Airports
U.S.
New Issue

State of Alaska

Alaska International Airport System (AIAS)

Rating History

Rating	Action	Outlook/ Watch	Date
A+	Downgrade	Stable	7/22/10
AA–	Affirmed	Stable	12/19/08
AA–	Upgrade	Stable	2/7/06
A+	Revision	Stable	11/12/03

Analysts

Michael M. Murad
+1 212 908-0757
michael.murad@fitchratings.com

Seth Lehman
+1 212 908-0755
seth.lehman@fitchratings.com

Related Research

For information on Build America Bonds, visit www.fitchratings.com/BABs.

Applicable Criteria

- *Rating Criteria for Infrastructure and Project Finance' (Aug. 16, 2010).*
- *Airports Rating Criteria Handbook for General Airport Revenue, PFC and Letter of Intent Bonds, March 12, 2007*

Other Research

- *U.S. Airports: Seeking Stability in an Uncertain Airline Market, Sept. 24, 2009*

Ratings

Class	Amount ($ Mil.)	Final Maturity	Rating	Note Type	Outlook
Revenue Refunding Bonds — Series 2010A	119.28	10/1/27	A+	N.A.	Stable
Revenue Refunding Bonds — Series 2010B	23.075	10/1/18	A+	N.A.	Stable
Revenue Bonds (New Money) — Series 2010C	15.51	10/1/33	A+	N.A	Stable
Revenue Bonds (New Money) — Series 2010D (BABs)	16.955	10/1/35	A+	N.A	Stable
Total Issuance	**174.82**				

N.A. – Not applicable. Note: Ratings are not a recommendation to buy, sell or hold any security. The offering circular and other material should be reviewed prior to any purchase. Closing will occur on Sept. 27, 2010. The ratings assigned above are based on the portfolio information as of Sept. 8, 2010, provided by the issuer.

Rating Rationale

On July 22, 2010, Fitch Ratings downgraded the Alaska International Airport System (AIAS) to 'A+' from 'AA–'.

The 'A+' rating reflects credit strengths that include the airport's strategic geographic location along the great circle route for air cargo activities; the essentiality of air travel into and within the state; the diverse presence of cargo operators serving out of AIAS and significant infrastructure investments and commitment by United Parcel Service (UPS) and FedEx Corporation (FedEx); stable airline passenger traffic and O&D nature of the market; the system's strong liquidity; and the residual nature of the operating agreement, which provides the airport some degree of flexibility in managing its operations and debt requirements in the face of shifting cargo activity and passenger traffic.

The rating also reflect principal credit concerns that include the system's heightened sensitivity to the volatile nature of cargo operations, which contribute to a majority of the system's $95 million of operating revenues. In fiscal 2009, cargo throughput declined by a steep 24.5% and demonstrates that AIAS, despite its uniqueness as a strategic hub for many leading all-cargo carriers, is subject to business-related risks in economic downturns that Fitch views to be more consistent with 'A' category airport credits. The unprecedented one-year decline in activity resulted in a commensurate 20% decline in operating revenue as well as a nearly $24 million drop in pledged net revenues from operations. Unlike other airports, AIAS does not have a rolling coverage account or a rebate program. Rather than

Considerations for Taxable/Build America Bonds Investors

This sector credit profile is provided as background for investors new to the municipal market.

Airport Bonds
Airport credits generally fall into four categories: fortress hubs and international gateways; large origination and destination (O&D) airports; secondary hubs and reliever airports; and small O&D airports. Credit risk for these types of airports can vary significantly. The large international gateway and fortress hub airports generally offer the broadest service, have the least competition for passengers, have less passenger volatility, and have the most underlying economic strength. The key issue for these airports is managing leverage, and in the case of fortress hubs, airline concentration. Ratings for these types of facilities range from 'A' to 'AA'.

raise fees and charges given the economic environment, AIAS took steps to draw on its existing strong levels of cash reserves to effectively reduce the debt service requirements in order to both satisfy the rate covenant requirement and maintain low landing fees to carriers at the airport. The use of such funds totaled $25 million in fiscal 2009 and AIAS is expected to similarly draw on reserves in fiscals 2010 and 2011.

While the system's current liquidity, particularly from excess balances in AIAS construction funds, allowed for the use of funds to offset the loss in revenue, it is uncertain whether this is sustainable beyond the near term given the volatile nature of the cargo business. Fitch views the cargo business as demonstrating more volatility than the passenger traffic component of airport operations, thus exposing AIAS to higher than average growth during expansions and potentially sharp declines during economic contractions. AIAS' debt service reserve fund is partially cash funded — about $18.6 million — while the remainder is held in the form of surety bonds provided by MBIA and AMBAC.

Although fiscal 2010 cargo operations are up 15.6% compared with 2009, they are at levels seen in 2003 and 2004. Given the continued challenges facing the U.S. economy, Fitch expects volume to slowly return to levels seen prior to the downturn. The rating assumes prudent management of competitive airline charges and fees, and the preservation of a healthy financial position.

Key Rating Drivers

Future rating actions are likely to be influenced by the following:

- Shifting trends in cargo and passenger enplanement activity.
- Material changes to the system's internal liquidity profile.
- Higher than expected airport cost structure and large debt issuances.
- Changes in the region's economic conditions.

Project Profile and Analysis

Overview

Airport

Ted Stevens Anchorage International Airport (ANC) serves as the primary passenger airport in the state and an important cargo airport globally. In 2009, ANC was ranked as

Project Summary Table

Project Summary Data	Financial Summary Data
Project Type — Airport	Rated Debt Terms — $174.8 million ($561 million parity bonds outstanding)
Project Location — Alaska	Rate Debt — Fixed rate %
Status — Operation	Amortization Profile — Final maturity 2035. Increasing debt service profile through to 2018 where the debt service requirement reaches $51 million and remains level until 2025. Maximum annual debt service occurs in 2026 with a payment of $52 million. Payments fall dramatically to $23 million in fiscal 2029 and to $7 million by 2032.
Revenue Basis — Actual	Debt Service Reserve — Partially cash funded (about $18.6 million) while the remainder is held in the form of surety bonds provided by MBIA and AMBAC.
Applicable Regulation — U.S Federal and Alaska State Laws	Other Reserves (as of July 31, 2010) — (1) Repair and Replacement Fund, $505,000; (2) Capital Projects Fund, $65.8 million; and (3) unrestricted cash, $113.5 million.
Operator — Department of Transportation and Public Facilities	Triggers — Rate covenant of 1.25x; additional bonds test (ABT) of 125%.

the No. 2 cargo airport (after Memphis and before Louisville) in North America with 1.99 million metric tons of cargo throughput, and No. 6 globally, after Paris, according to Airports Council International (ACI).

The State of Alaska Department of Transportation and Public Facilities (DOT&PF) operates AIAS. ANC, located approximately five miles outside of Anchorage, serves as the gateway to the state and a key international cargo crossroad for trans-Pacific air freighter activity. ANC provides primary service for business travelers, tourists, and residents traveling both intrastate and interstate. Located on approximately 4,800 acres, ANC has three commercial runways, a state-of-the-art fueling facility, and two passenger terminal buildings (the north and south terminals that serve primarily international and domestic flights, respectively); 16 taxiways; and aircraft parking aprons with hydrant-fueling positions for 78 wide-body and narrow-body aircrafts. The north terminal, divided into three concourses A, B, and C, has eight gates and a federal inspection services facility. The south terminal has 22 jet aircraft parking positions, 18 of which have jet bridges.

Additional facilities at ANC include cargo maintenance and support buildings, general aviation facilities, the state's largest post office, and federal and state offices. Landside facilities include more than 4,100 parking spaces, and a consolidated rental car facility. Airfield facilities include four cargo parks and a cargo refueling ramp that contains space for cargo transient parking, international customs clearing, and sorting hubs for various cargo carriers, including FedEx and UPS.

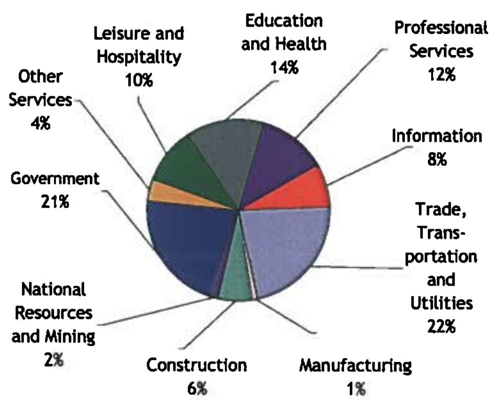
Fairbanks International Airport (FAI), in the heart of Alaska's interior, is located five miles southwest of Fairbanks, and provides essential intrastate air service, and functions as the distribution center for the interior of the state and northern Alaska. The recently completed passenger terminal facilities include a 146,000-squarefoot terminal building with five jet aircraft gates, four of which are equipped with jet bridges. FAI's airfield facilities consist of two runways (a main 11,800-foot runway and a general aviation runway) and a floating base with one water lane for seaplanes and ski planes.

ANC and FAI are key portals to the state and its network of airports, and serve as crucial hubs for transportation within Alaska. The state owns and operates 254 rural airports outside of ANC and FAI to make travel around the state feasible.

Service Area

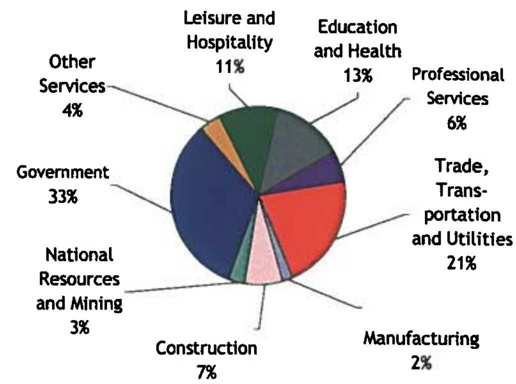
Alaska is a vast area with a small population concentrated in the urban areas that include Anchorage and Fairbanks. Given the intrastate hubbing operations at both ANC and FAI, the service area is considered to be much larger than the immediate regions of Anchorage and Fairbanks, as rural Alaskans must typically connect at either of these facilities to travel within-state or out of state. The state's economy continues to diversify and is represented by its large services sector, which includes government, hospitality, health and education, and transportation and utilities. Government at the local, state, and federal level is the largest employer in Anchorage and Fairbanks employing 21% and 33% of the workforce, respectively. The state's population grew at an average annual rate of 1.2% between 2000 and 2009 and stands at around 700,000 (as of July 2009). The Anchorage and Fairbanks regions comprise of more than two-thirds of Alaska's population having grown at 1.75% and 1.97%, respectively in the period from 2000 to 2009. The state's 7.9% unemployment rate for June 2010 outperformed the national average of 9.5%.

Anchorage Region Employment by Sector



Source: Issuer.

Fairbanks Region Employment by Sector



Source: Issuer.

Sponsors and Legal Structure

AIAS is a major enterprise fund of the State of Alaska, created by Chapter 88 of the Session Laws of Alaska of 1961. AIAS is comprised of the operations of the ANC and FAI. Inception of the AIAS dates to 1948, when Congress approved $13 million to fund two "international" airports in Anchorage and Fairbanks. Alaska became a state on Jan. 3, 1959; shortly thereafter the title was transferred from the federal government to the state of Alaska. The system is managed and operated by DOT&PF and is a self-sufficient enterprise fund with the books and accounts of the two airports consolidated for rate-setting and financial reporting. The DOT&PF provide policy direction while day-to-day management responsibility is assumed by the manager of each airport. The State of Alaska Department of Revenue arranges debt financing and investment management services for the system. The 11 member board appointed by the governor — has seats statutorily designated for a variety of aviation stakeholders and also has a statutory consultation role in the selection of the chief administrative officer of ANC and FAI — meets at least once each year to provide recommendations on aviation policy issues to the commissioner of the (DOT&PF).

Volume Performance

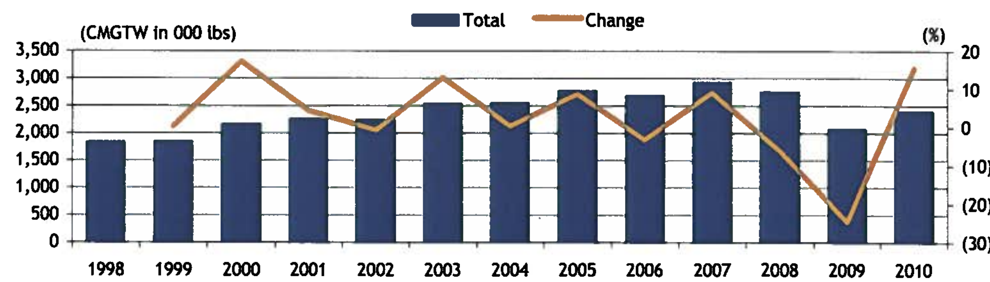
Cargo Operations

Air cargo operations are central to AIAS' operational and financial strength. Cargo activity, the main revenue engine of the airport system, has seen an upward trend in activity, growing at an average of 5.5% from 1999 to 2007. However, fiscal 2008 and 2009 experienced sharp drops in activity, declining 6% and 24.5%, respectively, as a result of the sharp contraction in global trade and capacity reductions undertaken by carriers. Fiscal 2010 saw a rebound in cargo activity ending 15.6% higher than the previous year. The airport's cargo component accounts for approximately 65%–70% of total operating revenues.

AIAS maintains cargo operations at both ANC and FAI. While most of the world's cargo is transported via ocean containers, cargo throughput at AIAS consists of those items that have a sufficiently high value per weight or have a unique perishable and obsolescence characteristics and, therefore, requires air transportation. The airport system's cargo operations are driven by the growth in world trade and by AIAS' location on the Great Circle Route. From this location, AIAS is approximately 9.5 hours to 90% of the industrialized Northern Hemisphere. AIAS's location allows cargo carriers to maximize payloads, as the economics favor refueling at AIAS. While the technology exists to over-fly Alaska, all-cargo aircraft incur a loss of payload capacity due to the added weight of the relatively heavy fuel required for the long nonstop flights.

Furthermore, favorable federal legislation permits the commingling of domestic and foreign cargo, which bolsters the airport system's unique position. At AIAS, cargo carriers are able to transfer and transload cargo between foreign and domestic carriers and between foreign and foreign carriers. Therefore, cargo carriers are able to benefit from the higher load factors and increased operational efficiency, as well as reach new and varied markets, similar to a passenger hub airport. As a result, it can be advantageous to utilize AIAS's facilities to redirect cargo to different markets. For example, cargo from Tokyo could be shipped to ANC and then be transferred and transloaded to other freighter aircraft bound for New York, Los Angeles, Singapore, or elsewhere.

All-Cargo Aircraft Historical Certified Max Gross Takeoff Weight (CMGTW)



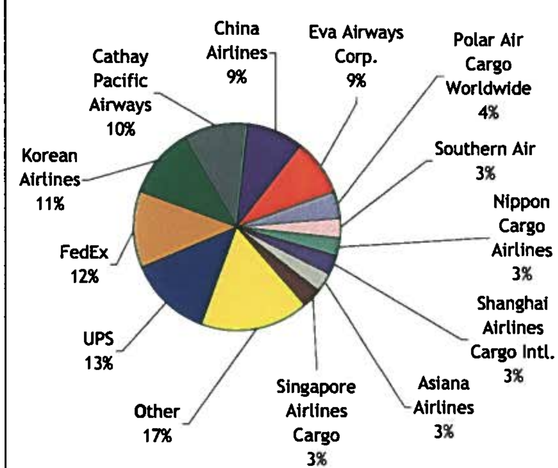
Source: Issuer.

Cargo Carrier Market Share

The diverse presence of cargo operators serving out of AIAS and significant infrastructure investments and commitment by UPS and FedEx serve as positive credit considerations as AIAS is not solely dependent on any one carrier or any one country's economy. There is no one carrier that accounts for more than 13% of cargo certified max gross takeoff weight (CMGTW). The diversity also offsets any revenue concentration risk with no cargo carrier representing more than 10% of system's total airline revenue.

FedEx has invested in excess of $150 million in Anchorage facilities and uses ANC as its primary hub for clearing packages from Asia through the U.S. Customs and Border Protection. In 2007, FedEx completed a multiphased expansion of its international package sorting facility, a ground service equipment maintenance facility, and two aircraft parking aprons to bring its total to 12 wide-body parking aprons.

Cargo Carrier Market Share by CMGTW



CMGTW – Certified max gross takeoff weight.
Source: Issuer.

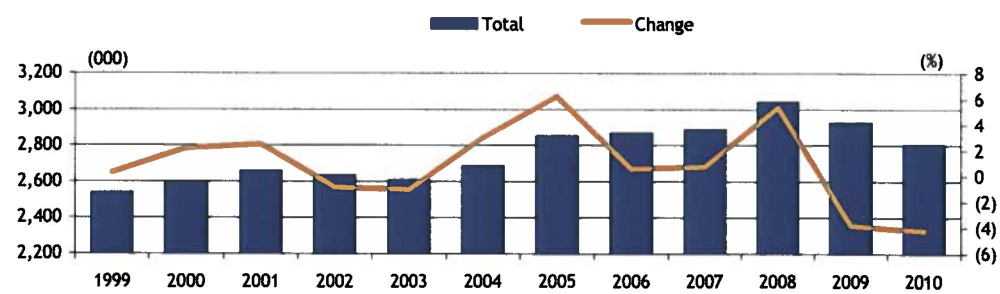
In 2008, UPS opened a 27,000 square-foot centralized wide-body pilot training facility, capable of flight training more than 400 crew members on 747-400 and MD-11 aircraft to support the rapid growth of UPS' worldwide international express and heavy freight network. UPS has invested in excess of $35 million on its facilities. Moreover, UPS tripled the size of its hub facility from 30,000 to 90,000 square feet to allow clearance of a portion of its Asia-U.S. packages in Anchorage.

Other cargo carriers utilizing the airport as a cargo hub are Korean Air, Nippon, China Airlines, Polar Air Cargo, and Atlas Air.

Enplanements

Passenger enplanements have been stable over time showing very little volatility. Essentiality of air travel in Alaska and the O&D nature of the air service area traffic supports this stable enplanement base. Over the period 1999–2009, the airport system has seen a growth rate of 1.4%. Fiscal 2009 enplanements dropped by 3.8%, which is the first decline in six years. Two large dips in the last two months (May and June) of the fiscal year saw enplanements plunge 19.5% and 11.6%, respectively. A slow summer tourism season in the state and the global economic slowdown are primary underlying reasons for this dip. The system also has increasing carrier concentration risk with Alaska Airlines servicing 64% of traffic at the airports, up from 44% in fiscal 2006. While air carrier concentration is a meaningful credit concern, at this time, the essentiality of air service and the high likelihood of another carrier stepping in to take profitable routes is a significant mitigant. The small share of passenger revenues to the system makes it a challenge to pass on costs to passenger airlines when cargo revenues decline. Fiscal 2010 enplanements are down 4.2% compared with fiscal 2009.

AIAS Historcial Enplanements



Source: Issuer.

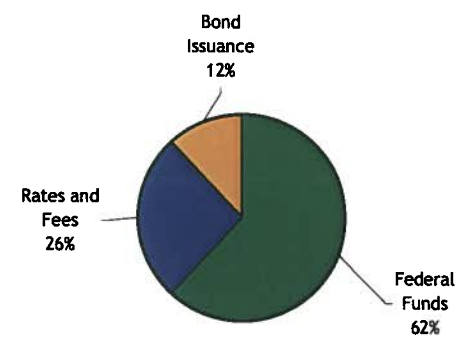
Airline Operating Agreement

The residual nature of the operating agreement provides the airport some degree of flexibility in managing its operations and debt requirements in the face of shifting cargo activity and passenger by setting and adjusting rates midyear to ensure sufficient revenues to pay operating and maintenance expenses, fund reserves, and satisfy rate covenant. The agreement has a five-year term effective through June 30, 2013, and as of Aug. 13, 2010, the system has 30 signatory airlines.

Capital Improvement Program

The airport's current five-year capital improvement plan (CIP) totals approximately $200 million through to fiscal 2013 and will fund a mix of airfield and terminal side rehabilitation projects. The capital projects are funded from federal airport improvement program grants (AIP), bond issuance, and other available funds of the system derived from rates and fees. The new money portion, approximately $32.5 million, of the series 2010 issuance will serve to finance the completion of a runway rehabilitation project that will have federal grant reimbursements. The extension and rehabilitation projects are Design Group VI upgrades that will give the airport the ability to accommodate the new large aircraft (NLA) 747-800 and A-380F. Management indicated that these upgrades will ultimately enhance the system's cargo market share.

Capital Improvement Plan Funding Sources



Source: Issuer.

Financial Profile and Analysis

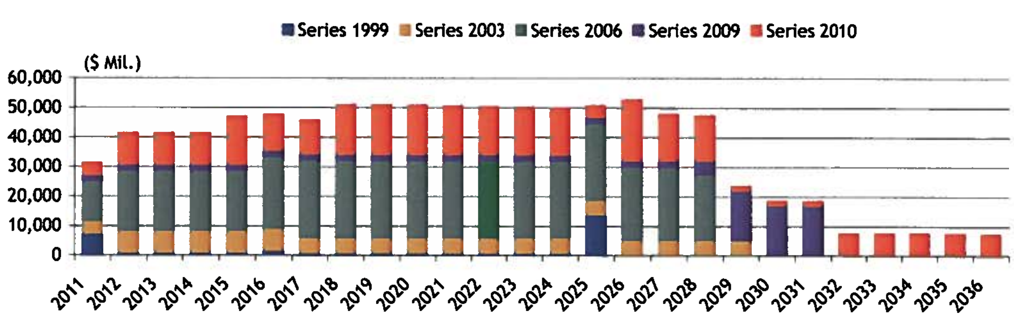
Debt Structure

Debt Characteristics

The issue is sized at approximately $174.8 million in principal, of which $142.4 million will refund series 1999A, 1999B, 1999C, and 2002B, and $32.5 million (of which about $17 million are Build America Bonds [BABs]) to finance various governmental and private activity projects with a maturity date of 2035. The series 2010 are issued on parity with the current outstanding debt of approximately $561 million. The debt structure has an increasing debt service profile through to 2018, where the debt service requirement reaches $51 million and remains level until 2025. Maximum annual debt service occurs in 2026 with a payment of $52 million. Payments fall dramatically to $23 million in fiscal 2029and to $7 million by 2032.

The new debt structure allows refunding for savings due to the current interest rate environment, funding a portion of fiscal 2009–2013 CIP, better match of life of assets to

AIAS Debt Profile



Source: Issuer.

bonds, building in a schedule of optional early redemption of bonds, and reducing dependence on surety bond policies by cash funding the reserve account over the next 10 years

Optional Bond Redemption Program

AIAS expects to use surplus cash over time to optionally redeem bonds to minimize the choppiness in debt service profile and support a more level aggregate amortization of the debt from 2012 to 2028. The debt service requirement drops significantly thereafter by more than 50% for three years through to 2031 and down to $7 million through maturity. The optional redemptions will only be from surplus cash in excess of O&M, reserves and capital projects after maintaining adequate liquidity position. The sources of surplus cash are from the coverage requirement and letter of intent (LOI) funds. AIAS intends to apply the anticipated cash receipts from 2012–2016 to redeem series 2003 bonds (callable in 2013) and series 2006 bonds (callable in 2016). Absent growth in cargo operations and a boost in operating revenue, Fitch does see some risk with this strategy if AIAS still chooses to redeem the bonds from previously built up liquidity.

Structural Features

Security — The bonds are secured by a pledge of general airport net revenues.

Additional Bonds Test (ABT) — Additional parity bonds may be issued if a consultant determines that AIAS is complying with the rate covenant, including the future parity bonds then being issued and financial projections for the three fiscal years following the earlier of: completion of the projects being financed with the proceeds of the bonds then being issued, or the date on which capitalized interest on future parity bonds is expended are projected to be at least 1.25x aggregate annual debt service on all outstanding bonds and future parity bonds.

Rate Covenant — Pursuant to the terms of the bond resolution, the commissioner of the Alaska Department of Transportation and Public Facilities is required to fix and collect such fees, charges, and rentals to be derived by the state from the ownership, lease, use, and operation of the airports, and all of the facilities and improvements of that or used in connection with that, as will provide net revenues (i.e. all revenues less the maintenance and operating costs of the system) in each fiscal year at least equal to 1.25x the sum of the aggregate annual debt service during such year, plus any deposits required to be made during such year in the reserve account and the repair and replacement reserve account.

Financial Summary

Prior to the current recessionary period, the system's finances have been healthy, particularly characterized by its strong generation of revenues over the period from 2005–2008, growing at a CAGR of 4.6%. However, fiscal 2009 revenues dropped by 20% due to the 24.5% decline in cargo activity. Unrestricted cash (excluding construction funds) stood at $126 million, or 641 days cash on hand at the close of fiscal 2009. As of May 2010, AIAS holds $111 million in unrestricted funds. However, preserving high levels of internal liquidity will be an important rating consideration as management has set a precedent to apply funds for debt service in lieu of adjusting landing fees under the airline's residual-based operating agreement. Operating expenses grew at a CAGR of 4.2% in the last five years. The increases in expenses in the past several years are attributed to the increase in debt expense. Fiscal 2008 costs grew at a modest 2% while fiscal 2009 remained flat.

Cost per enplanement (CPE) has been consistently around the $7–$8 range between 2001 and 2004. In 2005, landing fees increased from $0.66 to $1.07 resulting in a higher

CPE within the $9 range. This metric has remained stable since that time with a latest CPE of $9.08 for fiscal 2009. The key to maintaining a reasonable CPE and AIAS's strong financial operation is the sustained presence of and costs borne by cargo carriers.

As part of the series 2010 debt structure, management plans for possible optional early redemption of bonds and contribution of cash to the debt service reserve account to reduce dependence on surety bond policies, all from surplus cash over time. AIAS has already drawn on surplus funds to defease $25 million of debt service in each of fiscal 2009 and 2010 and set aside $15 million to pay a portion of fiscal 2011 debt service. In addition, AIAS uses passenger facility charge (PFC) revenue to offset PFC-related debt service needs, and FAA grant money continues to support much of the overall capital development. Since 2005, the state has applied $3.2 million of annual passenger facility charge toward debt service payments and intends to increase this amount to as high as $5.5 million annually from fiscal 2011 through fiscal 2026.

The airport generated coverage results ranging from 1.59x to 1.30x over the past five-year period with coverage of 1.52x in 2009, using $25 million in cash (0.76x coverage without the draw on cash balances). AIAS budgets operating revenues to remain flat and expenses to fall by 4.1% for fiscal 2010.

Fitch's Forecast Scenarios

Fitch's forecast scenarios contemplate conservative growth in cargo activity and enplanements. Fitch believes that in the near term, meeting the minimum 1.25x debt service coverage ratio under the rate covenant could depend on the continued use of internal liquidity absent a boost in operating revenue driven by cargo and enplanement activities or through upward adjustments in airline fees and charges.

The base and stress cases demonstrate coverage below the rate covenant after fiscal 2011 when flat growth of 1% in cargo is applied or in the event of a double-dip recession where cargo operations would be affected. These cases do not include the options available to the issuer in the event of a shortfall in coverage such as the upward revision of landing fees and terminal rental fees. AIAS has been managing the fee structure on a midyear and end of fiscal year basis. In addition, the issuer has the flexibility of redeeming some debt starting in 2013, which will significantly reduce the debt service through to 2028 while preserving current liquidity as the redemption will be made using future excess coverage funds and LOIs.