16

Revenue
New Issue

Chicago, Illinois

Chicago O'Hare International Airport

Ratings

New Issue

General Airport Third Lien Revenue Refunding Bonds, Series 2004 .... A

Outstanding Debt

First Lien General Airport Revenue Bonds .... AA–
Second Lien General Airport Revenue Bonds .... AA–
Third Lien General Airport Revenue Bonds .... A
First Lien Passenger Facility Charge Revenue Bonds.................. A+
Second Lien Passenger Facility Charge Revenue Bonds.................. A

Rating Outlook .... Negative

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New Issue Details

Approximately $457,220,000 General Airport Third Lien Revenue Refunding Bonds, Series 2004, are scheduled to sell during the week of Nov. 15 via negotiation through a syndicate led by UBS Financial Services, Inc.
Purpose: Bond proceeds will be used to refinance portions of the airport's outstanding 1993A first lien general airport revenue bonds (GARBs) and 1993C, 1994, 1996A, 1996B, and 1999 second lien GARBs.

■ Outlook

The ratings for Chicago O'Hare International Airport (O'Hare, or the airport) reflect the airport's central role in the national air transportation system, including major hubs operated by American Airlines (American; senior unsecured debt rated 'CCC' by Fitch Ratings) and United Airlines (United), a strong local origination and destination (O&D) market that complements the airlines' hubbing operations, and management's proven track record of sound financial operations. Credit concerns include the weakened financial position of the airport's two largest carriers, the airport's significant connecting traffic, which increases exposure to airline scheduling decisions, and the potential for substantial additional debt under the airport's extensive, though flexible, capital initiatives. The lower rating for the third lien bonds reflects their subordinate payment position and comparatively weak legal provisions, which include a sum sufficient rate covenant and additional bonds test (ABT) from net general revenues and allocated passenger facility charge (PFC) revenues. The long-term Rating Outlook for O'Hare remains Negative because of the financial difficulties experienced by the nation's airlines, particularly United, which continues to reorganize under Chapter 11 of the U.S. bankruptcy code, as well as the rising fixed costs associated with the airport's capital initiatives.

■ Rating Considerations

Both United and American operate major hubs at O'Hare, with United and its regional affiliates accounting for 49.8% of total enplanements during 2003, while American and its regional affiliate American Eagle represented 34.4%. As both airlines acted to consolidate connecting activity at their central hubs over the past year, connecting traffic increased by 8.2% in 2003 and now represents 61% of total enplanements at the airport, compared to the historical average of approximately 57%. The scale of hubbing operations makes O'Hare vulnerable to scheduling changes by its leading carriers, a particular concern based on the current financial difficulties experienced by United and American. However, Chicago's large O&D market and central location make it likely that other airlines would increase their activity at O'Hare somewhat, should either of the two leading airlines significantly reduce its presence.

Overall enplanements increased by 4.6% in 2003, with the airport recording 34.5 million enplanements to retain its status as the world's second busiest airport in terms of passenger traffic. For the first eight months of 2004, passenger volume increased by 10.8%, placing the airport on a pace to surpass its record volume of 35.9 million enplanements in 1999. These figures are well ahead of the airport's current feasibility projection, which forecasts enplanements at O'Hare to increase to 42.2 million in 2012. Fitch believes this forecast remains reasonable based on the airport's past performance.

Reflecting the residual nature of the airport's operating agreements, debt service coverage provided by net revenues approximates pledged covenants at 1.65 times (x) first and second lien debt service and 1.13x total debt service for the year ended Dec. 31, 2003. The airport's consultant projects debt service coverage to remain near these levels through 2012, while the cost per enplaned passenger (CPE) rises to a peak of $13.18 in 2010, compared with $8.78 in 2003, before declining to $12.85 in 2012, a level that remains competitive with those for industry peers. These cost projections include debt service associated with the first segment of the first phase of the O'Hare Modernization Program (OMP) and are likely to increase as the city undertakes additional aspects of this program.

The airport's extensive capital initiatives include a $1.7 billion five-year capital improvement program (CIP), for which a portion of the financing has been identified, and the $6.6 billion (in 2001 dollars) OMP, which eventually will realign the airfield into a set of six east-west runways and two crosswind runways upon its anticipated completion in 2013.

Strengths

- Broad and diverse primary market area ranks as the nation's third largest in terms of both population and economic output.
- Strategic geographic location places O'Hare at the center of the nation's air transportation system.
- History of steady growth in demand from the airport's primary service area.
- O'Hare ranked as the world's busiest airport in terms of operations and second busiest in terms of enplanements in 2003.
- CPE equaled a competitive $8.78 for 2003.
- Residual rate-setting methodology provides for stable revenues and substantially insulates the airport from airline industry volatility.
- Experienced management team with proven record of sound financial operations.

Risks

- Substantial hubbing operations expose O'Hare to potential fluctuations in enplanement levels because of airline scheduling and routing decisions.
- Weakened financial position of O'Hare's largest carriers, United (49.8% of enplanements in 2003) and American (34.4%).
- Use and lease agreement provides for exclusive use of gates, which could limit the airport's flexibility to accommodate new entrants should a major carrier significantly reduce service or liquidate through bankruptcy.
- Planned issuance of substantial additional debt over the next decade as the airport pursues its extensive though flexible capital initiatives, which could lead to rising airline costs.
- Subordinated position of the third lien pledge to senior first and second lien debt. However, the airport does not anticipate additional first lien bonds and closed the second lien to additional debt except for refunding purposes.
- Comparatively weak third lien indenture provisions include a rate covenant and ABT requiring sum sufficiency of net revenues and allocated PFC revenues to operating and maintenance expense, debt service, and required reserves.

Capital Structure

The city has issued debt for the airport under five separate indentures. After this issue, the city will have a total of approximately $3.3 billion of outstanding general airport revenue bonds (GARBs) on three separate liens: $259 million of first lien GARBs; $901 million of second lien GARBs; and $2.1 billion of third lien GARBs. The first lien remains open; however, the city does not anticipate issuing additional new money bonds under the first lien indenture and reserves the right to close the indenture in the future. As the city closed the second lien indenture to additional new money borrowing in 2002, the third lien serves as the working lien for the airport's future borrowing needs.

In addition, the city has $193.8 million in first lien PFC stand-alone bonds outstanding and another $685.4 million of second lien PFC stand-alone bonds. PFC revenues collected at the airport in 2003 provided 1.77x coverage of debt service due for the year.

Third Lien Security Features

Security: The third lien bonds are secured by a pledge of the net revenues generated at the airport (including other available moneys) on a subordinate basis to the airport's outstanding first and second lien GARBs.

Rate Covenant: The city covenants to establish rates, fees, and charges for the use of O'Hare, which, together with certain other available moneys and any cash balance held in the revenue fund on the first day of the fiscal year, support annual operations and maintenance expenses and produce 110% coverage of aggregate GARB debt service. The city further covenants to establish annual rates, together with PFC funds deposited with the trustee and other available moneys from the prior fiscal year, at least sufficient to produce debt service coverage of 100% on all outstanding bonds and payment of operations and maintenance expenses.

Additional Bonds Test: Additional bonds may be issued if, among other things: the city is current on all its obligations and satisfied the 110% debt service rate covenant during the most recently completed fiscal year; or an independent airport consultant provides a certificate stating that revenues and other available moneys are projected to satisfy the 110% rate covenant during each of the next three fiscal years following the issuance of the proposed bonds or, if later, then for each fiscal year through two years after the completion of the projects financed with the proposed bonds. Refunding bonds can be issued without satisfying this test.

Fitch considers the rate covenant and ABT contained in the third lien indenture weak compared with the legal structures of most GARB indentures. However, the stronger provisions of the airport's first and second lien indentures, which contain a 1.25x rate covenant on the first lien and a 1.10x rate covenant on the aggregate first and second lien, augment the structure of the third lien and provide adequate bondholder protection. The weakness of the third lien provisions becomes acute upon the maturity of the first and second lien in 2018, at which time the third lien becomes the senior lien. Unless the airport acts to strengthen the third lien provisions upon the maturity of the first and second lien through changes in the indenture, the lack of a stronger rate covenant and ABT may limit the future liquidity of the airport under its residual operating agreement and reduce the financial protection afforded to bondholders.

Debt Service Reserve Account: A separate debt service reserve account equal to the least of 10% of the original principal amount of the bonds, maximum annual debt service, or 1.25x average annual debt service will be established at closing. The airport may use an insurance policy, surety bond, or similar instrument to fund the reserve in lieu of cash.

■ Airport

The City of Chicago owns and operates O'Hare and Chicago Midway International Airport (Midway) as separate entities under its Department of Aviation. O'Hare occupies approximately 7,000 acres of land 18 miles northwest of the city's central business district. The airfield consists of three pairs of parallel runways, three of which exceed 10,000 feet in length. All but one runway approach are equipped with electronic and other navigational aids that allow operations in most weather conditions.

Passenger facilities include three domestic terminals and one international facility. The domestic terminals have a total of 157 aircraft gates, while the international terminal has 21 gates and five hardstand positions. O'Hare's public parking facilities accommodate 22,700 vehicles. An 858-room hotel is located adjacent to the three domestic terminals and the central parking garage.

■ Enplanements and Operations

O'Hare ranked as the world's busiest airport in terms of operations and second busiest in terms of enplanements for 2003. The 34.5 million enplaned passengers that used the airport in 2003 represented a 4.6% increase since 2002. This gain reversed a four-year downward trend since 1999, when O'Hare had a record 35.9 million enplanements, a period encompassing several events that depressed air travel nationwide.

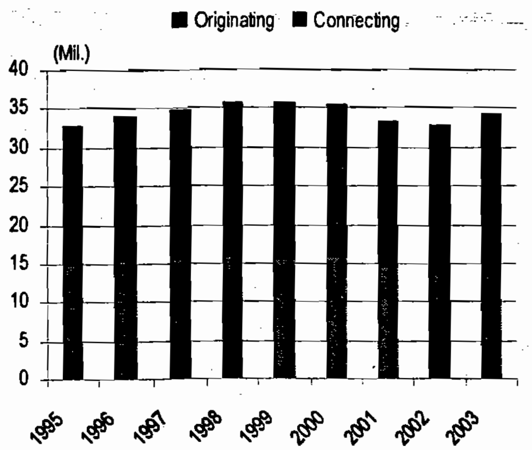
Much of the gain in 2003 reflected the actions of United and American to concentrate more connecting traffic at their larger hubs, as transfer volume increased by 8.2% for the year. As a result, connecting traffic exceeded 60% of total enplanements in 2003, which is above the airport's historical average of approximately 57%.

While O&D traffic at the airport decreased by a slight 0.5% in 2003, O'Hare still serves as the Chicago area's primary commercial airport, accounting for 68.9% of the local passenger base in 2003, and ranks third nationally in terms of O&D passengers. Midway accounted for the remainder of local traffic, at 31.1%, having steadily increased its share of the market over the past seven years. However, Fitch expects Midway's share of the market to stabilize over time as it nears its operational limits. Overall, local demand increased by 2% in 2003.

International traffic grew by 4.2% in 2003 and represented 13.2% of total enplanements, an increase from 9.0% in 1993. O'Hare ranked as the nation's fourth largest international gateway in 2003, serving 4.5 million international enplaned passengers.

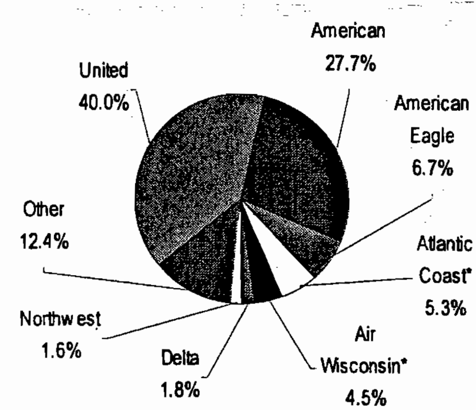
For the first eight months of 2004, passenger volume at O'Hare was up 10.8% from the 2003 level and on

Enplanements
(Years Ended Dec. 31)



Source: City of Chicago Department of Aviation.

Airline Market Share
(Year Ended Dec. 31, 2003)



*Operating as United Express. Source: City of Chicago Department of Aviation.

pace to exceed the record established in 1999. The airport's recent performance places it well ahead of expectations based on the 2003 feasibility analysis, which projected the airport to serve 32.6 million enplaned passengers in 2003 and 34.1 million in 2004. Thus, Fitch continues to view the consultant's forecast projecting the airport will serve 42.2 million enplaned passengers in 2012 as reasonable.

Airline Market Share

A total of 47 passenger airlines served O'Hare in September 2004, an increase from 43 for the past year, including 18 scheduled domestic passenger carriers, three unscheduled domestic airlines, and 26 foreign (scheduled and unscheduled) carriers. During the week of Sept. 13, 2004, these airlines provided nonstop service to 125 domestic destinations and 47 international destinations, compared with 122 and 43 destinations, respectively, for the week of June 14, 2003. In addition, 23 domestic and international all-cargo airlines serve the airport.

Both United and American operate major hubs at O'Hare, the only such sizable dual-hub airport in the world. During 2003, United and United Express, its commuter affiliate, represented 49.8% of total enplanements at O'Hare, compared with 45.7% in 1998. American and American Eagle represented 34.4% of total enplanements in 2003, down from 37.0% in 1998. Delta Air Lines (including regional affiliates), the third largest carrier at O'Hare in 2003, represented 1.8% of total enplanements.

The two leading carriers' market share concentration at O'Hare presents additional credit concerns because of the recent financial difficulties experienced by the nation's airlines, particularly United. United continues to restructure under Chapter 11 of the U.S. bankruptcy code. Fitch believes that both United and American will strive to maintain their relative positions at O'Hare. However, should either airline greatly reduce its presence at the airport, the exclusive use gate provisions granted these carriers under the airport use and lease agreement may limit the airport's short-term flexibility in seeking replacement service. Still, Fitch believes that it is highly likely other carriers would expand service quickly or enter the market to capture a greater share of the region's substantial O&D market should either of the two leading carriers significantly alter their operations at O'Hare.

Use and Lease Agreement

O'Hare operates under a residual lease agreement signed by the city and most of the carriers in 1983. The lease establishes rates and charges for the three domestic terminals and grants gates on an exclusive use basis though 2018 (the city owns one domestic gate, purchased from American in 2002, which is allocated on a common use basis). The international terminal is covered by a separate agreement between the city and the users of the facility. The city

Income Statement
($000, Years Ended Dec. 31)

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Landing Fees	100,237	93,230	99,573	124,086	128,819	105,909	136,375	131,369	141,426
Terminal Rental and Use Charges	167,585	154,657	148,165	164,395	158,307	152,536	144,653	138,440	150,151
Other Rentals and Fueling System Fees	17,543	18,505	20,277	19,052	32,381	31,694	31,283	32,102	33,511
Total Rental Revenues	185,128	173,162	168,442	183,447	190,688	184,230	175,936	170,542	183,662
Concessions	103,177	117,766	127,578	137,014	146,597	162,651	151,094	146,553	154,368
Reimbursements	1,945	1,761	2,519	2,323	3,752	2,561	2,354	2,582	2,501
Total Operating Revenues	390,487	385,919	398,112	446,870	469,856	455,351	465,759	451,046	481,957
Total O&M Expenses	241,152	261,108	270,323	270,815	305,118	317,507	325,392	325,370	331,550
Net Revenues Before Depreciation and Amortization	149,335	124,811	127,789	176,055	164,738	137,844	140,367	125,676	150,407
Revenues Available for Debt Service per Indenture	85,580	118,258	80,348	195,055	144,127	167,433	171,359	147,895	167,952
Aggregate First and Second Lien Debt Service	48,098	47,361	42,198	125,456	131,025	152,212	155,781	115,154	101,791
DSCR for First and Second Lien (x)	1.78	2.50	1.90	1.55	1.10	1.10	1.10	1.28	1.65
Debt Service on Third Lien Bonds	—	—	—	—	—	—	—	19,740	46,710
DSCR for First, Second, and Third Liens (x)	—	—	—	—	—	—	—	1.10	1.13
PFC Revenues	76,989	86,289	84,772	88,085	87,851	89,979	107,007	130,638	128,152
PFC Interest Income	4,352	6,463	6,447	7,431	3,898	4,654	664	2,139	1,667
PFC Revenue Available for Debt Service	81,341	92,752	91,220	95,516	91,750	94,633	107,670	132,777	129,819
PFC Debt Service*	—	—	13,977	13,977	24,092	24,096	41,227	63,685	73,498
PFC DSCR (x)	—	—	6.53	6.83	3.81	3.93	2.61	2.08	1.77
Cost per Enplaned Passenger ($)	—	5.34	5.48	6.11	6.79	7.10	8.84	8.68	8.78
Unrestricted Cash and Investments	104,251	89,261	99,775	63,784	75,329	99,846	40,032	82,268	109,608

*Bond year ended Jan. 1 of following year. O&M – Operations and maintenance. DSCR – Debt service coverage ratio. PFC – Passenger facility charge.

maintains control of the 21 gates under a common use provision, with international flights receiving priority consideration. The common use provision has allowed the city to accommodate several new domestic entrants, which operate at the international terminal during periods of minimal international flight activity.

■ Finances

The residual operating agreement results in O'Hare's consistently sound financial performance. For the year ended Dec. 31, 2003, the airport recorded total revenues of $482 million and net operating income, before amortization and depreciation, of $150.4 million. As operating and maintenance expenses totaled $331.6 million, net revenues provided 1.65x first and second lien debt service and 1.13x aggregate debt service on the airport's outstanding GARBs in 2003. Airline CPE equaled $8.78 for the year, up slightly from $8.68 in 2002, and remains competitive with CPEs for similar large-hub airports.

The 2003 forecast projected by the airport's consultant indicates that the airport will continue to generate net revenues sufficient to meet the rate covenants contained in the airport's revenue bond indentures through 2012. The consultant projects the airport's CPE to rise to $13.18 in 2010, then decline to $12.85 in 2012 based on the enplanement forecast and the current airport capital initiatives.

■ Capital Initiatives

The city's capital initiatives for O'Hare consist of two elements: a five-year CIP to address routine maintenance and upgrades to existing facilities; and the OMP, through which the city plans to realign the airfield into a set of six parallel east-west runways and two crosswind runways upon its anticipated completion in 2013.

Capital Improvement Program

The $1.7 billion CIP consists of: $626.5 million of terminal support projects, including improvements to Interstate 190 (the airport's entrance road) and other airport roadways, parking enhancements, improvements to the airport's automated transit system, and a consolidated rental car facility; $376.6 million of terminal projects largely designed to improve queuing and circulation space in terminals 2 and 3 and vertical circulation in all three domestic terminals; and $390.9 million of airfield improvements. The remainder of the program is divided among heating and refrigeration improvements, noise mitigation projects, fuel system enhancements, safety and security improvements, and planning projects.

The airport plans to finance the program though a mix of sources, including $258 million of proceeds from previously issued PFC revenue bonds, $282 million of proceeds of previously issued GARBs, $16.5 million of PFC revenues on a current basis, $78.7 million of discretionary airport improvement program funds received from the Federal Aviation Administration (FAA), $234.3 million in other airport revenues, and $854.9 million of additional GARBs. While the city has identified the funding sources for the program, several elements of the program require additional approvals from the airlines before their implementation.

O'Hare Modernization Program

The $6.6 billion (2001 dollars) OMP is designed to address the airfield's capacity constraints and improve operational efficiencies. Under the plan, three of the airport's current crossing runways will be relocated and a fourth runway constructed to create a set of six east-west parallel runways that capitalize on the region's prevailing winds. The two existing east-west runways will be extended under the plan, while the existing northeast-southwest runways remain to accommodate crosswind operations.

The OMP will be constructed in phases, with the city and the airlines entered into an agreement regarding the financing for the construction of the first phase, which is expected to span 2004–2008. The first phase is divided further into four components, with the airlines granting approval to the first two components and conditional approval to the final two components. As of September 2004, the city indicated it had met the conditions for the final two components of phase one, which were based on operational levels over a continuous 12-month period.

Planned financing for the first phase consists of $359.1 million in federal grants, $650.7 million in PFC funds on both a current and leveraged basis, $247.3 million from previously issued GARBs, and $1.6 billion in future GARBs. While this plan suggests the city will issue a considerable amount of additional GARBs over a relatively short time frame, the financing plan remains flexible. Construction of the OMP cannot commence until the city receives a favorable record of decision from the FAA. The FAA currently plans to release its findings in September 2005.

■ Service Area

O'Hare serves a 13-county region that includes Cook, DeKalb, DuPage, Grundy, Kane, Kankakee, Kendall, Lake, McHenry, and Will counties in Illinois, Lake and Porter counties in Indiana, and Kenosha County in Wisconsin. The region ranks as the nation's third largest metropolitan area in terms of both population and economic output. The U.S. Census Bureau estimates the region's 2003 population at 9.4 million, which reflects a 0.9% annual increase since 1994. The region's per capita income represents 115% of the national average.

The economic base of the Chicago metropolitan statistical area grew an average annual 4.9% between 1992 and 2002, slightly trailing the nation's 5.2% annual growth rate. The region's August 2004 unemployment rate of 6.2% slightly exceeded the national rate of 5.4%. The broad employment base includes the second largest concentration of Fortune 500 corporate headquarters in the nation, led by Sears, Roebuck and Co.; Motorola Corp.; McDonald's Corp.; Bank One Corp.; and UAL Corp., the parent of United.

For additional information on O'Hare, see Fitch Research on "Chicago, Illinois," dated Aug. 1, 2003, available on Fitch's web site at www.fitchratings.com.