Special Report

Global Infrastructure & Project Finance Outlook 2009

Analysts

Christopher Thorpe
+44 20 7682 7521
christopher.thorpe@fitchratings.com

Sector Contacts

Energy
Doug Harvin, Americas
+1 312 368 3120
doug.harvin@fitchratings.com

Dan Robertson, EMEA
+44 20 7682 7381
dan.robertson@fitchratings.com

Federico Gronda, EMEA Renewables
+44 20 7682 7464
federico.gronda@fitchratings.com

Oil and Gas
Dan Robertson, EMEA/Asia Pacific
+44 20 7682 7381
dan.robertson@fitchratings.com

Greg Remic, Americas
+1 312 606 2339
gregory.remec@fitchratings.com

Transportation
Mike McDermott, North America
+1 212 908 0605
michael.mcdermott@fitchratings.com

Alberto Santos, Latin America
+1 212 908 0714
alberto.santos@fitchratings.com

Nicolas Painvin, EMEA
+33 1 44 29 91 28
nicolas.painvin@fitchratings.com

Social/Leisure Infrastructure
Dan Robertson, UK
+44 20 7682 7381
dan.robertson@fitchratings.com

Nicolas Painvin, Continental Europe
+33 1 44 29 91 28
nicolas.painvin@fitchratings.com

Chad Lewis, US Sports
+1 212 908 0886
chad.lewis@fitchratings.com

Whole Business Securitisation
Guillaume Langellier, UK
+44 20 7682 7563
guillaume.langellier@fitchratings.com

Regional Contacts
Olivier Delfour, EMEA
+33 1 44 29 91 21
olivier.delfour@fitchratings.com

Cherian George, Americas
+1 212 908 0519
cherian.george@fitchratings.com

William Streeter , Asia Pacific
+65 6796 7224
william.streeter@fitchratings.com

Summary

Since the publication by Fitch Ratings of its first global infrastructure and project finance outlook in March 2008, the world's economy has faced unprecedented stress and core credit fundamentals have deteriorated more than expected. Current uncertainty points to material longer-term degradation in asset values, and consequently credit quality, than was predicted a year ago.

Some sectors (transportation, especially in the US, and consumer-related whole business securitisations in the UK) were already identified as having negative prospects. The key concern at the time was reduced availability of credit, leading to greater refinancing risk, rather than a profound and prolonged recession in major advanced economies (MAE) and a significant slowdown in developing economies. Deteriorating operational performance of the assets and extreme volatility of commodity prices were considered lesser factors than they are now.

Infrastructure credits, which largely fall into the areas of transportation, energy and government assets, are often essential and long term in nature. This underscores their economic value and makes them easier to understand and assess. As a result, Fitch still believes that the relative stability of project and infrastructure fundamentals will cushion the adverse effects of this turbulent global economy, which is likely to continue beyond 2009. The long-term contractual nature of financial and commercial arrangements in the sector and the structural protections usually present in project finance debt, plus the use of stress-testing prior to the assignment of the rating, provide additional margins of protection. However, the sector and its ratings are not immune.

- Refinancing risk, as mentioned in last year's outlook and further analysed in a report published in late 2007 ("*Infrastructure Projects Ratings : Resilient in Inclement Markets*"), is not a key rating factor in transactions rated by Fitch. This is because the vast majority of projects are not exposed to such risks. Nevertheless, a number of bank-funded acquisitions of infrastructure assets have exposure to refinancing risk in the next few years. The decline in the availability of credit in the latter part of 2008 makes this a greater concern.
- Although stress-testing was part of the initial rating analysis for projects rated by Fitch, in some cases the magnitude of these stresses did not reflect the extreme conditions that the world's economies are currently facing. A key factor for rating stability will be the length and depth of the current downturn. This will also have an impact on a long-term basis, as low or negative growth in the early years of a project may have a compounded impact on the long-term cash flows (which are often linked to inflation).
- Evidence of stress has already appeared in transactions dependent upon volume or price linked to levels of economic activity such as US traffic, commodities and discretionary spending. Fitch anticipates that transactions will be tested beyond 2008 expectations.
- Another potentially broad area of impact is through counterparty risk, from constrained liquidity or credit, and increasingly from the commercial effects of the recession. The former may be more significant for financial counterparties, and the latter for contractors and off-takers.

- Although largely a story of the recent past, cost and commodity price inflation may have ongoing implications for some projects through 2009. Indeed, in some cases, projects have been developed on the basis of high costs (now locked in) and high selling prices (now in question, as current volatility in inflation/costs, interest rates, GDP and commodity prices may lead to a revision of long-term estimates). Therefore, projects developed in recent years may suffer from a structural imbalance.

Increasingly, this now appears to be a globally synchronised downturn. As a result, outlooks across sectors and regions will be more convergent in 2009, with less differentiation than in the past. At the same time, no matter what, 2009 will be a turning point. Fiscal stimulus through infrastructure spending can at the same time support the sector but also arguably create assets that compete with existing operating assets in a depressed environment. In any case, any major new project initiated as part of these packages will likely have effects in the medium rather than short term, due to the inherent time-lag associated with designing and developing such projects.

Summary of Outlooks

Project sector	Sector outlook	Rating outlook
Thermal power	Stable/negative	Stable
Renewable power	Stable	Stable
Oil/gas (price risk)	Stable/negative	Stable/negative
Oil/gas (contracted)	Stable	Stable
US toll roads	Negative	Negative
Lat Am toll roads	Negative	Stable/negative
EMEA roads	Stable/negative	Stable/negative
Australia toll roads	Stable	Stable
India toll roads	Stable	Stable
US airports	Negative	Negative
EMEA airports	Negative	Stable/negative
Asia Pac airports	Stable	Stable
US seaports	Negative	Negative
EMEA seaports	Negative	Negative
EMEA Soc. infra (availability based)	Stable/negative	Stable
EMEA transport (availability based)	Stable	Stable
US sports assets	Negative	Stable/negative
UK whole business (pubs)	Negative	Negative
UK whole business (healthcare)	Stable/negative	Stable/negative

Sector outlook reflects Fitch's view of broad asset performance of projects in that sector while rating outlook reflects the prospective balance between upgrades, downgrades and affirmations of Fitch-rated instruments.
Source: Fitch

The precarious nature of the times is underscored by the distinct possibility that if the various stimuli proposed do not have the desired effect, the world could be facing a deep and prolonged recession. Such a scenario would be outside Fitch's initial stress scenarios, which assumed what was then thought to be severe declines and shock events, but did not envisage the extent of current events.

Sectors exposed to consumption or discretionary spending will likely be the most vulnerable with regional differences less pronounced due to the global nature of the recession. Projects not subject to demand or price risk such as public-private partnership (PPP) availability transactions and long-term, contracted projects will likely be more stable. However, this relies on stability in counterparty credit quality and in the financial structure. Power projects are also likely to be less affected (apart from counterparty risk-related issues) as electricity and gas consumption tend to be resilient in downturns, especially as generation was closer to undercapacity than overcapacity.

Lastly, across sectors and regions, projects with limited leverage, strong covenants and structural protections, and strong committed sponsors with long-term strategies are likely to be more resilient than others. Fitch expects that when new

funding is available, the terms will be far more stringent and creditor-friendly than was the case in the past few years. This will prove to be a strong credit positive when rating new project debt. Fitch also expects to draw lessons from the current situation, especially regarding stress scenarios and sensitivity analysis.

Thermal Power Projects

Overview

Sector Outlook: Stable to Negative
Rating Outlook: Stable

Fitch's sector outlook across the broad power industry is stable, although some regions have a slightly negative tendency. The credit crisis has created some counterparty concern in certain segments, which could introduce instability to a marketplace that otherwise displays sound underlying fundamentals. For the most part, the rating outlook for the project finance segment is stable as market issues should not dramatically affect individual asset performance unless a project's output is being sold to a distressed counterparty.

Industry Fundamentals Remain Sound

Fitch expects the fundamentals of the power industry to be more resilient than other consumer sectors to the worldwide economic downturn as electricity is an essential product of consumption. Although demand growth appears to have softened in 2008 - and is likely to be flat through 2010 - Fitch believes it unlikely that significant erosion in consumer demand will occur. Furthermore, the rate of new capacity additions in recent years has generally kept pace with demand growth, if not slightly behind. Accordingly, Fitch does not envision overcapacity conditions, which depress margins for power generators, as an imminent concern.

Gross margins for energy production continue to be highly correlated to fuel prices. Due to the dramatic decline in world oil prices, and the associated pull-back in natural gas and coal prices, energy margins have declined in recent months and are expected to remain close to current levels during 2009. The decline, however, must be considered in the context of relatively high margins earned in 2007 and the first half of 2008; current margins remain more than sufficient to cover fixed operating costs. Favourably, the lower commodity prices are expected to lead to reduced working capital and collateral requirements, providing liquidity relief for all market participants.

Counterparty Credit Quality: The Sector Wild Card

Fitch considers regulated utilities (the most common power project off-taker) to be a defensive sector for investors, and therefore still able to obtain financing in the current environment. Access to funding is particularly important as utilities are implementing expensive capital programmes for transmission, environmental compliance and new capacity additions. However, utilities are facing heightened regulatory risk as the pressure of a weak economic backdrop could result in political push-back to rate increase requests. Elevated capital budgets and the current restrictive credit environment are expected to put upward pressure on consumer rates. Conversely, the lower commodity prices may alleviate consumer rate increases. Although minor adjustment in credit ratings is possible, Fitch expects that utilities will not experience significant deterioration in credit quality that would jeopardise off-take contracts.

The prospects for non-regulated power generation companies are more challenging than for regulated utilities. In the face of collapsing commodity and power prices, this market segment has seen margin erosion, more restrictive credit availability and significant declines in market value. There are many large, financially strong competitive generators that should have sufficient flexibility to withstand the current environment. However, there are a greater number of mid-sized or highly-levered companies that relied on the free flowing capital environment to sustain

them. Fitch views the latter category of counterparties to represent a significant source of instability in the sector as the insolvency of one participant can be disruptive along an entire value chain.

Environmental Regulation a Future Risk Factor

Compliance with environmental regulations continues to be a dark cloud for the majority of power industry participants, with the exception of clean energy providers. Many programmes to reduce greenhouse gasses are in place, or merely envisioned, but are only recently being implemented. Accordingly, generators are not yet facing the direct impact of these regulations, which in many cases remain too uncertain to assess. Accordingly, Fitch's outlooks and ratings do not yet reflect the looming threat of environmental programmes.

Within Europe, environmental regulation in the power sector is dominated by three main EU-wide mechanisms, which often are cascaded down to national legislation and targets:

- the EU Emissions Trading Scheme (EU ETS), now in its second phase;
- targets for member states to generate increasing percentages of their energy requirements from renewable sources; and
- the Large Combustion Plant Directive (LCPD), which requires mainly older coal and oil fired generation plants to invest in emissions abatement technology or else to operate at a lower load factor and ultimately to close by 2015.

The fact that these mechanisms are all established reduces some uncertainty for the European power sector on environmental issues. However, each of the three areas is subject to ongoing change and development. For example, the European Commission is considering expanding the LCPD to include additional coal-fired plants and some older gas-fired ones. Therefore, some environmental uncertainty remains for European generators, but less so than in North America.

The US has lagged other developed economies in adopting programmes to combat global climate change. However, the change in the presidential administration and the congressional leadership are likely to result in profound changes in energy policies and environmental regulations. In Fitch's view, there will be an emphasis on a national renewable energy portfolio standard, energy efficiency and conservation initiatives while new nuclear power initiatives and clean coal technologies are unlikely to receive support. The agency expects legislation will be enacted by 2010 that will dramatically reduce carbon emissions.

The structure of any legislation or programme remains uncertain. Furthermore, the steep costs associated with government programmes to rescue the US financial system, the ongoing recession and the incremental expense of green power initiatives will affect the timing and implementation of any new programme.

What Impact on Project Ratings?

The majority of project finance transactions are oriented around long-term contracts, usually with investment-grade counterparties. Fitch's rating analysis typically reflects the project's standalone credit metrics derived under the pricing mechanics and delivery obligations of the contracts. However, as the counterparty's credit quality begins to decline, there is greater risk for contract termination or counterparty payment default. In these circumstances, the project's standalone credit quality as a merchant facility will be influential in determining the rating outlook.

Many project finance transactions have market exposure, usually via a merchant business plan but occasionally through contracts indexed to market prices. When evaluating these projects, Fitch's rating decisions are heavily based on the financial performance during stressed market conditions – typically involving fuel prices and

market overcapacity. Subsequently, if the agency believes there is a permanent shift in the market away from its initial stress assumptions, it could upgrade if the shift is favourable or downgrade if unfavourable.

As Fitch expects regulated utilities and financially strong competitive generators to withstand the current environment, the rating outlook for projects having fixed price off-take agreements with these counterparties is stable. The primary risk for this category of projects involves technical performance and operating costs. Although these are important contributors to credit quality, they are largely project-specific issues and not linked to industry-wide events.

The rating outlook for projects selling their output to mid-sized or highly levered competitive generators is negative, reflecting the possibility of deteriorating counterparty credit quality. The magnitude of rating action, if any, for an affected project will be highly specific to the original contractual arrangements and the project's prospects in its local marketplace.

The rating outlook for projects with market exposure is stable. Fitch acknowledges the steep decline in gross margins and expects debt service coverage will be meaningfully lower than in recent years. This is particularly true for coal fired and hydroelectric projects, and to a lesser degree for natural gas fired projects. However, Fitch notes that previous market conditions were extremely favourable for merchant generation. Notably, current fuel prices remain above the levels assumed in the agency's market stress scenarios and meaningful overcapacity is considered unlikely. Although cash flows will be lower than in previous years, Fitch expects financial performance of merchant generators will exceed that assumed in its stress scenarios on which the ratings are based.

What to Watch

- Fuel supply arrangements, especially for merchant coal-fired generators. Considering the steep decline in fuel prices, fixed price contracts executed in recent years may result in a negative margin on market-based energy sales. Notably, coal supply agreements often involve fixed prices for three- to five-year terms.
- Counterparty credit quality, especially when the counterparty is an independent generating company as this segment is more vulnerable to sudden credit issues.
- Maturity of credit facilities that satisfy debt service and maintenance reserves, performance obligations, and so on. A failure to replace or renew will likely result in additional indebtedness as funds may be drawn prior to maturity of the current facility.
- Environmental compliance strategies may alter cost structure and operating practices for European generators. Coal-fired generators appear particularly vulnerable.

Renewable Power Projects

US and European Projects

Sector Outlook: Stable
Rating Outlook: Stable

Fitch maintains a stable outlook on renewable energy power projects. While wind power still represents the majority of new and installed capacity, other technologies have witnessed strong growth during 2008. The Spanish photovoltaic sector, in particular, experienced very high activity, as investors rushed to complete projects to take advantage of the favourable tariffs scheme expiring at the end of September 2008. Solar thermal installations are being developed at utility scale while geothermal development is drawing increased attention in the US.

The primary challenge affecting the renewable energy sector, and wind projects in particular, is a shortage of skilled labour and spare parts. These issues, together with the fact that turbine manufacturers continue to enjoy a very strong position in negotiations with operators and sponsors, may have negative effects on maintenance programmes, thereby jeopardising the long-term reliability and performance of the projects. The reported problems with the blades of certain turbines or with obtaining appropriate insurance cover in Germany on a number of turbine foundations are examples of the technical issues currently affecting the market. Furthermore, the production cuts recently announced by Gamesa, one of the world's leading turbine manufacturers, do not suggest an imminent solution to the bottlenecks in the supply chain seriously constraining the industry and often causing significant completion delays. This situation is expected to persist in the medium term and is of concern for the healthy development of the industry. Projects not backed by experienced operators and sponsors are the most vulnerable.

Finally, the financial performance of the projects may come under pressure should the energy yield underperform compared to the forecasts. In Fitch's opinion, this risk is mitigated in the case of photovoltaic plants by the availability of extensive historical solar irradiation data and by the limited variability in solar resource availability. On the other hand, Fitch has observed a deviation of actual energy output from the original production forecasts in a variety of wind farm projects. Other studies produced by market participants also suggest that predictions have, on average, exceeded actual production. Although further data and analysis are needed, confirmation of the long-term nature of the observed trend may put pressure on the projects' financial performance.

In Europe, the renewable energy sector benefits from different forms of government support depending on the jurisdiction. In the countries experiencing the highest level of activity, these projects are subject to regulated feed-in tariffs, and are not therefore directly exposed to volatile wholesale energy prices. The financial viability of many renewable energy projects relies on the presence and continuity of such government incentives, leaving the sector exposed to shifts in future public sentiment. Fitch views as unlikely a change in the regulatory framework negatively affecting currently operating projects and it therefore values positively the removal of market price risk through the feed-in tariff mechanism.

In the US, the renewable energy sector benefits from a variety of federal tax credits and, more recently, federal programmes to facilitate the financing of greenfield renewable projects. However, until federal renewable portfolio standards or other environmental policy is in place, long-term off-take agreements continue to be the primary determinant of successful development. For several years, public utility commissions have looked favourably at renewable and alternative energy supply, adopting aggressive renewable portfolio standards. However, Fitch now anticipates a reversal in utility commission enthusiasm and a slowdown in the pace of development of new projects in the near term. In an environment of declining fuel prices, renewable energy is now relatively more expensive. Furthermore, the weak economic environment will likely soften public sentiment for the environmental benefits derived from renewable energy. Fitch believes state-level renewable portfolio standards could be relaxed over the near term, eliminating a major benefit for project financing – an off-take agreement with a regulated utility. Notably, the agency expects that previously executed contracts will remain in effect regardless of changing regulatory sentiment.

What to Watch

- equipment supply;
- technical failures; and
- reliability of forecasts.

Oil and Gas Projects

Oil & Gas (With Exposure to Hydrocarbon Prices)

Sector Outlook: Stable to Negative
Rating Outlook: Stable to Negative

Fitch maintains a stable to negative outlook on the credit quality of large-scale oil and gas projects whose ability to service debt is linked to global or regional hydrocarbon prices. This group includes projects involved in the development of proven hydrocarbon reserves, production of oil and gas, transit of oil and gas by integrated pipeline, gas liquefaction[1], oil processing and storage and oil refining.

In 2007 and 2008, the credit quality of such projects has been supported by strong hydrocarbon prices. However, at the same time, high demand for capital equipment and services in the sector has meant that capital costs in the industry have increased significantly and delays in construction are common.

With recent sharp declines in the oil price, those projects with relatively high capital costs and hence high breakeven hydrocarbon prices, are likely to be more exposed than projects with lower cost bases. Therefore, the credit quality of projects under construction or recently commissioned is likely to be less strong than projects in operation.

Nonetheless, projects in this category have generally been developed by experienced and financially strong sponsors and are often part of an integrated value chain. In addition, they often benefit from the equity sponsorship of the host government and are important strategic assets in their host country.

Projects in this group generally have financial structures that reflect their exposure to volatile market prices. Gearing is low (30-50% debt to project costs) relative to other infrastructure sectors. In addition, when rating these projects, Fitch uses a price deck that is considerably lower than recent market highs and more in line with the long-term average oil price.

What to Watch

- increasing capital costs;
- breakeven hydrocarbon price; and
- construction delays.

Oil & Gas (Long-Term Contracted Assets)

Sector Outlook: Stable
Rating Outlook: Stable

Fitch maintains a stable outlook on the credit quality of oil and gas projects that benefit from long-term contracts. This group includes: oil and gas pipelines whose revenue comes from transit tariffs; LNG shipping based on long-term charters with gas liquefaction companies; and LNG regasification based on tolling agreements.

Debt service for projects in this group is supported by long-term “use or pay” type contracts, typically with large oil and gas companies with strong investment-grade ratings or with significant oil or gas projects of investment-grade credit quality (which generally are owned by large independent oil majors, national oil companies or host governments).

These arrangements mean that these projects are partially insulated from the volatility of hydrocarbon prices, although a decline in credit quality of the contract

[1] Gas liquefaction is often supported by long-term sales contracts, but with prices still linked to global or regional oil prices or regional gas prices. Therefore, Fitch has classified them in this category rather than as long-term contracted assets

counterparty (potentially due to a decline in oil and gas prices) would begin to weaken the debt service prospects of projects in this category.

Pipelines and shipping companies have an additional strength in that they are often the primary route to market for a larger upstream or midstream project. Also, ships can potentially be deployed elsewhere. Pipelines, however, are more vulnerable than shipping given that they are fixed assets physically and often rely on only one source of upstream supply for their debt service.

LNG regasification terminals are often developed for their option value in trading LNG and because their capital cost is a relatively small portion of the upstream, transit and liquefaction costs of a large gas project. In some key LNG markets, there is an oversupply of regasification compared to liquefaction capacity. Therefore, the utilisation rates for regasification plants can be low, which means that debt service is reliant largely on robust "use or pay" clauses rather than being further supported by the strategic importance of the asset to the upstream project.

What to Watch

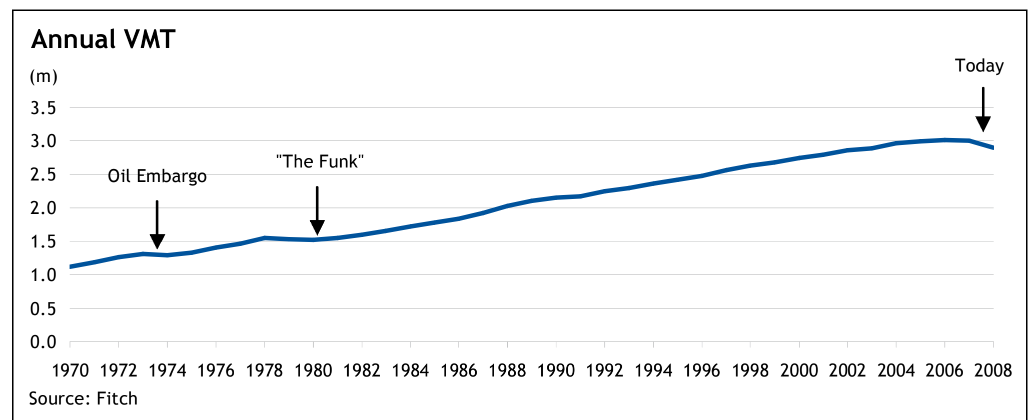
- counterparty risk.

Toll Road Projects

US Toll Roads

Sector Outlook: Negative
Rating Outlook: Negative

The outlook for the sector remains negative. It is Fitch's expectation that the poor performance in 2008 will likely moderate in 2009, with no growth for most facilities. Further declines will likely be experienced for those facilities with a large discretionary or commercial component, along with those that operate in economies harder hit by the recent crisis. Job losses in 2008 were severe, and the expectation is that losses will continue into 2009 as well. Coupled with the reduction in vehicle miles travelled (VMT, see chart), these conditions have led to less congestion on free alternatives. As a result, Fitch expects very modest growth beginning in 2011. A trend-line shift downwards is assumed to be a likely outcome. Against this backdrop, Fitch expects that negative rating actions will far outweigh any positive actions in 2009. Importantly, negative actions could exceed rating affirmations if the underlying fundamentals continue to worsen. For some facilities, refinancing - either to address non-performing variable rate debt or near-term maturities or bank bonds - is a risk that is much more magnified given credit spreads and the overall increase in the cost of capital.



Source: Fitch

In August 2008, Fitch indicated that the outlook for toll roads was negative given the deteriorating fundamentals that many facilities were experiencing. The deterioration was due in large part to the spike in fuel prices that began in the latter half of 2007. By October 2008, virtually all toll roads were either

experiencing no growth over the same month in 2007 to reductions of between 5% and 18%. In the last six months of 2008, fuel prices have dropped dramatically from historical highs, but employment growth replaced fuel as the key factor behind traffic and revenue declines. For the year ending 31 December 2008, Fitch upgraded one issuer and revised the Outlook to Stable from Negative on two issuers. Two credits were downgraded, one was placed on Rating Watch Negative while two other facilities were placed on Negative Rating Outlook. Indeed, 2008 was a difficult year for toll roads.

In April 2005, Fitch issued a report indicating that the key to rating stability was management's reaction to changes. In 2009, the challenge facing toll road managers, both public and private alike, is clear. To maintain financial flexibility, toll increases will need to be higher than planned and in many cases accelerated. However, depending on the extent of traffic declines, a recovery in revenues through toll increases may not revert to the prior trend line in the near to medium term without a substantial increase in tolls. This choice will be made in the face of a more charged political environment and greater toll elasticity driven by economic fundamentals.

The management of facilities with a rapidly escalating debt profile, i.e. toll roads in the 'BBB' and low 'A' categories, will need to make this choice much sooner as many of these credits depend on growing traffic and revenue to meet debt service obligations. And while this scenario does not indicate an imminent default, it does represent significantly diminished financial flexibility and increased default probability over time if no action is taken. Importantly, the management of private and a few public facilities have decided to increase and/or accelerate toll rates relative to plan, while many public authorities are still reviewing their options. To date, public agencies that have taken either action to deal with the current environment or have continued with annual increases include the Maine Turnpike, the SR-91 Express Lanes and the San Joaquin Hills Transportation Corridor Agency. On the private side, tolls have been increased as expected on the Dulles Greenway and the Pocahontas Parkway. Tolls on the South Bay Expressway have increased by approximately 10%.

In addition to near-term economic issues, there is the potential for the advent of longer-term trends that could adversely affect the essentiality and thus credit quality of US toll roads. Fitch anticipates that some form of economic stimulus will be provided in 2009 that has the potential to stabilise the economy and thus, by extension, traffic growth. However, if there is a significant emphasis on transit funding there could be longer term ramifications for toll road usage. In addition, improvements in primary and secondary education could attract more suburbanites to the urban core. These changes seem unlikely now, but were they to occur, the longer-term value of toll roads could be called into question.

What to Watch

- A continuation of the decline in vehicle miles travelled (VMT) could cause larger reductions in toll road traffic and make free alternatives less congested and more competitive on a travel time basis.
- Publicly run facilities will face increased political opposition to toll increases at a time when these increases will be critical for many facilities to maintain financial flexibility and to meet covenants.
- A significant increase in leverage on large regional facilities could materialise as governments utilise those balance sheets to accelerate transportation investments.
- Interstate turnpikes with a large commercial component could experience a significant loss in revenue if retail sales and consumer activity continues to drop.

Latin American Toll Roads Begin to Feel the Effects of Global Economic Slowdown

Sector Outlook: Negative
Rating Outlook: Stable to Negative

Despite initially appearing less vulnerable to the perfect credit storm, the financial crisis affecting the US and other parts of the world is finally catching up to Latin American toll roads. Fitch expects that the convergence of the global recession, capital markets instability and volatile commodities prices will challenge the credit metrics of the sector.

Given a higher degree of commercial integration among global economies, Fitch believes that declining levels of economic activity, particularly in the US, Europe and Asia, will negatively impact traffic and revenues for toll roads, mainly those that are heavily dependent on international commerce to support their export-related activities. For instance, toll roads located on the border between Mexico and the US or those linked to ports are particularly susceptible to declining traffic activity, as well as roads that are dependent on foreign tourism.

Although recent data suggest modest declines in traffic growth on some toll roads in the region, a continuation of a global economic downturn will likely result in a drop in traffic volume on a year-on-year basis. That said, Fitch does not anticipate that these macro issues will affect all toll roads equally, for it will depend on a project's reliance on commercial/tourist traffic activities. Toll roads exposed to the volatility of certain industries such as the auto sector or highly dependent on the tourism industry will be pressured to maintain their current credit profiles. Meanwhile, roads financed on a portfolio basis should benefit from diversity and are expected to be less affected by potential traffic and revenue declines.

Structural protections in certain instances will provide some risk mitigation. Transactions in Mexico with low mandatory, interest-only debt service obligations benefit from flexible principal amortisation that cushions stress. In addition, some toll roads benefit from a supportive regulatory environment and/or favourable concession terms that limit performance risk, such as in Chile, Colombia and the Dominican Republic. At the same time, toll roads in need of refinancing for capital expenditures or with near-term debt maturities will face challenges due to limited access to foreign and domestic capital markets.

Brazil

Fitch's rating outlook on Brazilian toll roads is stable to negative. A majority of toll road concessions in Brazil are mature and were moderately leveraged. Through the autumn/fall of 2008, traffic growth in Brazilian toll roads had increased by a significant 7.1%. However, reduction in expected traffic growth is likely given the sharp drop off in economic activity in the fourth quarter of 2008 and in early 2009, and the expectations are for further declines as the global recession takes hold. Projects that were financed in 2007 and 2008 and the new projects auctioned in October are more vulnerable to this downturn as they were financed at the peak of the cycle with much higher levels of leverage.

Chile

Fitch's rating outlook on Chilean toll roads is also stable to negative. Although traffic volume on Ruta 5, the central spine providing connectivity through Chile, grew by approximately 4.0% in 2008 it was noticeably less than the 6.8% in 2007. Unlike previous years of growth, declines in traffic volume are expected for 2009. As a result, cash flows may be pressured by lower revenues, potentially affecting debt service coverage. Nevertheless, Fitch-rated toll roads in Chile have financing structures that include manageable long-term debt amortisation schedules, which along with structured liquidity provide financial flexibility during stressful economic periods. To take advantage of inflation-linked tolls, various toll roads are financed in Unidad de Fomento (UF), a Chilean inflation-indexed unit. While this potentially

exposes these projects to some vulnerability in periods of high inflation, where toll increases may not economically or politically be able to keep up with inflation-linked debt, it is largely mitigated by the less volatile economic profile of Chile in recent decades and the favourable history of rate increases. The ability under some concession agreements to adjust tariffs over inflation levels under certain conditions may permit some catch up in more stable economic times. Minimum revenue guarantees and direct subsidies also serve to partially mitigate risk from adverse traffic conditions.

Mexico

Fitch's rating outlook on Mexican toll roads is also stable to negative. While urban and interurban highways in other parts of the world have shown declining traffic volumes, many toll roads in Mexico continue to exhibit some growth. Consequently, Fitch-rated toll roads have shown favourable financial performance. Nevertheless, negative repercussions in traffic volume to the global economic downturn are expected in the near term, as the effects of the US economic downturn accelerate their impact across the border in 2009. Roads in dense urban areas are less vulnerable, while those primarily serving commercial or tourist traffic are more exposed.

The expectation of lower cash flows due to traffic declines will add pressure to debt service coverage. However, many rated toll roads in Mexico have financing structures that contain manageable long-term debt amortisation schedules and flexible debt service provisions to ride through weaker traffic performance. Likewise, as an additional protection to bond investors, many toll roads rated by Fitch have zero flow structures. The mechanism of this financing approach is such that any excess cash flow after satisfying the waterfall are used exclusively to prepay senior debt. Hence, there is no release of cash out of the structure. Similar to Chile, to take advantage of inflation-linked tolls, most Mexican toll roads are financed in Unidad de Inversion (UDI), a Mexican inflation-indexed unit. Mexico's more volatile history exposes these projects to greater vulnerability in periods of hyper-inflation where toll increases may not economically or politically be able to keep up with inflation-linked debt.

What to Watch

- Sudden shifts from growth to declines on recently well-performing roads, and sharper drops in traffic on those that have already demonstrated declines.
- If inflation rises sharply, mismatches in the financial profile created by the inability to raise tolls commensurately with inflation-linked debt obligations.

EU Toll Roads Still Resilient; Some Schemes Affected

Sector Outlook: Stable to Negative

Rating Outlook: Stable to Negative

Roads (including road tunnels) constitute the most important subset of infrastructure in terms of number of projects and volume of finance raised in Europe (25 projects reached financial close in 2008, for a total of EUR9bn).

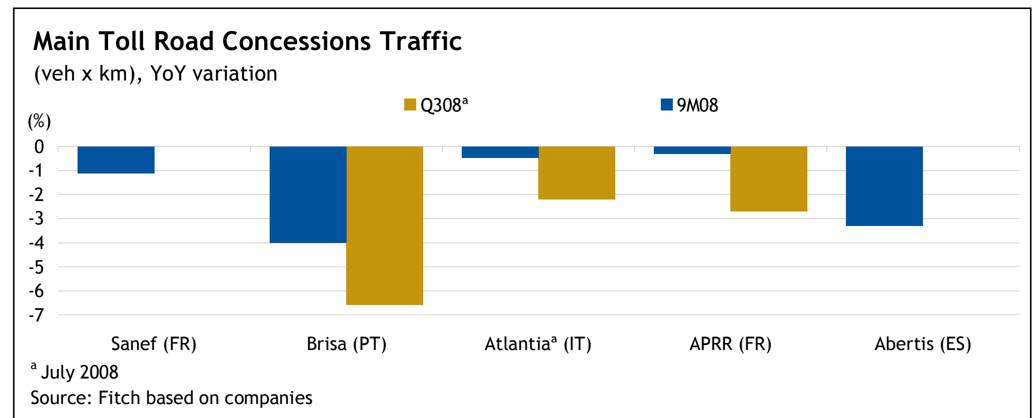
Until Recession: Strong and Stable Performance Despite Long-Term Threats

Over the course of the past decade, European toll roads have outperformed GDP growth and conventional road usage. This has been against a backdrop of very low growth in overall road traffic, stagnation of the car ownership rate, congestion of urban areas (which tends to eliminate the benefit of time savings made on the toll roads), political and civil reluctance to add new capacity, increasing climate change awareness among individual drivers and policies favouring rail freight, to name only a few examples. Fitch believes this is due to the value-added provided by these facilities (safety, speed, reliability), and, in the short term, this is likely to help mature facilities resist economic recession. In the longer term, however, Fitch believes that toll roads may post weaker performance than before the crisis and

may never recover the same pace of growth. This would reflect the long-term trend of toll roads' patronage growth converging towards that of general road networks.

Main Toll Road Concessions Traffic

(veh x km), YoY variation



[a] July 2008

Source: Fitch based on companies

Resilient, But Not Immune

Although less severe than in the US, the decline in traffic for European toll roads was clear during the summer of 2008. It was marked in countries such as the UK, Spain and Portugal, where economies are more prone to volatility. It was softer in France and Italy, where toll road networks are more mature and economies are supported by natural stabilisers.

With the main economic drivers for toll road traffic being GDP and employment, (and much less fuel cost), Fitch expects declines at least through 2009, in parallel to the economic slowdown.

Tariff hikes will partly compensate for traffic downturn and, in some instances, tariff hikes were in sponsors' base cases. But traffic declines were typically not taken into account in those base cases. In most cases, as a result both of affordability issues (lower disposable income for drivers) and political pressures (as seen in France and Italy), tariff hikes could be more constrained, clearly weighing on revenues.

Sector and Rating Outlook

Fitch adopts a stable to negative outlook on the sector generally. Indeed, although toll road transactions are generally resilient to brief economic downturns, with amortising long-term debt and coverage ratios accommodating a temporary slowdown of revenue growth, Fitch now believes that a recessionary environment may translate into materially lower performance for the toll roads collectively.

Fitch sees the outlook for asset performance as somewhat negative (traffic and revenues will be lower than expected). Some fragile facilities (notably those in ramp-up phase) could be severely hit, while mature and better positioned schemes will be more resilient.

Experience shows that the risk of variation on year-on-year growth is limited. However, while this risk was secondary for mature transactions with amortising long-term loans, it becomes more critical for transactions with relatively high leverage and/or mini-perm debt structures. These are more dependent on actual growth of traffic, as well as being more exposed to refinancing risk, should the credit crunch last several years.

The blended rating outlook is thus a mix of stable (for mature and well positioned facilities) and negative (for leisure-oriented schemes or those with aggressive business or financial plans). Most affected could be the facilities linking cities with weekend tourist destinations and those urban schemes expected to serve newly developed areas, as illustrated by some Spanish projects already in trouble.
Fitch's research has found that ramp-up phases are usually longer than forecasts

suggest, but traffic outcomes usually exceed targets in the longer term. Given the importance of the first few years in the overall financial outcome, projects financed in a more depressed economic context and with a higher cost of debt will probably have to rely on more conservative base cases than previously envisaged.

What to Watch

- schemes in ramp-up phases with urban development risk (e.g. Madrid Radiales); and
- transactions with refinancing risk (e.g. mini-perm in France).

Australia Toll Roads

Sector Outlook: Stable
Rating Outlook: Stable

Toll roads in Australia continue to benefit from traffic and revenue growth, as well as strong interest coverage. Monthly figures show that traffic growth slowed over the last few months, but remained positive in spite of steady deterioration over the last year in the economic performance of the States of New South Wales and Victoria, where the Fitch rated operating toll road projects are located. Traffic and revenues have also shown little elasticity to inflation adjusted toll increases. Scheduled refinancing needs for toll road debt in 2009 appear manageable, within the currently restricted financial environment. Various stand-alone tunnel projects in Sydney and Brisbane are heavily leveraged, and are reportedly having problems meeting their original forecasts, but none of these projects have Fitch rated debt.

What to Watch

- the management of refinancing risk in this environment of wider spreads and lower availability of credit; and
- the potential for debt restructurings for underperforming tunnel projects.

India Toll Roads

Sector Outlook: Stable
Rating Outlook: Stable

Most of the toll road ratings in India are in the 'BBB(ind)' category due to construction and completion risk, as well as usage and revenue ramp-up risk. Toll road project debt in higher rating categories reflects projects that are already operational, and that produce sufficient debt service coverage. Fitch does not expect upwards rating migration for many toll road project loans once they transition from construction to operation. This is because of their high level of indebtedness, the structure of their loans and susceptibility to cash flow volatility.

What to Watch

- willingness of Indian banks to continue to allow loan draw-downs for construction projects;
- ability of project cash flows to weather onerous loan provisions, such as frequent interest reset provisions and aggressive amortisation profiles; and
- willingness of highway regulators to approve completed project segments for initial tolling.

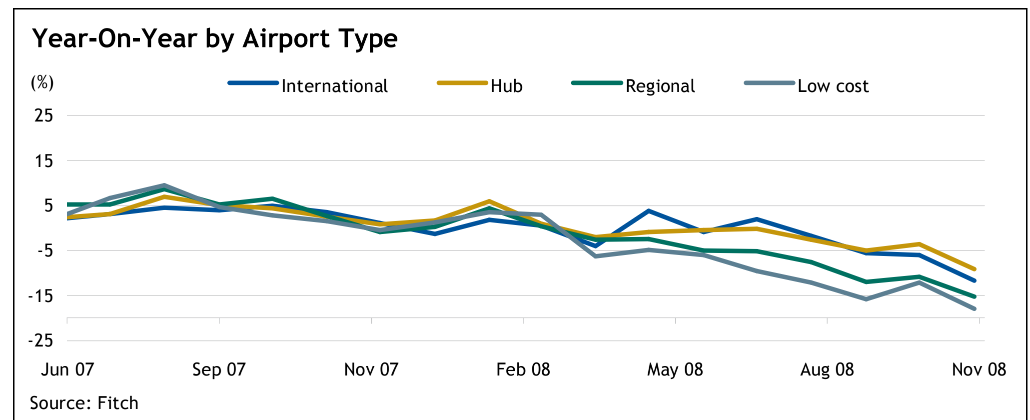
Airports, Ports and Other Transportation Projects

US Airports

Sector Outlook: Negative
Rating Outlook: Negative

The outlook for the sector remains negative for 2009. Even with fuel prices falling substantially from record highs in 2008, the primary drivers for air travel – business and leisure – still remain under significant pressure with employment down 2.8 million in December 2008 over December 2007. Further losses are expected into

2009. As a result, the previously announced capacity reductions for the fourth quarter of 2008 were increased after the summer and Fitch views the likelihood for either capacity or traffic growth in 2009 as limited to a handful of facilities (see chart). In addition, it is Fitch's view that business and consumer sentiment over the ensuing year will likely limit the effect of airline attempts to fill seats with lower fares and thus enplanement growth will likely be muted over the next few years. Enplanement trends for the near to medium term will likely be the most dramatic at secondary hubs, reliever[2] airports and those airports with a significant leisure component as they tend to exhibit more volatility to retrenchment and growth decisions of the airlines. Data for the second half of 2008 already indicate many of these airports have lost between 10% and 30% of their traffic.



Source: Fitch

As point-to-point services get eliminated when airlines face difficult operating environments, airports that serve as fortress hubs should see much less of a reduction, as will international gateway airports. In fact, Atlanta, Charlotte, Denver, Dulles (VA), JFK (NY), Miami, Newark and San Francisco are showing reductions of less than 10%. It is clear that airports with this underpinning perform better in challenging economic conditions and thus from a purely economic standpoint are more resilient than secondary hubs, leisure destinations and reliever airports.

In 2008, Fitch noted that delaying capital spending and increasing operating margins through expense reductions and the mothballing of facilities were two important tools that management could exercise to deal with declining enplanements. During 2008, most airports slowed capital spending and reduced expenses but only passed on limited increases in rates and charges. For 2009, it may be more difficult for airport management to offset airfield and terminal rate increases with other revenue and further expense reductions. Complicating this calculation is the fact that airlines are focused on sustaining profitability and will not likely be amenable to such increases unless underlying fundamentals allow for higher ticket prices. To the extent these increases do not occur, Fitch will discount to a greater degree the oft cited position that airports can increase airline revenue as generally permitted under most airline use agreements to maintain financial flexibility.

Importantly, airports can expect passenger facility charge (PFC) receipts to fall at levels commensurate with traffic reductions and non-airline revenue derived from parking and concessions will also come under pressure. Over the last several years many airports renegotiated concession agreements – with some taking more volume risk. To protect against the downside many of these agreements do have minimums, but the minimum can drop over time as it is often times pegged to a fixed percentage of the prior year. In addition, while parking rates have generally been a

[2] Airports just outside a larger metropolitan area with spare capacity. These grow much more rapidly when the overall system is growing. Likewise, when the cuts occur, they contract first and more severely

growing source of revenue over the past several years parking rate increases will only go so far given the tie to throughput. Further, the reduction in international traffic that Fitch expected is now eliminating the offset to domestic reductions that provided uplift for gateway airports in the first half of 2008. In short, airport managers face one of the most difficult operating environments in recent memory and it is Fitch's expectation that the balance of 2009 and most of 2010 will remain challenging. As a result, negative rating actions are likely to outweigh positive ones with secondary hubs, relievers and those with a large leisure component being more susceptible. Airports that have large debt burdens or are committed to heavily debt financed capital programmes may also see near-term pressure on both rates and financial flexibility. In addition, it is Fitch's expectation that the surge in overall air travel that began in the late 1990s and was spawned by a strong economy and lower real ticket prices offered by low cost carriers will not likely be repeated as airlines focus more on profitability growth than revenue growth. As a result, fuel prices and other cost pressures that will increase with economic growth could restrain growth rates below what was seen in the past.

What to Watch

- If the attempt by airlines to generate demand by lowering fares is unsuccessful, additional capacity cutbacks are likely, further lowering passenger throughputs.
- The airline industry's increased focus on the bottom line could make it harder for airports to pass along needed increases in rates and charges.
- To the extent that enplanement volume stays depressed over a two-year period, management will be less able to maintain financial flexibility solely through cost reduction efforts, delaying capital investment and raising parking rates.

European Airports Likely to Suffer From Economic Recession

Sector Outlook: Negative
Rating Outlook: Stable to Negative

Airport projects have less than robust prospects in the current economic climate. In some cases for projects in Fitch's rating portfolio, base case projections were built on phases of robust economic expansion, while Fitch expects major European economies to be in recession in 2009. Airports notably tend to be overly affected by GDP swings; on this basis, European airports bear a negative outlook.

Deregulation Used to Boost Traffic

Air travel has been by far the most dynamic segment of transport in Europe for the last decade. Passenger numbers (which usually drive the revenues for airports) have increased by more than 50% in the past 10 years in the EU, while total passenger travel had risen by around 20% when all modes are considered.

Fitch has observed that, in the long term, the strong rise in demand has been mainly fuelled by three drivers:

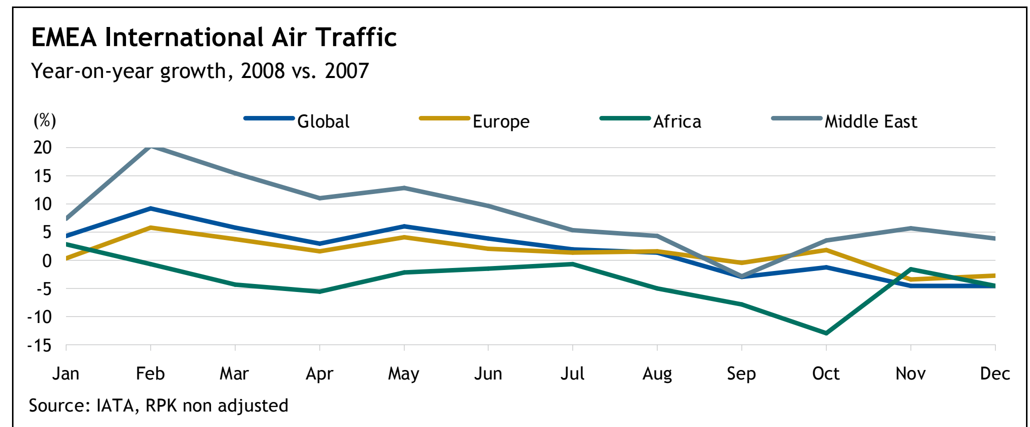
- GDP growth (on average, passenger kilometres have increased twice as quickly as GDP). GDP is usually seen as stimulating leisure traffic, as disposable income of households increases and economic activity stimulates trade and need for business travel.
- More affordable air fares (in Europe; fares have decreased regularly in constant prices). This was the result of improved technology and operational efficiency.
- Airline deregulation has transformed supply. Flag carriers have opened new routes and enhanced competition. Low-cost carriers have entered the market and attracted new clientele. Introduction of yield management has provided the opportunities for more attractive ticket offers. These three items contributed indirectly to the decrease in fares.

Recession Derails Growth Trend

Until and including the summer of 2008, air traffic was still growing, as illustrated by the chart below. Since September 2008, aviation traffic has declined compared to the previous year, as a result of the credit crunch and recession. Fitch expects declines in traffic at least through 2009.

Against a backdrop of capacity constraint, many European airports have engaged in large capital expenditure plans (in excess of EUR8bn p.a. in total for Europe). Not only does this investment effort not fit well with the current drop in passenger figures, but it proves to be difficult to finance in light of the credit crunch, with rocketing funding costs.

EMEA International Air Traffic
Year-on-year growth, 2008 vs. 2007



Source: IATA, RPK non adjusted

Sector Outlook

Fitch believes the current recession environment will act negatively on air traffic demand: With low or even negative GDP variation, traffic is likely to decrease, as already experienced in many airports, and revenues at airports will be lower than expected. Reduction of capacities by European airlines, which have not been compensated by higher load factors so far, may negatively weigh on the air fares factor (less competition); this could only be aggravated by bankruptcies of start-up airlines, as seen with XL, Zoom or Oasis Hong Kong. Jet fuel costs have decreased in the recent period, giving some relief to airlines, after a long period of rise. This factor will continue to be monitored.

Rating Outlook

A downturn of traffic could damage some highly leveraged transactions, which strongly relied on continuous EBITDA growth fuelled by expected traffic expansion. These airports are often the same as those relying on low-cost carriers. They would bear negative outlooks (this category is only included in Fitch's shadow ratings portfolio).

On the other hand, Fitch currently maintains a Stable Outlook on BAA Funding ('A-' for senior secured notes) and ADP ('A+' senior unsecured rating), which benefit from diversified client and route bases and are likely to better overcome the temporary turbulence.

What to Watch

- Leveraged transactions with aggressive growth plans.
- Non-diversified, leisure-oriented airports.

Asia Pacific Airports

Sector Outlook: Stable

Rating Outlook: Stable

Airports in Asia Pacific, in a lag effect to most of the world, are now beginning to see either slowdowns or declines in enplanements. While this has hurt the region's airlines more than its airports, especially with declining business travel, many

airports are beginning to revise their financial forecasts for the medium term. In Australia, debt regearing exercises have all but stopped, and several airports have revised their capital expenditure needs, both of which recognise the dampened environment for passenger growth, and are good moves for the preservation of airport credit quality. Airports in India continue with their facility rebuilding and modernisation exercises, which result in significantly higher debt loads (and lower ratings profiles), even though many have developed significant passenger bases in recent years. Revised passenger forecasts in line with the slowing economy portend increased revenue reliance on non-airport revenues; primarily real estate, which is very speculative in India at the moment. Other risk factors for Indian airports include heavy aviation authority taxes, the government's continuing delay in constituting an independent aviation industry regulator and its "in-principle" approval of competing airport facilities for several major cities. Nevertheless, the low ratings profile takes these multiple risks into account.

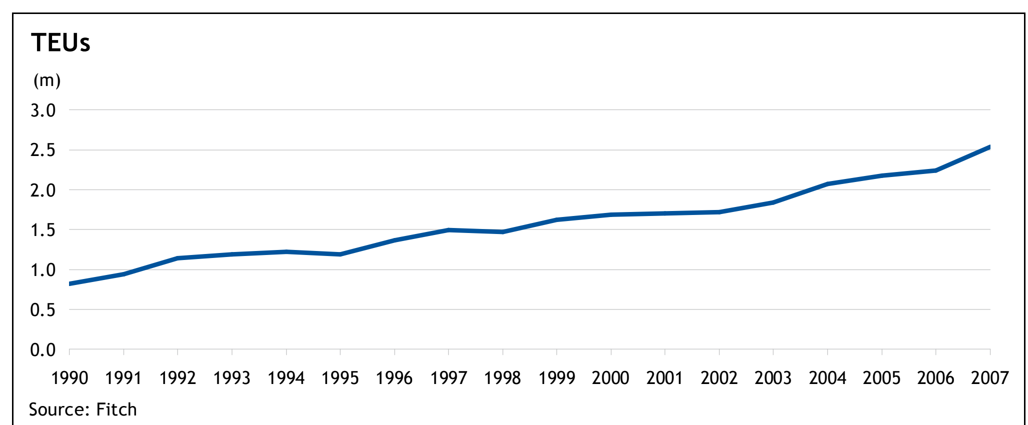
What to Watch

- the pace of airline service contraction throughout the region and the effect that it might have on deferred capital expenditures;
- the financial counterparty risk faced by some major publicly owned airports in Asia to offshore airport project joint ventures; and
- the implications to airport capital expenditures of the growing market presence by low cost carriers.

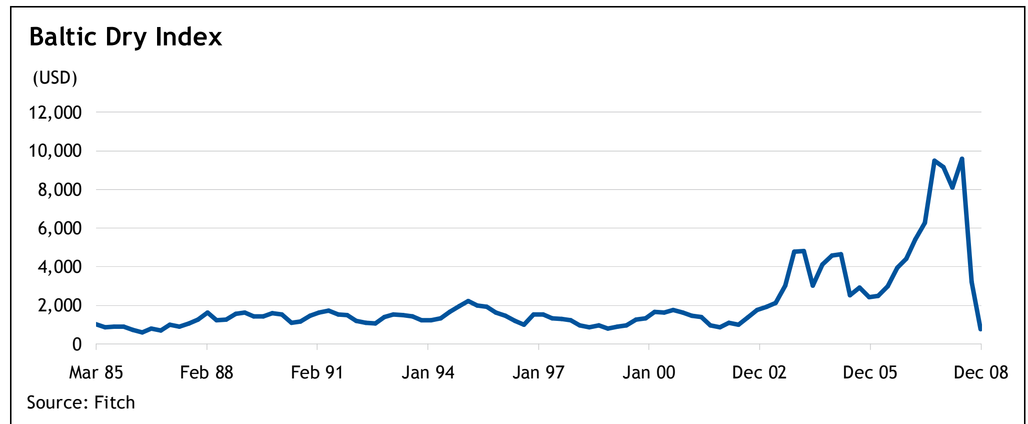
US Seaports

Sector Outlook: Negative
Rating Outlook: Negative

The outlook for the US seaport sector is negative, and it is likely that negative rating actions will exceed affirmations or positive rating actions. This is due in large part to the dramatic reversal in global trade that began in the latter half of 2008. Prior to this time, most ports were debating and/or financing facility expansion to handle or attract the seemingly endless growth in container and cargo volume. Container volume at US ports, in 20 foot equivalents (TEUs), grew by an average annual growth rate (AAGR) of nearly 7% from 1990 to 2007 (see chart). Likewise, the Baltic Dry Index (BDI), which measures the demand of shipping capacity versus the supply of bulk carriers, grew at an AAGR of nearly 11% over the same period (see chart). For 2008, TEU data for the three largest ports on the west coast dropped between 6% and 11%, placing volumes at levels not seen since 2004 or 2005. Importantly, these three ports comprise approximately 40% of the total TEU volume seen at all US ports. On the cargo side, the BDI dropped by nearly 92% over a period of six months from its all time high in June 2008 to a level not seen since the late 1980s. On top of this, the state of international financial markets also left its mark on trade as letters of credit used to guarantee purchases have become very difficult to procure, further contributing to the slowing volume.



Source: Fitch



From a risk perspective, those ports that are fully exposed to volume risk and those that built facilities based on continued robust growth face the greatest challenge as they will need to substantially increase rates and cut costs to prevent what could otherwise be a double-digit drop in operating revenue. In addition, ports with an exposure to cruise terminals will also face challenges as discretionary travel of all modes is seeing large cutbacks. While landlord ports may be protected from changes in volume to varying degrees, their ability to favourably renegotiate leases that expire in the next three years will likely be tested. In Fitch's view, the depth of the current crisis points to an economic recovery that may be one or more years away, which could mean that global trade levels will not likely reach those seen in 2007 for some time.

Given the competitive nature of the industry and the drop in rail/truck costs, ports that expanded with the intent of grabbing market share could very well see a significant change in their financial metrics as shippers become and are likely to remain more price elastic. To deal with these issues, port managers can reduce costs, defer capital and raise rates. If the downturn keeps global trade depressed for two to three years, managers will have to rely more heavily on the latter as expense cuts can only go so far.

What to Watch

- Continued declines in consumer spending and its spillover effects on production will add further pressure on global trade volume, as will governmental efforts to increase internal manufacturing jobs.
- To the extent that trade Letters of Credit continue to be difficult to procure and demand stays depressed, major shipping companies could be in a more difficult financial position to make contractual lease payments.
- Lease renewals over the next 3-5 years could potentially be less advantageous to ports.

European Ports: The End of a Cycle

Sector Outlook: Negative

Rating Outlook: Negative

Ports have more cyclical performance than other infrastructure assets, with less monopolistic positions. They are sensitive to swings in international trade activity, which is basically a function of economic growth (with correlation around 1.5 to 1). The low economic growth prospects in EMEA may open a phase of volatility and contraction of revenues for ports, notably the smaller ports.

Maritime Ports Have Strongly Benefited From Globalisation

Along with the whole maritime trade industry, ports have enjoyed strong growth in the past decade, on the back of globalisation: producers, transformers and consumers are now scattered around the globe and require the services of sea trade

for supply to meet demand. More than 80% of international trade in goods is carried by sea, and an even higher percentage of developing country trade is carried by ship. World container port throughput grew by an estimated 11.7% to reach 485 million TEUs in 2007.

In line with other segments of the industry (shipping companies have ordered more and bigger vessels, increasing the world merchant fleet by 6.5% p.a. since 2004), ports have engaged in capacity increases. In Europe, the slowness of works (notably due to permits and environmental constraints) suggested that over-capacity would not become a sudden threat.

Large projects have arisen in Africa (Ngqura), the Persian-Arabic Gulf (Sohar, Ras Azzawr), the European North Range (Le Havre, Rotterdam, Wilhelmshaven) and Russia (Ust Luga). Yet many port operators will have to honour their capex commitments just when they experience declines in revenue resulting from the economic downturn. This is unfavourable timing.

Hit by Contracting Trade

The unfolding financial crisis has spread to international trade with negative implications for developing countries, especially those dependent on commodities. This is illustrated by the dramatic fall in the most-used freight rate index (Baltic Dry Index), which has declined more than 11-fold: from 11,793 points in May 2008 to 891 as of early November. This is due to the economic crisis that drives lower demand for goods, but more importantly to the credit crunch that has triggered a shortage of letters of credit for shippers.

Sector and Rating Outlook

All ports are likely to suffer from the contraction of seaborne volumes. Those enjoying a good balance between inbound and outbound traffic (e.g. Antwerp or Bremerhaven), as well as irrigating a solid hinterland (e.g. Rotterdam), are likely to be more protected against volume drops. On the other hand, ports focusing on transhipment, by nature more exposed to competition, are likely to suffer hard. Alongside the geography, efficiency (the quicker a port can handle a cargo, the more cost-effective for the shipper) and size will play a significant role: smaller ports, not able to accommodate the bigger and more fuel-efficient ships, may prove less competitive.

What to Watch

- Recently expanded or currently expanding ports (risk of over-capacity).
- Smaller, less hinterland-related facilities (tougher competition).

Social Infrastructure and Availability-Based Projects

UK Non-Transportation PFI/PPP

Sector Outlook: Stable to Negative

Rating Outlook: Stable

Fitch maintains a stable to negative outlook on each of the main UK non-transportation PFI/PPP sectors. Debt service for projects in these sectors is supported by availability-based payment mechanisms with UK government-related counterparties of strong credit quality. The main PFI/PPP sectors now have reasonably long track records of contract tendering and delivery. These projects are governed by well developed contractual frameworks, which allocate risks between the public sector and the project company and have clear provisions governing performance standards and termination.

Key threats to credit quality in these sectors are as follows:

- Typically, the construction and operational risks in these projects are passed down to subcontractors. A deep UK recession would put pressure on subcontractors (especially construction firms) who are the main risk takers in

PFI. This could lead to delays and cost overruns as subcontractors have to be replaced and hence test the financial flexibility built into these projects.

- In line with their relatively low risk profile (relative to other project finance sectors), PFI/PPP projects are structured with high gearing and low debt service coverage ratios (DSCRs). Combined with the common practice of sculpting the debt amortisation to create a flat DSCR profile, these projects have relatively little buffer to accommodate shocks, particularly timing differences (e.g. with capex or taxes).
- Many of the accommodation projects are exposed to the long-term lifecycle costs of maintaining the buildings. These costs can be difficult to predict.
- A common structural feature for mitigating cost risk to the project company in PFI is benchmarking of certain costs on a periodic basis. However, this process is not sufficiently proven.

What to Watch

- impact of recession on subcontractors;
- sculpted amortisation; and
- lifecycle costs and benchmarking.

Non-Transportation PPP in Continental Europe

Sector Outlook: Stable to Negative

Rating Outlook: Stable to Negative

Most PPP projects in continental Europe are in essence comparable to the UK PFI schemes, with availability payments being the most used pattern. A majority of these projects are likely to benefit from a stable financial performance, although some risks may be introduced or aggravated by the adverse economic environment:

- Factors mentioned above for PFI would be applicable as well.
- Payers could be financially less robust. Unlike most UK PFIs, which benefit directly or indirectly from central government's support, many PPPs in continental Europe were carried out by decentralised entities, which are not enjoying any backing by an upper tier of government. As tax revenues decrease (even for local authorities) and public spending goes up due to natural stabilisers being at work, local and regional governments could be under financial and political pressure. Thus they may change their behaviour in relation to PPP suppliers, engaging in tougher scrutiny of value for money assessments or being more prone to litigation. Counterparty risk in this respect is not expected to be a material factor with large local and regional governments enjoying solid credit standing, but would be particularly relevant for projects endorsed by second-tier, financially weaker local governments and public authorities.

Besides pure availability schemes, Fitch has rated (in its shadow ratings portfolio) some schools and hospitals with a degree of exposure to demand risk. One could expect they would not be exposed to the effect of economic downturn, as social services tend to be immune from adverse GDP swings, if not counter-cyclical. Economic shocks may not affect pupils' or patients' fundamental needs and behaviours with regards to basic healthcare or education. However, demand-driven elements, mostly funded by user fees and bringing significant operating margin contribution, could be exposed: in hospitals and schools, catering could be affected, as well as non-compulsory spending such as recreational activities in schools.

What to Watch

- performance of facilities managers providers;
- labour and material costs; and
- change of behaviour by patients and pupils.

EMEA Availability Payment Transport Schemes

Sector Outlook: Stable
Rating Outlook: Stable

PPP/PFI transportation projects with availability risk (roads, rail and urban transit systems) broadly share the same characteristics as public accommodation projects, although with a higher degree of technical operational risk, on average. By definition, these projects are mainly exposed to non-performance risks, which mean they are mostly immune to demand swings, and rely on individual performance of their facilities managers (FM). With strong FM providing companies (transport projects generally involve large and global players, for which performance is a key reputation factor), these projects have stable outlooks. In some cases (UK, Spain), the depression of the labour markets have brought some relief, as contractors were concerned by the impact on their cost base of the then overheating markets.

What to Watch

- performance of FM providers; and
- labour and material costs.

US Sports Assets

US Sports Assets

Sector Outlook: Negative
Rating Outlook: Stable to Negative

The sector outlook for US sports-related assets is negative as the sustained weak economic conditions will place increased pressure on individual and corporate discretionary spending levels, which will likely affect ticket price levels and other game day revenues as well as corporate advertising and sponsorships. The ratings outlook for the sector is stable to negative, as there is a high level of contractually obligated income at the league, franchise and facility level that will provide some financial stability. Additionally, Fitch's investment-grade ratings in this sector benefit from high levels of debt service coverage (1.75x and above depending on the transaction structure, the sport and the market); economic and financial risks are largely borne by the teams, which are subordinated in most cases and benefit from residual revenues.

Fitch expects that attendance levels at regular season games, particularly for weaker market teams, could see declines due to the economic slowdown. The environment for the renewal of premium seating, advertising and sponsorships has become more challenging. Teams in stronger markets, such as New York, Chicago and Los Angeles, will probably hold the line on seat pricing rather than implement normal increases, but sales that are already slowing could result in a greater percentage of unsold tickets depending on the sport and on team performance. Teams in weaker markets will have greater pressure to lower seat prices or tolerate more vacant seats. This could also affect which games are televised in local and national markets.

Longer term and annual advertising and sponsorship agreements that are up for renewal will likely see greater pressure. Fitch expects continued active management of pricing to optimise revenues for the medium term and continuation of aggressive marketing and sales, and creative franchise product development to mitigate downside risks. In relative terms, the National Football League and its teams, with fewer games, more performance parity and a strong national following, appear less vulnerable than other leagues.

The Importance of Broadcast Rights

The NFL, MLB and NBA national broadcast contracts extend through 2011-2013, 2013 and 2016, respectively. As a result, at the league level, lenders are largely

insulated from near- to medium-term risk of payment default. However, were the depth and length of the recession to affect longer-term fan commitment, the viability of certain teams could be threatened and consequently some deterioration in league credit quality cannot be ruled out.

The NHL continues efforts to obtain a large multi-year national television broadcast similar to the other leagues, but has smaller television contracts. Renewal levels of local media programming, including radio and television, may also face uncertainty in the medium term as media advertising revenues face pressures from the declining economy.

Stability in Collective Bargaining Agreements

The NFL, MLB, NBA and NHL currently have collective bargaining agreements (CBA) in place with their respective players association that guarantee play in the short term. The NFL's current CBA runs through 2012 while MLB, the NBA and the NHL have CBAs that extend through the 2011 season. Fitch notes that some of the CBAs have certain conditions, either from the standpoint of owners or the players association, which allow for the agreements to be opened prior to their expiration dates. Some of these provisions are similar to those in prior agreements.

While labour issues are not at the forefront currently, degradation in advertising revenue at the networks from economic weakness could ultimately affect future broadcast contract renewals and the ability of teams to support the high player salaries in place today. As a result, the next round of CBA renewals may occur in a more challenging and contentious environment. The risk of a partial or full year work stoppage, which has always been a key rating factor for sports-related assets, may be more elevated in the coming years.

What to Watch

- team and league attendance levels;
- renewal rates and levels of season tickets, luxury seating and sponsorships and advertising; and
- ownership's proactive management of expenses.

UK Whole Business Securitisations

Pubs

Sector Outlook: Negative

Rating Outlook: Negative

With a deteriorating UK macro-economic outlook for 2009, negative effects should intensify in the wider retail sector and the pub industry. Rising unemployment, continuing tight credit conditions for retail consumers, increasing pressures on disposable income and a widening price gap on alcohol with the off-trade should increase pressures on pubs' footfall and drink sales. Drink volumes from managed pubs, which can sell at lower prices than leased pubs, should outperform. It is also likely that the drinks offer will see increased substitution, benefiting cheaper standard or value-end beers and wines at the expense of premium products.

The growth in food sales, which have been mitigating the effects of the smoking ban for leased and managed pubs, is also likely to slow or even decline for premium formats when cheaper catering or retail alternatives are available. However, food sales offering good quality at very competitive pricing should continue to benefit from positive sales growth. Generally, on the revenue side, the agency believes it is probable that the sector will experience a contraction of retail prices and an increase in promotions and vouchers as operators and tenants fight harder to attract or retain customers.

Increases in the cost base are also likely to continue, particularly in the first half of 2009 as declines in utility and commodity prices take some time to materialise.

Margins should also be affected by the current unfavourable international pound sterling exchange rates on food and drink imports as well as national minimum wage increases. As a result, the agency expects many pubcos' gross margins to suffer and decline in percentage terms. It is likely that many managed and leased operators carefully review their cost base, especially for overheads and staff at every level of their operations, from pub staff to regional business management.

Fitch expects development capex to be substantially scaled down if not completely scrapped for this year. The agency also expects an increase in bad debt at the pubco level, a higher number of pub conversions from managed to tenanted format, a decrease in number of long fully-repairing and insuring leases, an increase in short tenancies, a higher number of closures, a lower number of applicants per lease and an overall reduction in pub stock in the UK to possibly 55,000 by the end of this year.

What to Watch

- UK economy; and
- wet led estates.

Healthcare

Sector Outlook: Stable to Negative
Rating Outlook: Stable to Negative

Recent fee increases from UK local authorities (LA) have been below UK average inflation. The cost base (national minimum wage, rates, utilities, overheads) continues to increase above LA rates, so a decline in EBITDA margin is expected across the sector. Operators with the ability to maintain high occupancy rates and less exposed to single LA fee increase policies should be able to maintain stable financial performance, although possibly with declining operating margins. Small, less granular operators with more exposure to individual home performance or an individual LA fee policy are likely to experience more volatility. Operators with a more premium proposition and more reliant on private segments could experience shorter average elderly patient stays or less inquiries, as families look for cheaper alternative or delay placement in homes as long as possible. It is possible that, as the recession bites, LAs are required to extend the social support obligations in parallel with all other normal funding requirements, in a budget-constrained environment. LA nursing fees could suffer as a result. Operators with a focus on speciality patients should benefit from more stable revenues as this segment is normally less exposed to patient churn.

In the private hospitals sector, economic pressures on the financial services and wider corporate industry could affect the size of the private medical insurance subscribers' market. It is unclear how negotiations between private medical insurers and private hospital groups could affect the treatment fees paid by insurers for certain schemes. Private hospitals are also likely to suffer from increased NHS competition as the delay between GP reference and treatment continues to shorten.

What to Watch

- local authority policies on fees;
- loan refinancing; and
- cost inflation.

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