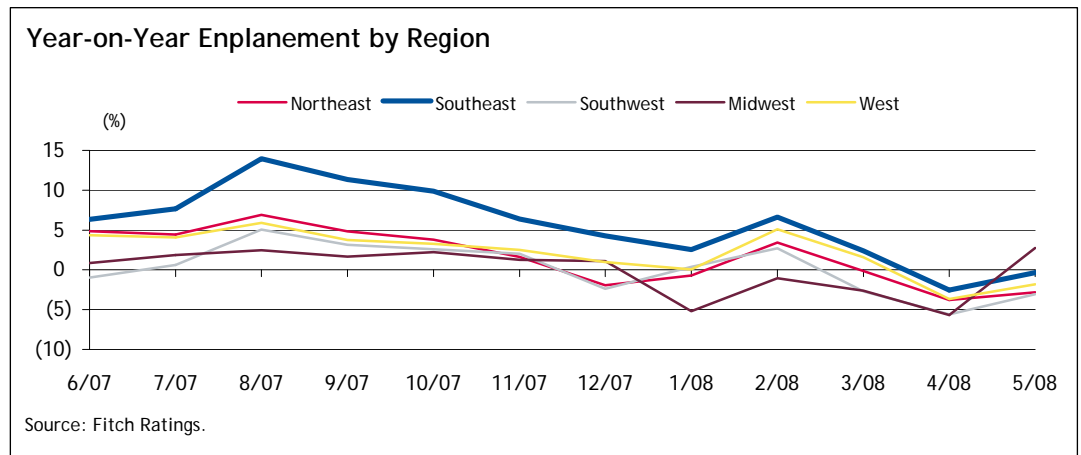
As noted above, airports with a large international component have been stabilized relative to their more domestically focused counterparts by an increase in international travel, likely spurred by the significant weakening of the U.S. dollar. However, as fuel prices have continued to increase, many planned additional international flights have been put on hold, and similar to U.S. airlines, many international airlines are also reviewing their schedules; therefore, reductions here are also likely. As service reductions commence, Fitch expects year-on-year reductions to be in the negative 5% to negative 10% range for hub, regional and low-cost airports, and reductions at airports with a significant international component to be flat to down 5%.

May enplanements for a sample of airports collected by Fitch indicate that overall enplanements are down by 0.6%, 3.9%, and 6.6% for airports characterized as hubs, regional and low-cost, respectively. The low-cost number is being driven in large part by the nearly 19% reductions at Oakland airport stemming from the bankruptcies of Aloha Airlines and ATA Airlines, the ceasing of operations by American Airlines and Continental Airlines, as well as other reductions by various other airlines. Airports with a significant international component were up 2.9%. As indicated above, the growth



trend in enplanements began to weaken for most airports in the early part of 2008. Looking at the average of year-over-year enplanements from June 2007 to May 2008, the trend for international, hub, regional and low cost airports was for growth of 2.4%, 3.3%, 0.9% and 2.0%, respectively. Looking at the average from February through May reveals a very different story with international, hub, regional and low-cost airports showing growth of positive 0.5%, positive 1.2%, negative 1.0% and negative 5.0%, respectively. The chart above highlights the monthly change in enplanements by airport type, and the chart below displays monthly changes by region. Importantly, these trends do not reflect the significant capacity reductions of between 6% and 14% announced by most of the major U.S. carriers, which will take effect in the third and fourth quarters of 2008. Preliminary schedule changes for the fourth quarter of 2008 reflect capacity reductions ranging from as much as 30% to as little as 0.1%, with a very small number showing slight growth.

Given these reductions, airports with a larger non-airline revenue component would seem to be better off. However, concession and parking revenue could likely fall as much as enplanements, especially if such revenue is not protected by minimum contract payments. In Fitch's view, the significant operating pressure faced by domestic airlines could significantly limit the ability of airports to pass along increases regardless of what adjustments the use and lease agreements allow. The pressure felt by domestic airports to limit increases in the cost-per-enplaned passenger (CPE) will be greater than existed in 2001 and 2002, as aircraft leasing companies eased the crunch by providing carriers with lease flexibility. Such flexibility will be hard to find with the current volatility in the financial markets. In addition, the airlines are cutting routes



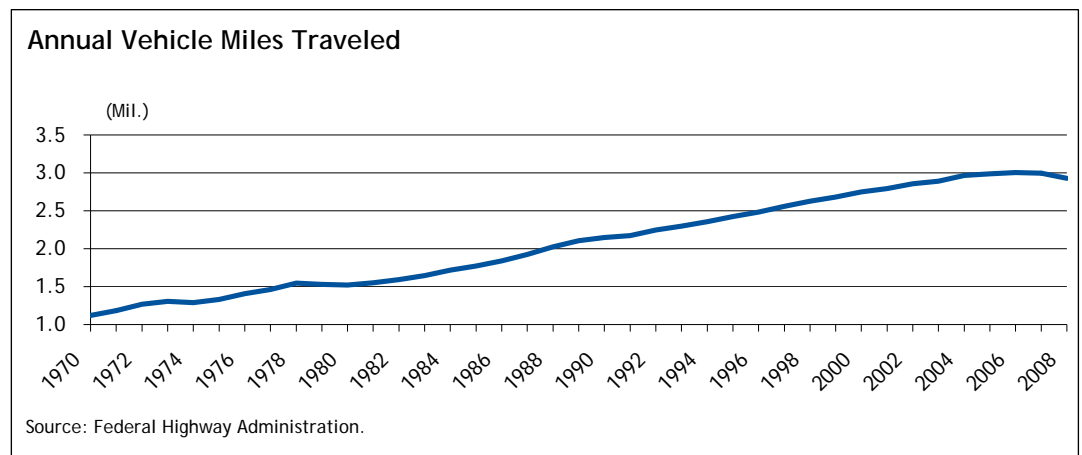
and raising fares to restore operating margins. While the CPE is a small part of airline operations, increases in this environment come at the cost of further labor reductions elsewhere.

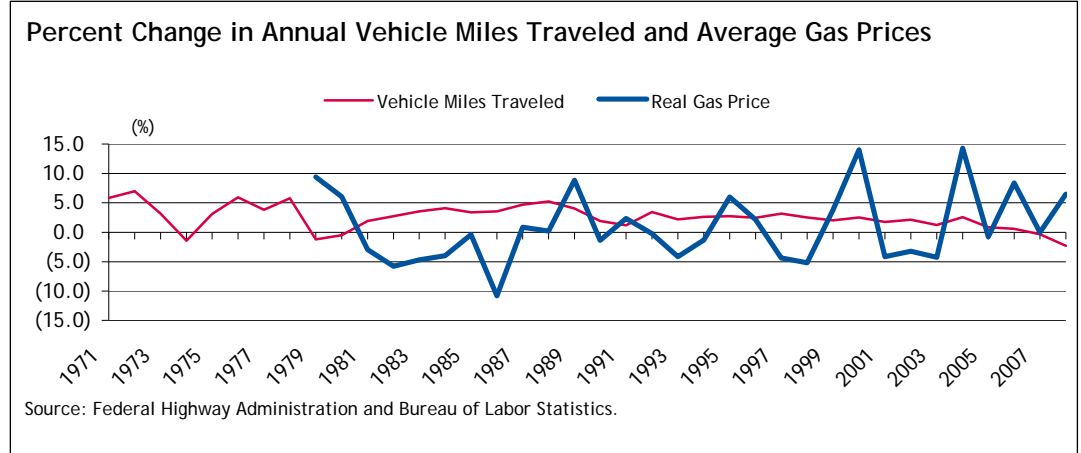
Most U.S. airports have a relatively flat debt-service profile with fixed obligations and thus limited ability to defer principal amortization. The key options available to airport managers to deal with revenue pressure are capital plan deferral, mothballing of underutilized terminal space, generating space utilization efficiencies from airlines if cost increases are contained, entering into concessions with guaranteed minimum annual payments, and raising parking fees. That said, in this environment the use of unrestricted cash and limited or deferred capital plans should help weather the storm as debt-service coverage and financial flexibility will likely be more pressured. Those airports in the midst of a large plan will likely have less flexibility to defer capital expenditures. A new paradigm may be on the horizon with regard to airports' historic ability to pass along cost increases, and as a result a greater partnership between airports and airlines will likely result as passengers are key to the long-term success of both.

Over the next several weeks, Fitch will be issuing supplementary research evaluating Fitch-rated U.S. airports and the risks they face, starting with second- and third-tier hubs and leisure markets, followed by the gateway international airports and large hubs. The focus will be a review of scheduling information, coupled with a number of credit metrics, including debt-per-enplaned passenger, airline concentration risk, CPE, liquidity and outstanding capital plans, to name a few.

U.S. Toll Roads

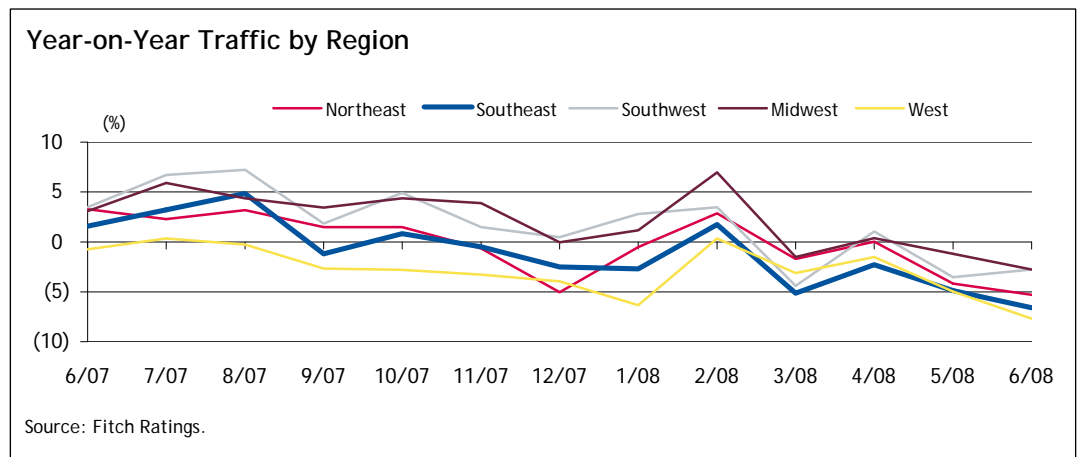
In the case of surface transportation, overall traffic patterns as measured by vehicle miles traveled (VMT) reported by the Federal Highway Administration declined by 0.4% in 2007, and are on pace to decline by 2.3% in 2008 if current conditions continue. This is significant as there is only one other period since 1970 with two consecutive years of VMT declines: 1979 and 1980. In addition, the only other year with a decline in overall VMT is 1974, which coincided with the oil embargo (see chart below). The current and past declines are not totally surprising, given the movement in real prices for gasoline. The chart on page 6 highlights the relationship between the percentage change in annual VMT and the percentage change in annual fuel prices. One other trend that is important to point out is the reduction in the overall growth rate in annual VMT, which began in the 1990s.

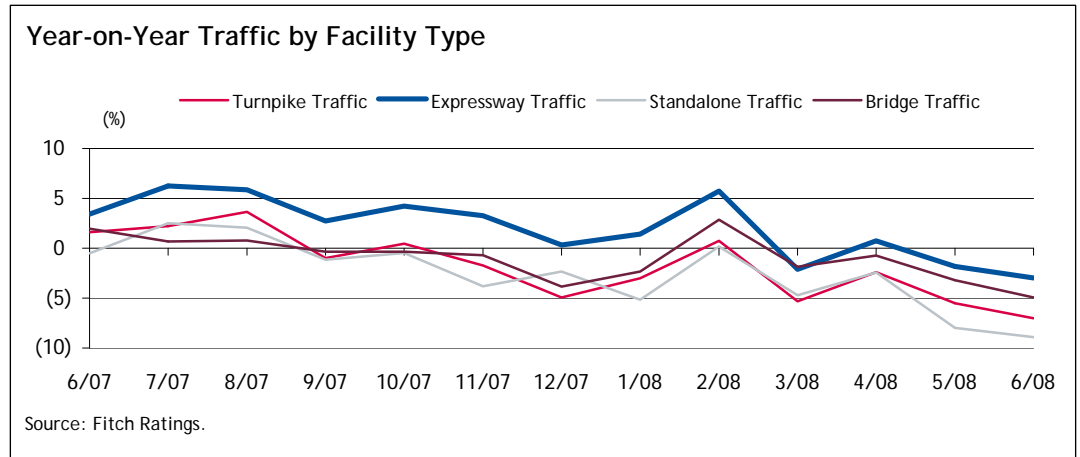




Despite a slowing in the growth rate of annual VMT, toll road volume on many facilities during this time frame grew rapidly, indicating that despite slower growth in overall vehicular traffic, toll roads were continuing to grow at a more rapid pace, and thus growing overall market share. Beginning in the second half of 2007, however, the decline in overall traffic affected toll facilities as well. In Fitch's March global infrastructure outlook report, traffic was down most noticeably in portions of the Southwest and Southeast, areas with significant exposure to the fallout in subprime lending. Since December of 2007, this trend has become increasingly evident, to varying degrees, in all areas of the country. In the past, as VMT increased, toll roads grew at a faster rate, indicating the value they provide. As VMT has begun to decline, toll roads appear to be losing more traffic, although it remains to be seen if this will continue, since free alternatives remain significantly more congested and faster travel times result in lower fuel consumption.

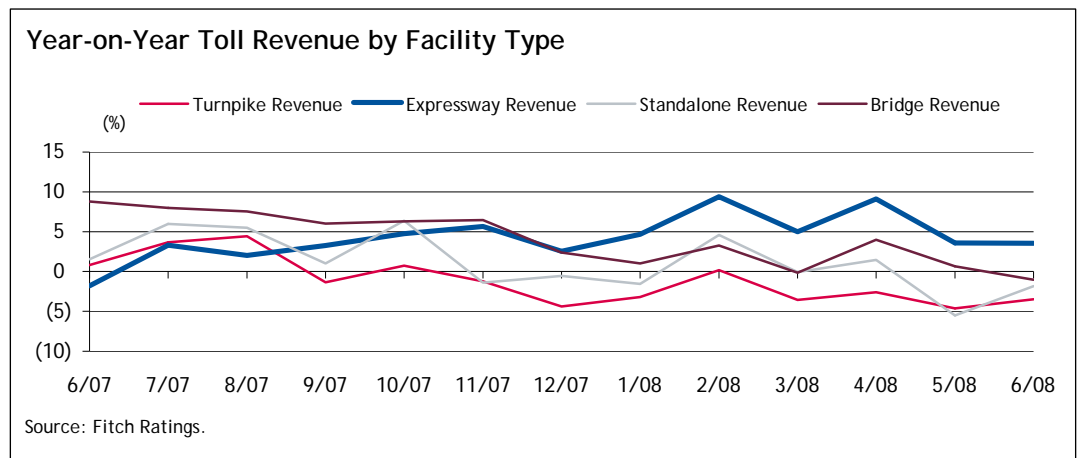
Facilities in Southern California are down more than 10%, with revenues down to a lesser degree given toll increases that were put into place before the crisis began. Facilities in Florida are also showing signs of stress, with some facilities exhibiting traffic declines for the first time in more than 10 years. Facilities in Texas appear to be a bright spot, with year-on-year reductions of less than 5%, which is half of what most other facilities in the Northeast, Midwest, Southeast and the West are experiencing to date. In addition, the reductions appear to be impacting standalone facilities the most, with June year-on-year reductions approaching nearly 9%, while turnpikes, expressway systems and bridge systems are showing declines of 7%, 3%, and 5%, respectively. On





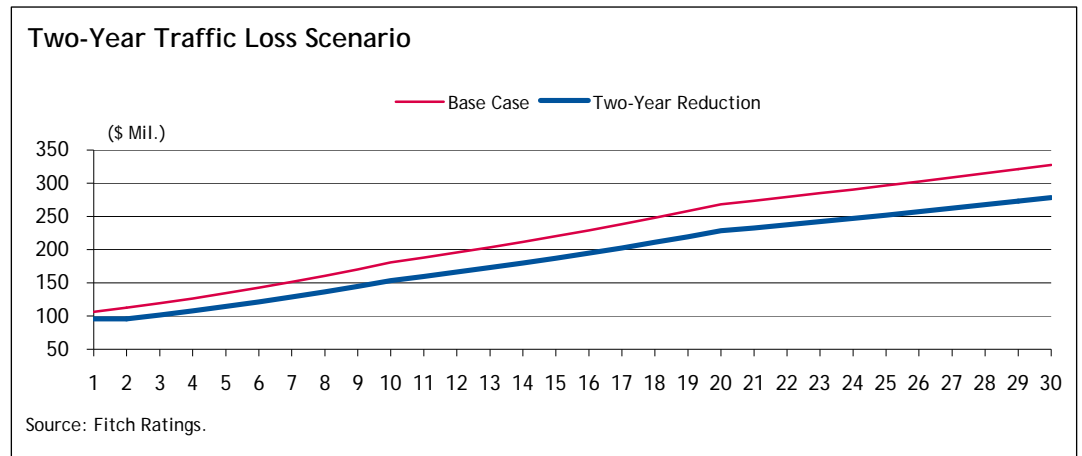
the revenue side, June revenue growth is negative 2%, negative 3.5%, positive 3.5% and negative 1% for standalone, turnpike, expressway and bridge systems, respectively. The declines are not as severe given toll increases implemented by many facilities in mid-to-late 2007, a number of which were tied to borrowing for capital improvements. That said, even if revenue growth is performing better than traffic, the loss in volume indicates that revenue is underperforming projections.

With respect to rate increases, U.S. toll roads have proven fairly inelastic in the recent past. However, the combination of fuel prices and a weak economy will likely be an important test for U.S. toll facilities. Fitch notes that a number of the roads included in the data are run by private operators, and despite economic conditions, toll rates have gone up according to schedule to date, resulting in revenue growth, albeit less than forecasted. Also in the sample are a number of toll roads that have not exercised their ratemaking flexibility in a number of years, and it is Fitch's view that the management of these facilities faces greater hurdles in terms of passing along rate increases and may very well experience more initial rate elasticity given this history. Fitch expects that those facilities with a higher penetration of electronic or open road tolling to experience less elasticity than those that have a significant cash component.



With the exception of several mature facilities, most U.S. toll roads have an escalating debt profile, with the newer facilities and the highly levered roads facing the largest increases in future debt service. In Fitch's view, the key to maintaining financial flexibility during the current environment is for a combination of rate increases and

cost-cutting measures. Those facilities with a significant liquidity position and/or a flexible debt structure will likely be in a better position to deal with the current environment. Nonetheless, most facilities are dependent upon varying degrees of revenue growth, and their ability to catch up will be important. Small but frequent toll increases will likely be necessary over the next several years to maintain credit quality if current conditions persist. For example, if over a 30-year period a toll road was dependent upon traffic growth of 3% for the first 10 years, 2% for the second 10 years and 1% for the remaining 10 years, and the same growth in toll rates was expected, a two-year decline in traffic totaling 10% would reduce revenues over a 30-year period by nearly \$1.0 billion, assuming an initial toll of \$1.00 and initial traffic of 100,000 annual transactions (see chart below). Without any additional traffic growth a rate increase of over 20% in the initial year or smaller but more frequent increases over several years would be needed to mitigate the impact on revenues. Put simply, the \$1.30 toll in year ten would need to be \$1.53 and the \$1.64 toll in year 20 would need to be \$1.92.



For private concessionaires, this scenario could prove somewhat difficult to deal with, as they will likely have toll rates already set at the maximum allowed. While tolling formulas generally prescribe the allowable increase to be the greater of an inflation/gross domestic product-linked index and a fixed percentage of 2.5%, for example, a 20% increase would not be permitted. However, most such concessions do have cash lock-up requirements and flexible debt structures that provide protect against such events.

Over the next several weeks, Fitch will be issuing supplementary research evaluating U.S. toll roads and the risks they face based on certain metrics, including coverage of maximum annual debt service by current revenues, debt per lane-mile, average toll, days cash on hand, refinance risk and future borrowing plans, to name a few.

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