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BAA Funding's Ratings Affirmed After DFT Announcement And Gatwick Sale; Outlook Stable

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OVERVIEW

- We affirmed the ratings on notes issued by BAA Funding following the announcement on October 13 by the Department for Transport (DFT) amending its March 2009 consultation paper on potential regulatory changes for U.K. regulated airports.
- We revised the outlook to stable from negative, reflecting the fact that the U.K. government will not proceed with proposals to introduce a special administration regime for U.K. regulated airports (including BAA London airports).
- We also affirmed our ratings on the tranche A and B refinancing facility lent to Heathrow Airport. Gatwick Airport, and Stansted Airport, which together form part of the borrower group.
- We believe that the sale of Gatwick Airport has reduced the liquidity uncertainty at the BAA borrower group in respect of its forthcoming debt maturities and BAA Funding's now improved ability to tap capital markets.

PARIS (Standard & Poor's) Nov. 9, 2009--Standard & Poor's Ratings Services today affirmed its debt ratings on all classes of notes issued by BAA Funding Ltd. following the announcement on Oct. 13 by the U.K. DFT that the U.K. government will not proceed with proposals to introduce a special administration regime that it considered in its March 2009 consultation paper. Also, we see the Gatwick sale as an improvement to the BAA borrower group's liquidity.

We also affirmed our ratings on the tranche A and B refinancing facility lent to Heathrow Airport Ltd. (HAL), Gatwick Airport Ltd. (GAL), and Stansted Airport Ltd. (STAL), all non-bankruptcy-remote operating entities, which together form part of the borrower group. At the same time, we revised the outlook on the ratings to stable from negative (see list below).

On Oct. 13, 2009, the DFT announced the measures it intends to introduce to strengthen the financial resilience of major U.K. airports. We understand that the DFT intends to issue its full new regulatory proposals before the end of 2009.

Implementation of the final proposals will require changes in law, which we don't think are likely to occur before mid-2010. The measures will include:
- A new duty on the Civil Aviation Authority (CAA) to ensure that airports can finance their licenced activities;
- A package of license conditions to introduce financial ring-fencing (there will be derogations for those elements of the ring fence which would cut across existing financing arrangements, including BAA's); and
- A license condition requiring that airport operators maintain a minimum creditworthiness (such as financial covenants or an independent credit rating).

The government will also consult on proposals to require airport operators to maintain a continuity-of-service plan and to allow the CAA to switch ring-fencing provisions on or off, if circumstances were to change (for example because an operator had moved from a secured to an unsecured financing structure).

We view these proposed changes positively, because they primarily remove the possibility of special administration and hence reduce the likelihood of a potential restructuring event (for details, see "BAA Funding Ltd. Debt Issues Assigned Negative Outlook On Dept. for Transport Consultation Paper; All Ratings Affirmed" in "Related Research" below). We also believe the future regulation would incentivize airports operators to improve their performance, and retain investment-grade ratings.

We had previously indicated that a divestiture of Gatwick or of both Gatwick and Stansted would weaken the borrower group's overall business risk profile to "strong" ('A' rating category) from "excellent" ('AA' rating category). Based on the proposed regulatory changes—which we consider to provide further support to the business profile as well as the comparative (to other European hubs) traffic resilience of Heathrow—we now expect the business risk to remain unaffected by the assets sale.

Positively, Heathrow has so far been the most resilient of the three London regulated airports, with 2.3% traffic reduction in the first nine months of 2009, compared with the same period of 2008, versus 7.2% and 12.0% at Gatwick and Stansted, respectively. Over the same period, Heathrow has also outperformed its main European peers and we would consider it likely that Heathrow will retain its dominant European position.

Nevertheless, the Gatwick divestiture will reduce BAA Funding's securitized portfolio diversification, as well as potentially leading to increased competition in the medium term. In addition, Heathrow has the most considerable capital program among the three BAA London airports.

LIQUIDITY/SHORT-TERM CREDIT FACTORS

Liquidity at Sept. 30, 2009, was, in our view, satisfactory. We understand the BAA borrower group had about £2.2 billion of undrawn credit facilities, which should allow the group to cover its negative free cash flow (after interest paid and capital expenditures) forecast of about £0.8 billion to £0.9 billion by year end 2010.

We believe the liquidity situation has improved with the sale of Gatwick announced on Oct. 21. Completion of this sale is scheduled for December 2009, subject to, among other things, EU merger regulation clearance.

In terms of BAA group's liabilities and future issuance:
- The March 2010 £1 billion coming due will be met through the cash net proceeds in line with the structure's documentation;
- This will leave capital expenditure and revolving facilities untouched and available to meet future business needs; and
- We believe that in conjunction with the DFT's announcement this puts BAA in a better position to start issuing bonds and refinancing its debt.

We note that at the borrower-group level, none of the refinancing, liquidity, capital expenditures, or revolver facilities contain individual material adverse change (MAC) clauses. However, these facilities are bound by the terms of the common terms agreement and the security trustee, and the intercreditor deed (STID).

The STID contains several references to "material adverse effect". The documentation defines this as the effect of any event or circumstance which is materially adverse to:
- The business, assets, or financial condition of the security group taken as a whole; or
- Taking into account the resources available to it from other members of the security group, the ability of an obligor to perform its payment obligations under any transaction document; or
- The legality, validity, or enforceability (subject to the reservations) of any transaction documents in a manner which is prejudicial in any material respect to the interests of the borrower-secured creditors.

OUTLOOK

The stable outlook reflects our view that, although ongoing stress to passenger traffic figures remains a concern (from the current global economic downturn), we believe that the downturn in passenger traffic has started to plateau. Full recovery in passenger traffic is, however, expected to take longer than initially expected and observed in previous similar downturns, leading aviation and airport industries to revise downward their volume expectations for 2010 and beyond.

As a result, we expect BAA securitized group to fall short of the EBITDA and cash flow assumptions used for regulatory settlement, as well as those prevailing at financial closing, in August 2008.

However, we believe the financial projections remain consistent with the original forecasts. The degree and timing of the recovery in passenger traffic and in financial performance will be a key determinant of the ratings. We will assess the degree of deviation through the regulatory period and the measures BAA management is able and willing to implement to narrow the gap with initial forecasts.

Finally, we will look closely at the ability of the borrower group to maintain strong liquidity and cover future funding needs beyond March 2010, for example by issuing long-term securities.

We will publish a transaction update on the BAA Funding transaction shortly.

RELATED RESEARCH

- BAA Funding Ltd. Debt Issues Assigned Negative Outlook On Dept. for Transport Consultation Paper; All Ratings Affirmed, March 12, 2009
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Criteria: Methodology For Rating And Surveilling European Corporate Securitizations, Jan. 23, 2008

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RATINGS LIST

BAA Funding Ltd.
€2.500 Billion And £2.796 Billion Multi-Currency Program For The Issuance Of Asset-Backed Notes

RATINGS AFFIRMED, OUTLOOK REVISED

Class	Rating	
	To	From

A-1	A-/Stable	A-/Negative
A-2	A-/Stable	A-/Negative
A-3	A-/Stable	A-/Negative
A-4	A-/Stable	A-/Negative
A-5	A-/Stable	A-/Negative
A-6	A-/Stable	A-/Negative
A-7	A-/Stable	A-/Negative
A-8	A-/Stable	A-/Negative
A-9	A-/Stable	A-/Negative

THE BORROWER GROUP—REFINANCING FACILITY

Tranche	Rating	
	To	From

Heathrow Airport Ltd.
£2.75 Billion Multicurrency Program For The Issuance Of Asset-Backed Notes
Issued By BAA Funding Ltd.

A1	A-/Stable	A-/Negative
A2	A-/Stable	A-/Negative
A3	A-/Stable	A-/Negative
A4	A-/Stable	A-/Negative
B2	BBB/Stable	BBB/Negative
B3	BBB/Stable	BBB/Negative

Gatwick Airport Ltd.
£1.05 Billion Multicurrency Program For The Issuance Of Asset-Backed Notes
Issued By BAA Funding Ltd.

A1	A-/Stable	A-/Negative
B1	BBB/Stable	BBB/Negative
B4	BBB/Stable	BBB/Negative

Stansted Airport Ltd.
£600 Million Multicurrency Program For The Issuance Of Asset-Backed Notes
Issued By BAA Funding Ltd.

A2	A-/Stable	A-/Negative
B1	BBB/Stable	BBB/Negative

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