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FITCH AFFIRMS BAA FUNDING BONDS; OUTLOOK NEGATIVE

Fitch Ratings-Paris/London-04 August 2009: Fitch Ratings has today affirmed BAA Funding Limited's (BAA) Class A and Class B bonds - issued under its GBP50bn multi-currency debt issuance programme - at 'A-' and 'BBB' respectively. The Outlooks are Negative:

In affirming the ratings, Fitch believes that the medium-term outlook for BAA has not materially changed since April 2009 when Fitch changed the Outlook to Negative. The key issues for BAA remain the economic downturn and its impact on passenger numbers (pax), refinance risk including the ability to issue bonds, and uncertainties surrounding the in-progress sale of Gatwick and the required disposal of Stansted airports by March 2011 which BAA is appealing.

Although Fitch views the current downturn in pax as temporary, as passenger volumes have tended to recover quickly (particularly for a capacity-constrained airport such as Heathrow) following prior downturns, the Negative Outlook reflects uncertainties regarding the depth and duration of the downturn. The agency does not currently envisage long-term material effects from the swine flu on BAA's airports.

In the short-term, Fitch expects BAA to repay a GBP1bn tranche, which matures in March 2010, under its GBP4.4bn refinancing facility. BAA can either use the proceeds of the London Gatwick disposal, raise new debt by issuing bonds, or use internal cashflows (post-interest cashflow of GBP600m-700m p.a.) plus its largely undrawn GBP2.7bn five-year capex facility. Should the first two options prove unfeasible, and despite the adverse economic conditions, BAA would have enough cash to meet the March 2010 repayment under the third option. Fitch notes that BAA is not reliant on the imminent disposal of Gatwick to repay the 2010 amortisation. Even if the net proceeds received from the Gatwick sale are as low as around 50% of Gatwick's regulatory asset base, BAA Funding would still be in compliance with its post-disposal leverage covenant limits.

Depending on Gatwick proceeds used to reduce the refinancing facility debt across its different maturity buckets, a second GBP1bn amortisation is also due in March 2011. Fitch estimates that by this time, BAA will probably not be able to use operational cash flows and draw on the remaining capex facility but will likely need to tap the bond markets or seek shareholder support. Failure to raise funds by mid-2010 would put the ratings under pressure.

Pax for the period September 2008 to June 2009 through the three London airports - Heathrow, Gatwick, and Stansted - have declined 6.7% (leap year adjusted) year-on-year. The traffic decline for Heathrow airport, potentially the sole asset for this transaction going forward, is a more staid utility-like 3.4%. Against this backdrop, the financial performance of BAA was aided by better-than-expected commercial revenue per passenger. However, profits will be affected by lower (if not negative) inflation in the future as aeronautical charges (54% of total revenue) are linked to the previous year's RPI. RPI for 2009 is likely to be negative by 1-2%, which will affect 2010 tariffs (Heathrow's aeronautical tariff, for example, will be increased by 7.5% minus RPI of 1%-2%).

Fitch will continue to monitor the development of traffic and other profit drivers. Ratings could be downgraded if traffic continues to decline significantly and weakens financial performance such that the Fitch-calculated post-maintenance interest cover ratio (PMICR) falls below 1.5x-1.6x for Class A and 1.2x-1.3x for Class B without remedial action. The Outlook could be revised to Stable if traffic stages a robust recovery in the coming six months.

The Negative Outlook also captures uncertainty surrounding the Department for Transport's (DfT) proposed reform of the economic regulation framework for certain UK airports, which includes the prohibition of security on airports assets and the introduction of a special administrative receivership. At present, Fitch expects the reform to have a neutral impact on BAA Funding ratings.

The DfT seems aware of the disruption this has caused to BAA and its ability to confidently access the bond market. Fitch will be carefully monitoring the final recommendations from the DfT, likely to be published in the autumn 2009.

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