Domestic Credit by Anthony K. Wikrent

A new threat to airport financing

The bankruptcy of Continental Airlines may cause headaches for officials trying to market airport bonds.

Immediately following the bankruptcy filing by Continental Airlines on Dec. 3, Standard & Poor's announced that it was placing three of Continental's four hub airports on credit watch. The announcement illustrates how the unraveling financial schemes of the 1980s can set off far-reaching and quite unexpected shock waves.

Continental's four hubs are Houston, Denver, Cleveland, and Newark. S&P placed the first three on credit watch, due to the significant presence Continental has at each airport. Newark was omitted because it is administered by the far larger Port Authority of New York and New Jersey.

According to David Swierenge of the Air Transport Association, airports are generally financed on the bond market. The marketability of airport bonds is based on the dedicated stream of revenues derived from the airlines, which are charged landing fees, gate rentals, or some combination of the two. These charges are established by negotiations between the airlines and the airport authorities, and are not uniform across the country. The charges may be higher at an airport which is in the process of modernizing or expanding by building new facilities.

The charges are designed to recoup the total costs of maintaining and operating the airport. At Cleveland, for instance, the contract between the airport and the seven airlines which use it, stipulates that any shortfall between airport revenues and expenses shall be made up by the airlines at the end of the year. If the airport shows a surplus at the end of the year, it is distributed to the airlines.

The federal ticket tax that goes into the Airport and Airway Trust Fund comprises a very small portion of airport financing, because the Reagan and Bush regimes have refused to spend the money on new airports, thereby creating a "surplus" that has been used to hide the size of the federal budget deficit.

By placing Continental's three hubs on credit watch, S&P is signaling to bond investors that there exists some risk that the revenue stream of those airports might suddenly be disrupted, were Continental's bankruptcy to result in the liquidation of the airline.

Swierenge, along with airport officials in Denver and Cleveland, insisted that it was very unlikely that another airline would not step in to fill the void left by a liquidation of Continental. Swierenge conceded, however, that "there is no guarantee that other airlines would fill the gap."

But with the airline business headed for a loss of around $2 billion this year, these may be hollow reassurances.

At Cleveland, according to Mark Courtney, manager of marketing and communications at the Department of Port Control (the airport authority in that city), Continental controls about 40% of the market. The second largest share of the Cleveland market is held by USAir, with 25%.

USAir, which recorded the first annual loss in its history in 1989 and has racked up $233.4 million of losses in the first three quarters of this year, announced in September that it was reducing its work force by 7%, or 3,600 workers. With the run-up in jet fuel prices since August, it is unlikely USAir's financial situation is going to improve anytime soon.

George F. Doughty, director of aviation for the Denver airport, insisted that the liquidation of an airline "is not relevant" for an airport authority, because "revenue ultimately comes from passengers and shippers. If Continental evaporated tomorrow, we would not lose 15% or 20% of the passengers" which are served by Continental.

Despite Doughty's assurances, Denver has a special interest in Continental's survival. Denver broke ground this year for a new airport to replace Stapleton Field. It will be the first large airport built in the United States in almost 20 years; $210 million in bonds have already been sold for land acquisition, and another $900 million to finance construction. Doughty said that Denver plans to sell another $1-1.5 billion in bonds for construction. So far, the only airline to sign a contract to operate at the new airport is Continental.

Though S&P has indicated to officials at both Cleveland and Denver that a downgrading of their bond ratings is not imminent, potential investors in the remaining $1.5 billion that needs to be raised, will be watching closely to see if Continental can avoid liquidation, or if Denver can sign up more airlines for its new airport.

There could be big trouble ahead for U.S. airports, which need $50 billion in new capital expenditures by the end of this decade if they are to avoid gridlock. With the airline industry now on its knees, many investors may no longer be willing to provide the necessary financing for such projects.