ANSConf-WP/52
11/04/00
ITEMS 3, 4, 5
(English, French & Spanish only)

CONFERENCE ON THE ECONOMICS OF AIRPORTS AND AIR NAVIGATION SERVICES

(Montreal, 19 - 28 June 2000)

Agenda Item 3: **Funding issues**

Agenda Item 4: **Determinants of the economic regulation of airports and air navigation services**

Agenda Item 5: **ICAO policy**

PRE-FINANCING OF AIRPORT CAPITAL EXPENDITURES

(Presented by Airports Council International)

SUMMARY

Airports are capital intensive enterprises with long lead times for planning and implementing projects to expand capacity and improve service levels. To avoid large and abrupt increases in airport charges when such projects come on stream, it is sometimes prudent to pre-finance projects from internal sources through the gradual increase of charges during the construction period. This practice carries the added benefits to both airports and their users of reducing the airport operator's reliance on external sources of funding, keeping debt service payments to a reasonable level, and safeguarding the airport's credit rating. Where pre-financing is used, financial information should be provided where appropriate, to assist in quantifying the benefits for users. ACI welcomes ICAO's thoughtful and constructive elaboration of its view on pre-financing in WP/15 as a basis for defining circumstances in which prudent pre-financing could be utilized.

1. Introduction

1.1 ACI's 1999 Airport Economics Survey estimated annual global capital expenditures of ACI member airports rose from USD 17 billion in 1997 to USD 22 billion in 1999 to meet the anticipated doubling of passenger traffic over the next 12 to 15 years.

1.2 These airport investments are unusual in that they require massive up-front capital expenditure for large individual projects. This is only repaid by the gradual growth of traffic over many decades. Airport investments also suffer from major cost escalation risks during construction and cannot be turned to alternative use if traffic does not materialize. In contrast, the time horizon for airline investment is much shorter, and the assets purchased have more flexible use. For this reason, the general airline rule that investments are not pre-financed from operating revenues may not always be appropriate for airports.

2. **Key Issues**

2.1 Airports are highly capital intensive, and capital investment is 'lumpy' and sporadic rather than continuous. A single investment in a new or expanded airport may exceed the financial resources of the airport. Given this situation, all possible sources of finance may need to be exploited, external and internal, particularly where government funds are not available or are insufficient.

2.2 There are three sources of finance potentially available for airport construction. Loans are the most common source. For very large investments , however, the airport operator may simply not have the borrowing capacity. If very large debts are required, the risk to creditors increases, and the airports credit rating falls, resulting in a requirement for higher interest rates. (As an illustration, if the rating falls from AAA to A, annual interest payments on USD1billion of debt would rise by USD 3 million). This higher interest cost would ultimately have to be paid by airport users.

2.3 A second source of finance is equity, but even where this is available it is normally more expensive than debt, and is often tax-inefficient.

2.4 Internal funds represent the third source of financing. These sources include retained profits, the depreciation charge, commercial revenues and ultimately, increases in user charges.

2.5 Most major airport investments will involve a 'blend' of different sources of finance. Reliance solely on loans may prove expensive in the long term, and result in steep rises in charges after a new facility or airport is opened. It may therefore be preferable to include some element of pre-financing through airline or passenger user charges to temper increases in charges after the facility becomes operational and to avoid an excessive debt burden.

2.6 ACI welcomes ICAO's thoughtful and constructive elaboration of its views on pre-financing in WP/15, particularly in para. 4.4, which cites specific cases in which pre-financing could be justified. ACI addresses these important issues in greater detail in WP/55.

3. **Conclusions**

3.1 The practice of controlled pre-financing is well established internationally. In the UK, in 1996, the Airports Regulator approved pre-financing at London Heathrow through five years of price rises three percent lower than consumer price inflation (CPI -3), followed by five years of CP1 +2. Avoidance of pre-financing would have required five years of CPI -8, followed by CPI +13.5 annually. In the US, a passenger facility charge can be levied to pre-finance investment for up to five years before construction starts. In Canada, passenger facility charges are also used at certain privatized airports which no longer have access to government funding.

3.2 It is, however, reasonable that airlines should be able to identify and track any pre-financing to avoid double payment and that airports accept that financial information should be provided where appropriate.

4. Action by the Conference

4.1 The Conference is invited to agree that controlled pre-financing may form part of an efficient airport investment plan, subject to safeguards for users including appropriate financial transparency and take the action proposed by ACI in WP/55.

– END –