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July 15, 2008

Presale:

BAA Funding Ltd.

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Presale:

BAA Funding Ltd.

Up to £50 Billion Multicurrency Program For The Issuance Of Asset-Backed Notes

This presale report is based on information as of July 15, 2008. The credit ratings shown are preliminary. This report does not constitute a recommendation to buy, hold, or sell securities. Subsequent information may result in the assignment of initial credit ratings that differ from the preliminary credit ratings.

Notes	Ratings*	Preliminary amount (Mil. £)§	Maturity**
Class A wrapped bonds	A- (SPUR) ¶	TBD	In compliance with maturity restrictions
Class A unwrapped bonds	A-	Up to 7,910	In compliance with maturity restrictions
Class B wrapped bonds	BBB (SPUR) ¶	TBD	In compliance with maturity restrictions
Class B unwrapped bonds	BBB	Up to 1,000	In compliance with maturity restrictions

*The rating on each class of securities is preliminary as of July 15, 2008, and subject to change at any time. Initial credit ratings are expected to be assigned on the closing date subject to a satisfactory review of the transaction documents and legal opinions, and completion of a corporate overview. Standard & Poor's ratings address timely payment of interest and payment of principal not later than the legal final maturity. ¶The class A and B wrapped notes may benefit from an unconditional guarantee. The long term ratings on these classes will reflect the higher of the long-term ratings on the financial guarantor and the underlying ratings on the notes. The unconditional guarantee, provided by a financial guarantor still to be determined, is expected to be in compliance with our criteria. §The ratings address issuance of senior debt (class A wrapped and unwrapped notes plus any senior debt issued by the borrower group ranking pari passu with the class A notes) up to debt to regulatory asset base (RAB) of 70% before April 1, 2018 and then 72.5%; the ratings address issuance of junior debt (class B wrapped and unwrapped notes plus any junior debt issued by the borrower group ranking pari passu with the class B notes) up to aggregate debt to RAB of 85%. **Debt totaling no more than 30% of RAB (at issuance) matures during any biennial, or 50% of RAB (at issuance) within any "quinquennium" (a five year period). TBD-To be determined.

Transaction Participants	
Borrowers	Heathrow Airport Ltd., Gatwick Airport Ltd., and Stansted Airport Ltd.
Co-Arrangers	The Royal Bank of Scotland PLC and Citigroup Global Markets Ltd.
Borrowers and issuer cash manager	BAA Ltd.
Borrowers' agent	BAA Ltd.
Paying agent and agent bank	Deutsche Bank AG
Facility agent	The Royal Bank of Scotland PLC
Borrowers and issuer security trustee	Deutsche Trustee Company Ltd.
Principal paying agent and agent bank	Deutsche Bank AG
Issuer and borrowers' hedge counterparty	Citigroup N.A., The Royal Bank of Scotland PLC, Banco Bilbao Vizcaya Argentaria, Banco Santander S.A., BNP Paribas, Caja de Ahorros y Monte de Piedad de Madrid, Calyon, HSBC Bank PLC, and other financial institutions named in the final documents
Issuer and borrowers liquidity facility providers	Lloyds TSB Bank PLC
Issuer's and borrowers' account bank provider	The Royal Bank of Scotland PLC
Refinancing facility providers	TBD
Initial capex providers	TBD
Initial Working capital facility providers	TBD
Non-migrated bond facility providers	TBD

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Transaction Participants(cont.)	
Non-migrated bond trustee	Prudential Trustee Company Ltd.
Shared services provider	BAA Ltd.

Supporting Ratings

Institution/role	Ratings
Caja de Ahorros y Monte de Piedad de Madrid	AA-/Negative/A-1+
Citigroup N.A. as hedge provider	AA+/Stable/A-1+
Banco Santander Central Hispano, S.A. as hedging provider	AA/Stable/A-1+
BNP Paribas as hedging provider	AA+/Stable/A-1+
Calyon as hedging provider	AA-/Stable/A-1+
HSBC Bank PLC as hedging provider	AA/Stable/A-1+
The Royal Bank of Scotland PLC as hedging provider and bank account provider	AA/Negative/A-1+
Financial guarantor	An entity with a minimum rating as high as the ratings assigned to the wrapped notes

Transaction Key Features	
Expected closing date	August 2008
Collateral	Security in the form of first fixed and floating charges over the securitized assets that include Heathrow, Gatwick, and Stansted airports, legal mortgages over all real estate, and pledges of shares provided by each entity within the ring-fence
Country of origination	U.K.

Borrower and issuer combined liquidity facility initial commitment

Transaction Summary

Standard & Poor's Ratings Services has assigned preliminary credit ratings to the first note issuances out of a £50 billion multi-currency program by BAA Funding Ltd. (the issuer), a limited liability company incorporated in Jersey. The proceeds will be lent to the borrower group, which includes Heathrow Airport Ltd. (HAL), Gatwick Airport Ltd. (GAL), and Stansted Airport Ltd. (STAL), all nonbankruptcy remote operating entities.

This program substantially refinances:

- The senior acquisition facility entered into at the time a Ferrovial-led consortium acquired BAA Ltd. (BAA, the ultimate parent);
- The existing nonconvertible bonds issued by BAA (existing noteholders will be given the option to migrate); and
- The ongoing capital expenditure (capex) program.

The program is designed to consolidate debt for BAA's core portfolio under a single program of debt issuance. Further issuance of debt, including bank debt and rated notes, is permitted.

The program is ultimately backed by intra-security group loans secured by the three largest U.K. airports, Heathrow, Gatwick, and Stansted, as well as the Heathrow Express rail link.

The preliminary credit ratings assigned to the program reflect, among other things:

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- The underlying credit quality of the operating assets of BAA's three designated airports and the Heathrow Express. The overall business risk profile of the borrower group is considered "excellent" (equating to a 'AA' category); and
- A structure that allows timely payment of interest and payment of principal no later than legal final maturity through the appointment of an administrative receiver in the event that the borrower group becomes insolvent.

At the closing date, the transaction will feature:

- The issuance by BAA Funding of class A and B bonds in an approximate aggregate amount of up to £4.8 billion;
- The novation or "migration" of up to £4.5 billion existing BAA obligations to the issuer to the class A level; and
- The issuance by companies within the borrower group of tranche A and B capex debt, certain working capital debt, tranche A and B refinancing facility debt, and the European Investment Bank (EIB) facility debt in an approximate aggregate amount of up to £3.2 billion (assuming no draw on the refinancing facility).

To the extent that the issuer cannot place any or all of its new class A and class B bonds, then the borrower group will draw on the refinancing facility. The issuer and the borrower group (collectively the financing group) will enter into a pledge of collateral security to be shared among the holders of the financing group's debt obligations (financing group obligations). The financing group will, to the extent that the borrower group has drawn on the refinancing facilities, seek to refinance such draw with a capital markets issuance.

Principal and interest in respect of the financing group obligations will be serviced through various revenue sources but primarily through passenger charges. Maximum passenger charges at the designated airports are determined by the Civil Aviation Authority (CAA). Under the Airports Act 1986, the CAA is charged with establishing caps on airport charges at airports "designated" by the Secretary of State for Transport (SoS). "Designated airports" include Heathrow, Gatwick, and Stansted.

One of the major determinants of a designated airport's cap is its regulatory asset base (RAB). The RAB is a proxy value of the airport's regulated operating assets, upon which the owners of the airports earn a return. The higher the RAB, the greater the level of airport charges revenue that the airports are allowed to earn. Caps are set for five-year periods (each a "quinquennium" or QQ). Before establishing a cap for a designated airport, the CAA is required to solicit the views of the Competition Commission and other interested parties.

Notable Features

This is a landmark corporate securitization transaction. The borrower group, and ultimately BAA and its parent company Airport Development and Investment Ltd. (ADIL), expects to improve its financial flexibility, reduce its debt costs, and standardize its secured financing covenants. For existing BAA noteholders who exchange their notes for higher rated notes, the transaction provides first ranking security over the three designated airports and Heathrow Express, increased reporting transparency, and an improved asset and financial covenant package.

This transaction includes the following notable features:

- This transaction is one of the first to attempt to combine substantial bank debt and capital market issuance (Land Securities, a commercial mortgage-backed securities transaction rated in 2004 includes a similar structure). The security structure allows for the appointment of an administrative receiver at the borrower group through enforcement of the floating charge assigned to the issuer trustee for the benefit of the noteholders. Timely

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payment of interest and senior costs upon the appointment of an administrative receiver are supported by liquidity provided at the issuer and at the borrower level. Timely use of the liquidity at the borrower group (a nonbankruptcy remote entity) upon the appointment of an administrative receiver is supported by a standby letter of credit (LOC) and a trust structure available to the refinancing facility providers, the hedge providers, and the EIB. This is the first time we have given credit to the timely use of liquidity to an entity that is nonbankruptcy remote to our rating standard.

- In the event that the borrower group becomes insolvent, timely payment of interest and payment of principal no later than legal final maturity through insolvency proceedings is achieved by the appointment of an administrative receiver to the borrower group. Compared with traditional corporate securitization transactions where ratings rely on the appointment of an administrative receiver, the amount of liquidity available to pay timely interest on the tranche A debt (class A bonds, EIB, and refinancing facilities) is lower: 12 months versus the traditional 18 months. We view the proposed amount of liquidity made available to the financing group as commensurate with the risk embedded in this transaction due to the business risk of the borrower group considered as excellent and the strong incentive and public interest to keep the designated airports operating in the event that the operating companies become insolvent.
- The secured debt does not amortize but the repayment of each class/tranche of debt coming due relies on the ability of issuer/the borrower group to refinance and issue new debt through capital market or bank facilities (authorized credit facilities).
- The back-loaded nature of the debt with bullet maturities is supported/offset by the perpetual nature of the designated airports and their essentiality for the U.K. economy and London as the European financial center.
- One of the core elements of the structure is the shared services agreement (SSA) between the borrower group and BAA. This contract allows BAA to provide all the services needed for operating the airports. The consequence of having such a contract in place is the discretion BAA has in deciding servicing prices to the borrower group. Upon a trigger event, the trustee could ask for an independent review of the prices applied for the services provided. The preliminary ratings analysis is based on the assumption that the borrower group will keep on operating in the event that the service provider (BAA) becomes insolvent. The rationales behind this assumption are: (i) in the event BAA goes into insolvency any administrator would have an incentive to keep on operating the servicing of the designated airports, its main revenues source; (ii) in case there is a need to replace BAA as a servicer provider we believe that a replacement could be found to keep operating the airports.

Strengths, Concerns, And Mitigating Factors

Strengths

- BAA has an excellent competitive position as the dominant U.K. airport operator and the key hub in Europe.
- The borrower group benefits from diversification through ownership of a portfolio of airports (and Heathrow Express link connection).
- We expect continued supportive regulatory environment and government policies.
- The passenger traffic activity is considered as stable and resilient.
- Half of revenues are regulated and subject to a five-year price-cap mechanism, which supports visibility on future revenues.
- The borrower group is ring-fenced from the ultimate parent, BAA, and from ultimate owners.
- Financial forecasts significantly sustain stress-testing.

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Concerns

- The capital structure is considered as aggressive, with class A and B debt to RAB likely to average 83% over most of the life of the transaction, resulting in weak credit ratios.
- There is negative free cash flow due to a lumpy capital plan for the foreseeable future, and consequent need to access the debt markets for additional financing.
- There is a significant and recurrent refinancing risk.
- Under the structure, BAA has limited incentive to aim for debt-protection measures that are materially better than covenant levels, and expectation is that cash will be returned to shareholders to the maximum extent possible.
- A potential break-up of BAA London airports could be imposed by the Competition Commission leading to a reduced portfolio and diversification effect and creating uncertainty about the future ring-fenced assets as well as proceeds generated from any forced sale.
- The Department for Transport (DfT) recently announced that it intends to review the existing regulatory framework for U.K. regulated airports, which creates uncertainty about revenue generation in the next quinquennium.
- The borrower covenants are more flexible than has traditionally been seen in corporate securitization transactions in the U.K. where ratings rely on the appointment of an administrative receiver in the event that the borrower group becomes insolvent.
- The transaction structure is complicated by BAA being reorganized into a security group, including the three designated airports and a group that maintains the ownership of nondesignated airports.
- The lenders to the security group may include several different lenders in addition to the capital markets debt. At closing the noncapital market debt includes a capex facility, a working capital facility, an EIB facility, and refinancing facilities.
- Further issuance could materially change the debt maturity profile.
- The group structure and inclusion of bank and capital markets debt has resulted in an increase in tax risks above those generally seen in corporate securitization transactions with a limited-purpose entity and no third-party debt.
- Tax amounts in relation of group relief are provided by BAA's self-certification. We understand that these amounts will be self-certified.
- Under the SSA, there is a potential risk on transfer pricing taxes being payable by the borrower group, the amount of which is difficult to quantify.
- This structure includes bank debt and capital market issuance, which presents additional risks compared with other corporate securitizations because, for example, an appointment of an administrative receiver over the borrower group might be challenged.

Mitigating factors

- A strong covenant package to protect secured debt holders, including limitations on additional debt and business activities, such as a rating confirmation requirement for acquisitions above certain thresholds (the latter creating certainty that the revenue profile will not change dramatically), a post enforcement cash waterfall of payments giving senior debt priority, a minimum level of financial performance, and restrictions on upstream distributions outside the ringfence.
- The overall debt profile has certain maturity limitations.
- No payments permitted to shareholders until the refinancing facility has been repaid down to £1.3 billion. Payments to service the subordinated debt will continue to be permitted subject to compliance with the restricted payments test of the securitization. This is an incentive for shareholders to refinance the refinancing facility as

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soon as possible.

- The additional indebtedness levels will be 72.5% for the class A debt (including any additional authorized credit facilities of the borrower group ranking pari passu with class A) and 85.0% for the class B debt (including any additional authorized credit facilities of the borrower group ranking pari passu with class B) increasing to 90.0% once the refinancing facility is fully refinanced.
- Two levels of financial covenants (distribution lock-up/trigger events, and events of default) provide creditors with significant control over the borrower group at the earliest stage of financial and/or operational difficulty, or of material changes in business circumstances. These covenants are aimed at preventing administration and minimize the borrower probability of default, which creates an additional credit cushion.
- Liquidity facilities cover 12 months of senior interest and six months of junior interest.
- Capital expenditures and revolver facilities are designed to cover about 40% of the capital plan at the beginning of each regulatory period (starting with a £2.7 billion capital expenditure and a £50 million revolver facilities for quinquennium five (QQ5)).
- The DfT has indicated that it will use the framework developed in other U.K.-regulated industries as a potential basis for any new regulation. Furthermore, it remains the intention that the regulatory system facilitates the continued capital investment into the U.K. airport assets.
- Secured lenders to the borrower group (apart from non-migrated bondholders) accede to a common terms agreement and a security trust intercreditor deed that pool security and seek to regulate enforcement.
- Although there is no absolute limit on development, significantly increased asset development expenditures would probably result in the borrower operating under increasingly tighter loan covenants.
- There is a tax deed of covenant that seeks to mitigate risks on secondary tax liabilities.
- The self certification for group tax relief by BAA is limited to up to 0.5% of total RAB. Any amount in excess of this limit will be certified by an independent advisor.
- The risk of transfer pricing taxes being payable under the SSA has been mitigated by the fact that, firstly, the regulator has historically accepted the mark-up applied to the borrower group by BAA and, secondly, BAA has operated this practice since privatization and HM Revenue & Customs has never challenged the basis, which should mean that HM Revenue & Customs is less likely to challenge this position now.
- We understand that the transaction opinions will confirm that the transaction benefits from a capital markets exemption and, notwithstanding the inclusion of bank debt in the transaction, an administrative receiver could be validly appointed in the event of the enforcement of loan security for the companies included in the borrower group.

Transaction Characteristics

The debt refinancing details

The refinance of existing debt and acquisition facilities will involve the following debt issuances and liquidity sources.

The issuer will issue two classes of rated bonds:

- The principal amount of the class A bonds will be approximately £7.9 billion (up to 70% debt to RAB). The aggregate class A debt may include certain bonds of about £4.503 billion previously issued by BAA which will novate to, or otherwise become obligations of, the issuer. The class A bonds will also include "new money" bonds of approximately about £3.4 billion.

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- The class B bonds will comprise new money bonds in an approximate principal amount of up to £1 billion.

The class A and B bonds will be backed by, among other things, security in the form of first fixed and floating charges over all material assets and undertakings of the borrower group with the ability to enforce security on the securitized assets, legal mortgages over all real estate, and pledges of shares provided by each entity within the ringfence.

The class A and B bonds may benefit from financial guaranties issued by a monoline. The long-term ratings on the class A and B wrapped notes will reflect the higher of the financial guarantor ratings and the underlying ratings on the notes. The unconditional guarantee is expected to be in compliance with our criteria.

Holders of the class A and class B bonds will have the benefit of an issuer liquidity facility providing at least 12 months' interest and senior expenses coverage for the class A bonds and six months' interest for the class B bonds.

In addition to the loan lent by the issuer to the borrower group that reflects the issuer class A and B notes obligations, the borrower group will enter into various loan obligations with a syndicate of banks in relation to the financing of its activities. These include a capex loan facility in respect of certain capital improvements to be carried out by the borrower group; a working capital loan facility to support the day-to-day working capital needs; an EIB facility for the funding of certain capital projects; and a refinancing facility that will be drawn to the extent the issuer is unable to issue bonds up to £3.4 billion of class A and £1 billion of class B debt. The expected amount of this debt at closing is summarized in table 1.

Table 1

Borrower Group Additional Debt

Facility	Amount (Mil. £)
Capex facility tranche A	2,300
Capex facility tranche B	400
Working capital facility	50
EIB facility tranche A	439
Refinancing facility tranche A	Up to 3,400
Refinancing facility tranche B	Up to 1,000

The borrower group will maintain a liquidity facility in the form of a standby LOC or cash-funded liquidity reserve (borrower group liquidity reserve account) sufficient to provide 12 months' tranche A interest (EIB and tranche A refinancing facility) and senior expense coverage and six months' tranche B refinancing facility interest coverage to provide liquidity to the borrower group if, for example, there is a shortfall in ongoing operational cash flows. As described below, the borrower liquidity reserve account will be held in a liquidity trust on behalf of certain secured lenders and the LOC may be drawn on behalf of certain secured lenders.

The tranche A debt (including the EIB facility) and tranche B debt rank pari passu to class A and class B debt, respectively, in a post-enforcement/pre-acceleration borrower priority of payments. The tranche A and B bank debt as class A and class B debt benefit from the appointment of the administrative receiver to the borrower group.

Transaction structure

BAA is a wholly-owned subsidiary of ADIL, which is itself controlled by a Ferrovial-led consortium (Consortium) that acquired BAA in 2006. The principal activity of BAA, its holding companies, and its subsidiaries (the BAA

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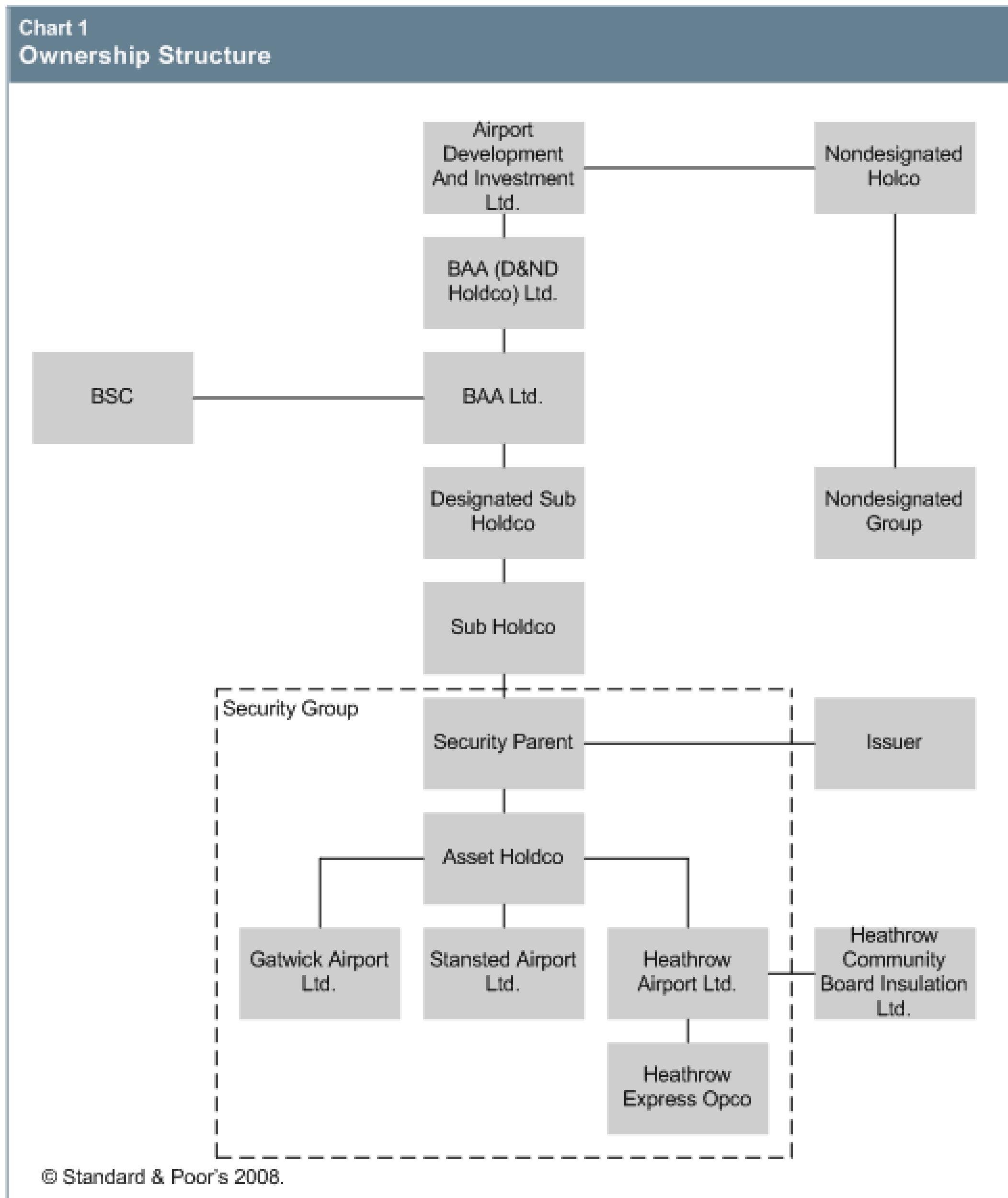
group) is the provision and management of various airport facilities in the U.K. including London's Heathrow, Gatwick, and Stansted airports. The BAA group also owns and operates the Heathrow Express, connecting Heathrow and central London. (The designated airports and the rail link are collectively referred to as the securitized assets) (see chart 1).



This transaction will be made under a secured-loan structure, comprising a borrower group and an issuer, which will be bankruptcy-remote to our rating standard, that issues the rated debt and grants a loan to the borrower group. We expect the issuer to satisfy our special-purpose entity and bankruptcy remoteness criteria.

Charts 2a and 2b summarize the overall structure of the transaction and the various parties involved.

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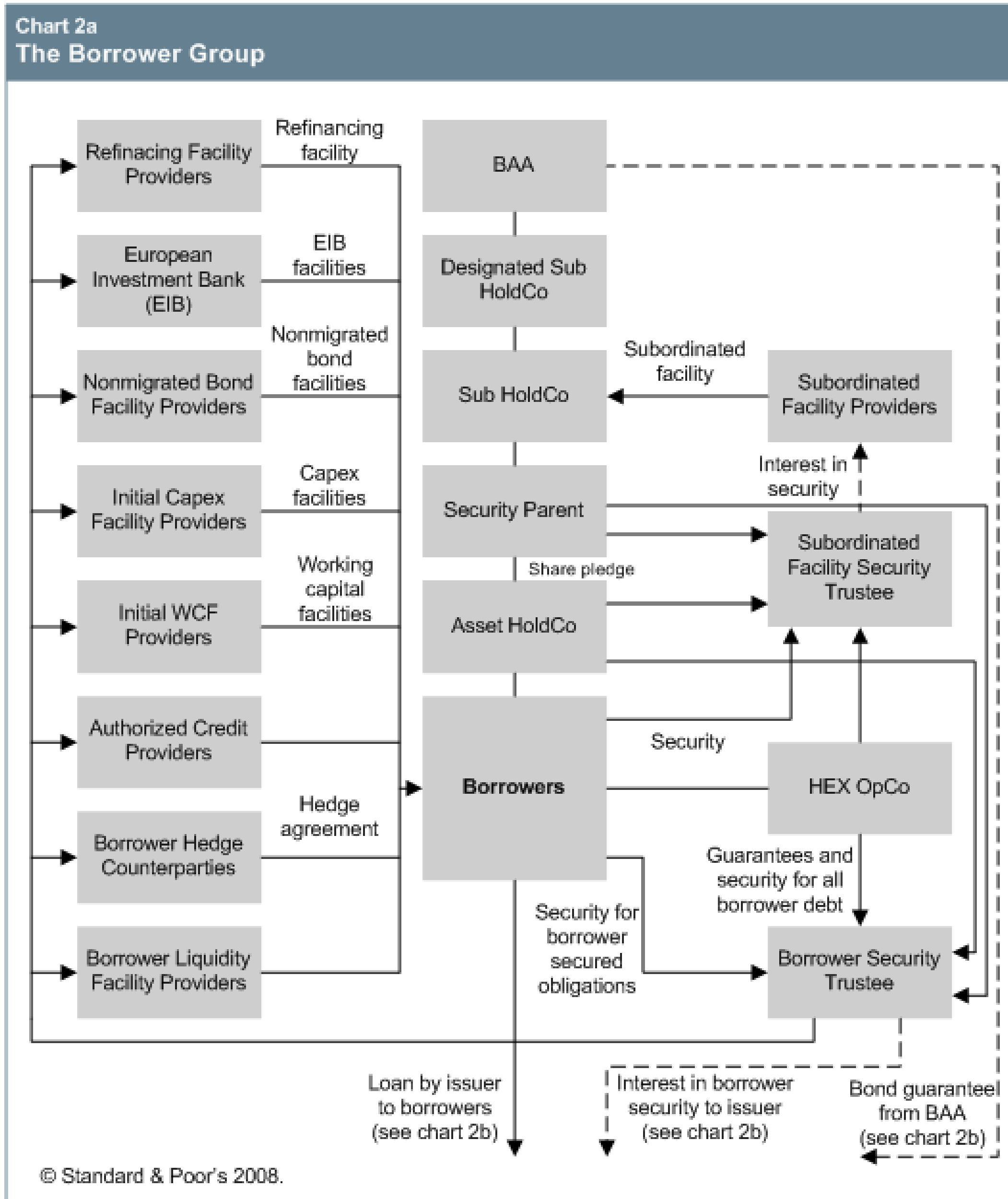

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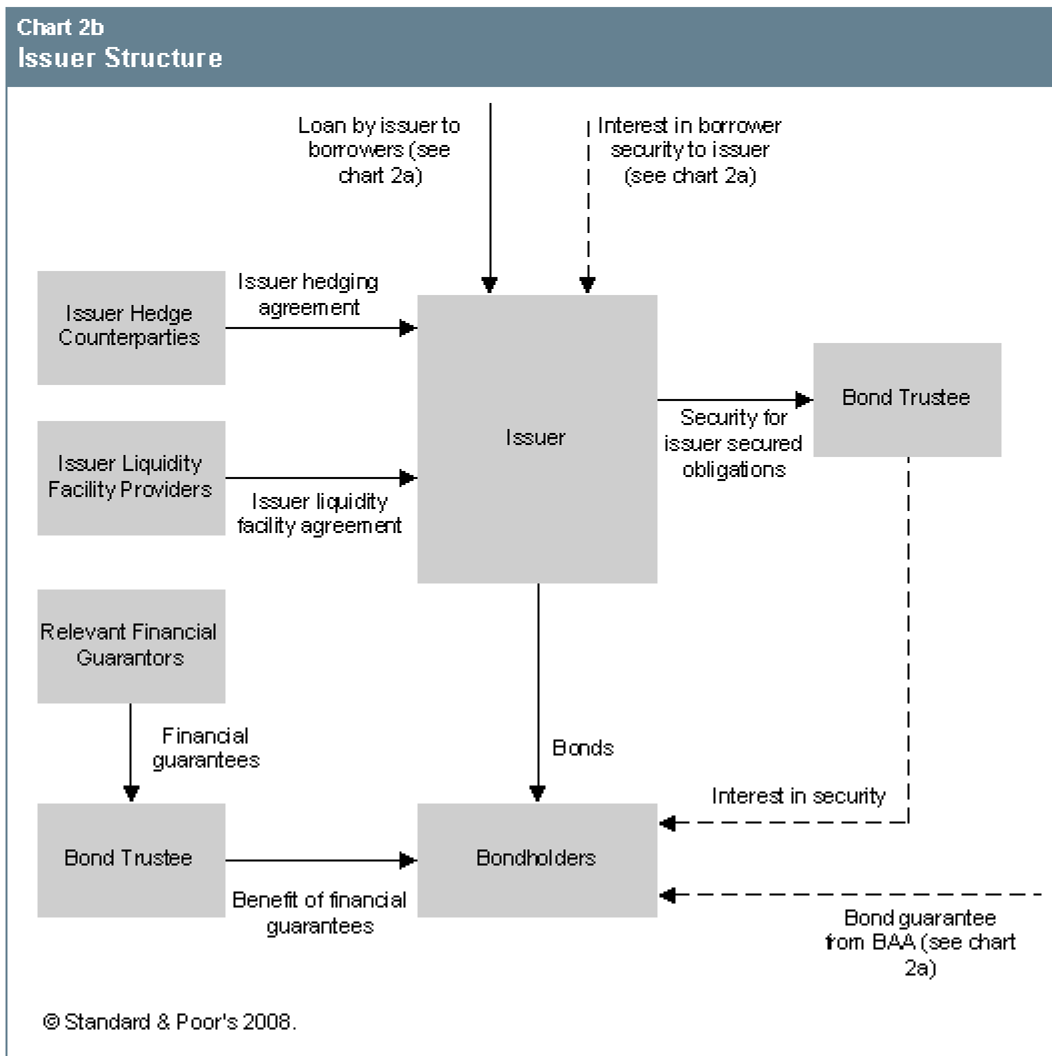

Triggers

A trigger event occurs if a ratio or test is failed, including the following:

- Ratios (where senior debt to RAB is higher than 70.0% for QQ5 and QQ6 and 72.5% thereafter, where senior and junior debt to RAB is higher than 85%, where senior interest coverage is lower than 1.40x, and where junior interest coverage is lower than 1.20x);
- Rating downgrades (where the rating on the class A notes is lowered below 'BBB+' and the rating on the class B notes is lowered below investment-grade by at least two rating agencies);
- Greater-than-expected capex (where the forecast capital expenditure of the borrower group over 12 months is higher than the aggregate of available capex facility and available and excess cash);
- Issuer debt service and fees (where senior debt service and fees, 12 months' interest on the class A notes, and six months' interest on the class B notes exceed amounts available to the issuer from its liquidity facilities and reserves); and
- Borrower group debt service and fees (where senior debt service, including hedges and the EIB facilities, exceeds amounts available to the borrower group from its liquidity facilities and reserves); and

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- Inflation-linked hedging agreements (where indexed accretions are greater than 8% of senior debt).

Other trigger events include the drawdown on issuer or borrower liquidity facilities, the enforcement order by any regulator, the termination of any license required to continue the business of the borrowers, adverse governmental legislation, or a loan event of default.

A transaction trigger event will result in (i) cash not being distributed outside the borrower group; and (ii) the borrower group having to provide information about the breach along with a proposal to cure this breach. If the breach is not cured within six months, the trustee may demand a termination plan of the SSA. In addition, the trustee can also demand an independent review of (i) the service charges applied to the borrower group by BAA over the 12 months before the breach and (ii) of HAL, GAL, and STAL's operations to determine the reason for the breach. Asset disposals to joint ventures are not permitted for the duration of this breach unless required by the regulator.

Restricted payment conditions

Obligors cannot make a restricted payment unless the restricted payment condition is satisfied. To satisfy the restricted payment condition:

- No loan event of default or potential loan event of default can have occurred;
- No trigger event can have occurred; and
- The restricted payment must be made within the 90 day period commencing on the date of delivery of the most recent compliance certificate or, if later, the date on which any financial statements required to be delivered with this compliance certificate are delivered.

If the refinancing facility is outstanding, until it has been repaid to £1.3 billion, no payments are permitted to shareholders. Payments to service the subordinated debt will continue to be permitted subject to compliance with the restricted payments conditions.

Disposal and acquisition

Borrowers and other obligors within the security group are limited to dispose of assets that fall within the definition of "permitted disposal". Permitted disposals include, among other things, transactions done on an arm's length basis in the normal course of the business and that do not result in the senior debt to RAB rising above 70.0% in QQ5 and QQ6 or 72.5% thereafter. Permitted disposal also includes the sale of either Gatwick or Stansted if ordered by the Competition Commission.

Heathrow is required (subject to creditor consent) to remain within the security group for the life of the transaction. In addition, HAL's holding company is prohibited from selling any of the HAL shares unless in either case creditor consent is obtained.

The proceeds from the sale of any of the designated airports will first be applied to repay the refinancing facility and thereafter must be used (at the borrower group option) to:

- Prepay the borrower loan agreements (and consequential early redemption of any bonds in an amount equal to this prepayment amount and reduction of future scheduled principal repayments); and/or
- Make market purchase of bonds (and consequential cancellation and surrender of any bonds and prepayment of the corresponding borrower loan agreement advances and reduction of future scheduled principal repayments); and/or

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- The repayment of the capex facilities, EIB facilities, the refinancing facility, or the nonmigrated bond facility.

To avoid a trigger event the amount of prepayments needs to be sufficient so that following a prepayment the total senior debt to RAB is less than 70% in QQ5 and QQ6 or 72.5% thereafter.

After a trigger event (which includes an event of default) the obligors should apply the net disposal proceeds within six months of receipt in prepaying debt or make market purchases of bonds. If no refinancing facility remains outstanding, the obligors must offer proceeds pro rata to all senior creditors (at par excluding any redemption premium). To the extent that bondholders decline any prepayment, the obligors will have sole discretion as to which debt or bonds to prepay or purchase with the remaining proceeds. The amount of net disposal proceeds required to be applied in these prepayment or market purchases is limited to the amount required to ensure that the senior debt to RAB for each subsequent relevant date (adjusted to take account of the disposal) is not more than 70.0% in QQ5 and QQ6 or 72.5% thereafter and junior debt to RAB is less than 85%. Further net disposal proceeds are required to be deposited into the disposal proceeds account only if a trigger event has occurred and is continuing (which includes an event of default).

On an enforcement of security any disposal proceeds will be applied to pay down debt in accordance with the borrower post-enforcement/pre-acceleration priority of payments.

If the refinancing facility has been drawn and it is still outstanding, all disposal proceeds need to be applied to: (i) pay debt maturing in the next six months, (ii) make sure that there is at least 12 months' funds available for capex (or 18 months after 50% of the drawn amount at closing has been repaid), and (iii) pay the refinancing facility.

If no loan event of default or potential loan event of default has occurred and is continuing, the borrower group may acquire:

- Any company, or, subject to the limits in respect of permitted joint ventures, shares in any company, the principal business of which is a permitted business or which falls within the permitted nonregulated business limits;
- Any assets required to replace obsolete, damaged, or destroyed assets which in the reasonable opinion of the applicable borrower are required for the efficient operation of its business;
- Subject to limits in respect of permitted joint ventures, any interest in a partnership, the principal business of which is a permitted business or falls within the permitted nonregulated business limits;
- Any asset that is intended to form part of a permitted business; and
- Any issued share capital of any member of the security group provided that the sale of those shares constitutes a permitted disposal.

The above is permitted provided that:

- The cost of any proposed acquisition, by itself or aggregated with other acquisitions within the same financial year, is not in excess of 5% of the then total RAB of the borrower group (rating affirmation applies); and
- No loan event of default or potential loan event of default occurs.

Borrowers' event of default

The followings are considered as loan event of default under the finance document:

- Senior debt to RAB more than 92.5%;
- Three year historical average senior ICR less than 1.05x;

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- A nonpayment of any amount of debt due under the borrower financing documents, including borrower loan agreement and authorized credit facilities;
- Breach of other obligation, including compliance with any covenants or undertakings;
- Misrepresentation;
- Cross default with nonpayment of any nonauthorized credit facilities (non-ACFs). This does not represent a loan event of default when the aggregate amount of non-ACF indebtedness is less than 0.5% of total RAB;
- Insolvency or insolvency proceedings of any of the obligors;
- Termination of material license or authorization to carry on the business;
- Effectiveness of transaction documents;
- Effectiveness of security;
- Failure to comply with judgment;
- Change in law;
- Nationalization of the asset;
- Change of permitted business; and
- Material proceedings.

The enforcement process will start if a loan event of default occurs and is not cured within the appropriate remedy period and the creditors wish to do so.

Risks related to enforcement

This transaction is a structured financing that ultimately only isolates the assets backing the financing structure on an enforcement of the security.

Consequently, there are risks to noteholders that the circumstances that give rise to the enforcement of security may arise for nonsecurity group issues. The transaction includes various devices, including a shared services agreement, and certain covenants, particularly regarding taxation, which are designed to reduce these risks. In our view, these risks may be reduced but not eliminated.

The rating approach, therefore, relies on enforcement of security and on the appointment of an administrative receiver in the event that the borrower group becomes insolvent to support timely payment of interest and payment of principal no later than legal final maturity through insolvency proceedings. Therefore, the use of administrative receiver is attractive to bondholders both as regards the control, enforcement, and efficient operation of the underlying assets to repay debt by the legal final maturity.

The Enterprise Act 2002 introduced a streamlined form of administration in the U.K. Section 72A of the Insolvency Act now provides for the appointment of administrative receivers in limited circumstances, including in certain qualifying capital markets transactions. If this were a transaction involving capital markets debt alone, the certainty of retaining the right to appoint an administrative receiver would be more certain. Because this transaction includes bank debt ranking pari passu to noteholders, there is a risk that an appointment of an administrative receiver might be challenged.

The overall BAA group will have trade creditors for both the security group and nonrestricted group. Both groups may have tax liabilities. Both groups will have third party lenders and may have intercompany loans.

The security group could have bank debt and capital markets debt at both the tranche A and tranche B levels. The borrower group security trustee for the bank lenders would likely appoint a receiver for the majority of the assets

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under the security trust and indemnity deed. The bond trustee is likely to appoint an administrative receiver under the obligor floating charge agreement.

A security trust intercreditor deed, a common terms agreement, and voting procedures endeavor to regulate the competing interests of the various debtholders. We consider the enforcement process could be somewhat challenging as the interest of various bank debt lenders and various classes of bondholders may not be aligned.

The borrowers and obligors are not considered limited-purpose entities either. For example, initially, cash is commingled across the BAA group because the borrower group pays BAA a certain amount of days before BAA pays the expenses and tax losses can be surrendered between the restricted and unrestricted groups for payment.

Finally the issuer is a wholly owned subsidiary of the BAA group and not an orphan entity. While the transaction seeks to reduce the risks that may arise from third party creditors and lenders both within and outside the security group, we consider they were not eliminated.

Borrower post enforcement pre acceleration priority of payments

Upon the delivery of a loan enforcement notice but before an acceleration of the loan, the borrower group claim will rank according to the borrower post-enforcement priority of payment as provided by the intercreditor agreement.

The claims of the non-migrated bond trustee and non-migrated bondholders ranking pari passu with the senior debt will stop if any independent enforcement action is taken. If the nonmigrated bonds exercise independent enforcement action, these claims will rank subordinate to senior debt, the BAA pension liabilities, and the junior debt.

On a loan enforcement, all the money received by the appointed receiver (the administrative receiver appointed through the enforcement of the floating charge and the receiver under the borrower security agreement will be the same person) will be applied as follows:

- Costs and expenses related to the borrower security trustee and to the issuer for the costs related to the bond trustee;
- Costs and expenses related to the borrower account bank and to the issuer for the paying agents, agent bank, registrar and transfer agent, calculation agent, the issuer account bank, and the corporate services provider;
- An amount to the issuer of payment due to any third-party creditors of the issuer, and any amounts payable by the issuer or other obligors in respect of all U.K. corporation tax and other tax plus amount related to operating expenses;
- Costs related to the issuer liquidity facility provider and bond guarantee and costs related to the borrowers' liquidity facility provider.
- Scheduled amounts payable to the issuer's or the borrowers' swap counterparties
- Interest and commitment commissions due in respect of the borrower loans relating to the class A bonds and any amount due under the class A bond financial guarantee; interest, underwriting, and commitment commissions due in respect of senior debt outstanding under any other authorized credit facility; amounts due to a finance lessor; and, for so long as no independent enforcement action has been taken, all amounts payable in respect of interest due to the nonmigrated bonds then outstanding; termination amounts on interest swaps; scheduled amounts on currency swaps;
- Principal relating to the class A bonds; to the issuer, any principal exchange amounts in relation to any swap agreements in respect of the class A bonds and any amount due under the class A bond financial guarantee; to the

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issuer, any termination amounts due to each hedge counterparty under any cross-currency hedging agreement in respect of the class A bonds; all amounts of principal due to other senior authorized credit facility and for so long as no independent enforcement action has been taken, all amounts payable in respect of principal due in respect of the nonmigrated bonds still outstanding;
- Interest to the class B bonds and any amount due under the class B bond financial guarantee; interest in respect of junior debt outstanding under any authorized credit facility; any amounts due to a finance lessor; scheduled amounts on B currency swaps;
- Principal due to the class B bonds; to the issuer, any termination and principal exchange amounts in relation to any currency swap agreements in respect of the class B bonds and any amount due under the class B bond financial guarantee; all amounts of principal due in respect of junior debt outstanding under any authorized credit facility;
- Payment of class A subordinated step-up fee;
- Payment of class B subordinated step-up fee;
- Any subordinated amount due to the liquidity facility providers;
- Any subordinated amount due to the hedge counterparties;
- If any independent enforcement action has been taken by the nonmigrated noteholders, all amounts payable by the borrowers as guarantors in respect of interest and principal due to nonmigrated bonds then outstanding;
- Any further subordinated cost from the instance in relation to the BAA bond guarantee;
- To the issuer, an amount equal to the issuer profit amount; and
- Any surplus will be deposited in the surplus revenue collection account.

Surplus operating cash flow will continue to be applied as currently provided without any mandatory requirement to apply any cash surpluses in permanent reduction of senior debt. Operating cash flow available to be applied in accordance with the post enforcement/pre-acceleration waterfall will be calculated as available enforcement proceeds less amounts credited to the disposal proceeds account and any debt collateralization account referred to as "Revenue Collections".

On the appointment of an administrative receiver the amounts credited to the disposal proceeds account ("principal collections") are applied in accordance with a separate waterfall as follows:

- Toward making up any senior revenue shortfall (as defined below);
- Unscheduled amounts payable to the issuer's or the borrowers' swap counterparties as a consequence of any secured debt prepayment;
- In prepayment or payment (for floating-rate debt/hedges) or (for fixed-rate or index-linked debt/hedges) in collateralizing, on a pari passu, pro rata basis, the principal amounts outstanding under all borrower loans relating to the class A bonds; any termination amounts due to each hedge counterparty under any cross-currency hedging agreement in respect of the class A bonds; to the issuer, all amounts due under the class A bond guarantee; the principal amounts outstanding in respect of any authorized credit facility senior debt; the principal amount of claims outstanding under the nonmigrated bond guarantees in respect of the principal amount outstanding under each eligible tranche of nonmigrated bonds then outstanding; to the issuer, all unscheduled amounts (including termination amounts) payable to each issuer hedge counterparty under any interest rate hedging agreement; all amounts in respect of all unscheduled amounts payable to each borrower hedge counterparty under any interest rate hedging agreement; and amounts due to the BAA pension trustee;
- Toward making up any junior revenue shortfall (as defined below);

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- In prepayment (for floating-rate debt) or (for fixed-rate or index-linked debt) in collateralizing, on a pari passu, pro rata basis, the principal amounts outstanding under all borrower loans relating to the class B bonds; any termination amounts due to each hedge counterparty under any cross-currency hedging agreement in respect of the class B bonds; to the issuer, all amounts due under the class B bond financial guarantee; and all amounts of principal due or overdue in respect of junior debt outstanding under any authorized credit facility.
- Actual or collateralizing debt which has taken independent enforcement action.

With respect to amounts required to be applied in collateralizing senior debt (including any related index-linked hedging) or junior debt, the obligation will be satisfied by depositing the required amounts into an account in the names of the borrowers designated as the debt collateralization account and maintained with the borrower account bank and charged by way of first-fixed charge in favor of the borrower security trustee under the security agreement. On the delivery of a loan acceleration notice, amounts credited to the debt collateralization account will be applied by the borrower security trustee in the immediate permanent reduction of the claims that have been collateralized and will be treated as extinguishing the principal amount of the claims of the fixed rate or index-linked creditors.

A "senior revenue shortfall" will arise if and to the extent that on any payment date, the aggregate amount of revenue collections are less than the aggregate amount of claims falling due for payment down to payment of principal of the class A notes or any other debt or expenses ranking pari passu with the class A principal, according the post-enforcement/pre-acceleration waterfall. A "junior revenue shortfall" will arise if and to the extent that on any payment date the aggregate amount of revenue collections (after deducting any senior amounts to be applied on such payment according to the post-enforcement/pre-acceleration waterfall) are less than the aggregate amount of claims falling due for payment after the payment of principal of class A notes or any other debt or expenses ranking pari passu to the class A principal, in accordance with the post-enforcement/pre-acceleration waterfall.

Refinancing risk

The refinancing risk within the transaction is a key credit feature as the structure does not contemplate any amortization of debt as this is anticipated as being at a constant value against the designated airport's RAB. The transaction—through a covenant requirement—restricts the financing group regarding the profile of debt maturities to partially mitigate the concentration of refinancing risk with the future regulatory periods. The covenant requires that debt totaling no more than 30% of RAB (at issuance) matures during any two years, or 50% of RAB (at issuance) within any quinquennium.

Any cash flow "trapped" will be applied to the repayment of senior debt in two circumstances. The first is upon a trigger event that is a result of a breach of the debt-to RAB ratio (the RAR test) and the second is on an event of default.

The structure provides for a cash sweep to amortize senior creditors in certain trigger events. This goes someway toward addressing the class A debt refinancing risk upon a trigger event and, in certain stress scenarios, ensure de-leveraging of the senior notes. However, this does not mitigate the refinancing risk related to the overall bullet structure being used, the long-dated and back-loaded capital structure, nor the absence of principal amortization. That said, the structure contemplated by BAA is consistent with the other structures seen in the utility sector, which are also exposed to this refinancing risk and do not incorporate amortizing structures. That is to say, recent comparable utility transactions such as Thames Water have also been "bullet" finance structures, which, in effect, reflect the perpetual and increasing RAB—debt is raised to fund capex and incorporated into the RAB.

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Refinancing Facility

The refinancing facility is lent to the borrower group. The refinancing facility will be in place to cover any shortfall in the required capital markets issuance at financial close. The refinancing facility will have a maximum size of £4.4 billion. It will be drawn to this amount only if the issuer is not able to issue one single new bond. For each pound sterling of bond issued, the refinancing facility will reduce in size.

If the full £4.4 billion amount of bonds can be issued at transaction's closing date, then the refinancing facility will be cancelled. If £1.8 billion of new bonds can be issued at close, then the refinancing facility will be drawn to £2.6 billion and so on. However, any amount not drawn at the close of the transaction will be immediately cancelled. As the refinancing facility is only in place to cover any shortfall in bond issuance at the time of completion, the un-drawn commitment serves no purpose post completion. Therefore, it is not possible to draw under the refinancing facility post closing.

Any drawn amount under the refinancing facility (and capex facility for that matter) is treated as class A/B debt (as appropriate) and is subject to all the provisions of the common term agreement (CTA)—including the maturity restrictions, maximum debt to RAB, and hedging policy.

The tranche A and tranche B of the refinancing facility rank pari passu to the issuer borrower loan tranche A and tranche B, respectively, and ultimately to the class A and class B bonds.

In case of nonpayment, the back-stop facility (as well as the capex and working capital facility) will not accelerate for a period of 18 months. However, the facility will accrue defaulted interest as long as payment is not resumed and for a maximum of 18 months before accelerating.

The Nonmigrated Bond Facility

The nonmigrated bond facility is provided at the borrower level. Any outstanding BAA bonds that choose not to migrate will still hold security and guarantees from HAL, STAL, and GAL. In addition, they will not be part of the intercreditor agreement and they have an independent enforcement right. This implies that the nonmigrated bonds could potentially accelerate their debt making it due and payable. To avoid the ringfenced borrowing group becoming insolvent following such an action, a liquidity facility to meet this potential liability has been provided. The nonmigrated bond facility will be a term facility (no renewal risk) whose legal maturity will match the legal final maturity of the nonmigrated bonds. The commitment under the nonmigrated bond facility will match the principal of the nonmigrated BAA bond. The commitment of the nonmigrated facility will decrease as the nonmigrated bonds get repaid. This facility ranks pari passu with the tranche A debt that includes a working capital facility, capex facility, back-stop facility, and the tranche A issuer borrower loan.

Liquidity Facility Arrangement

The issuer and the borrower are expected to enter into liquidity facility agreements.

Under the CTA, the liquidity cover that the borrowers and the issuer are required to maintain can be satisfied by commitments provided under the liquidity facilities from suitably rated counterparty or deposits made to a dedicated account of the borrowers (or the issuer) charged in favor of the borrower (or issuer) security trustee.

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If the liquidity facility provider is downgraded below 'A' or fails to renovate the facility, it needs to be replaced within 60 calendar days or the funds available under the facility must be paid into the issuers' account.

The issuer and the borrowers are expected to have a liquidity facility of at least 12 months' class A notes interest and tranche A interest (that includes hedges, the EIB and the refinancing facility), respectively, and senior expenses and six months' class B notes interest and tranche B refinancing facility interest, respectively. The liquidity is available to the issuer and borrowers to be withdrawn to enable it to cover any temporary shortfalls in senior expenses, note interest, or unpaid hedging amounts due in connection with the security group. While the issuer is a bankruptcy remote to our rating standard and the liquidity facility will be available to be drawn on a timely basis despite the appointment of an administrative receiver at the borrower group, the same does not hold true for the borrowers, nonbankruptcy remote entities. Indeed, despite the obvious incentives to use cash in the borrower liquidity reserve account and to request a draw from the liquidity facility, there is no certainty this will occur on a timely basis to meet these shortfalls in the event that borrower group becomes insolvent and the appointment of an administrative receiver.

Timely payment of interest to the EIB and the refinancing facility providers at the borrower level upon the appointment of an administrative receiver is ensured by a standby LOC facility and a trust declared by the borrowers on the borrower liquidity reserve account and the deposits credited to this account. Under this structure, a standby LOC maybe issued and called upon by the borrower security trustee as a beneficiary of the standby LOC on behalf of the EIB, refinancing banks, and borrower hedge counterparties. In addition, the trust property will be held on trust for the borrower security trustee as trustee for (i) the EIB (for payment shortfalls arising from supported EIB facilities), (ii) the refinancing facility agent for and on behalf of the refinancing lenders (for payment shortfalls arising from the refinancing facilities), and (iii) the borrower hedge counterparties.

Hedging Arrangements

The issuer will enter into hedge agreements to cover its interest rate, inflation rate, and currency exposure. We expect the swap agreements to comply with our criteria for swap agreements.

The borrowers may enter into currency swap agreements to hedge nonsterling revenues in the normal course of business.

Business Profile: Excellent Due To Very Strong Competitive Position, Solid Operations, Supportive Regulation, And High Profitability

We consider BAA's business profile to have weakened over the past couple of years but to remain "excellent" (commensurate with the 'AA' category) based on the assumption that it will retain all three London airports. As this is largely driven by the continued ownership and operation of the securitized assets, which serve diverse airlines, traffic, destinations, and passengers, the business risk of the securitized assets also reflects this excellent profile.

The BAA group is the largest airport operator in the world, handling around 150 million passengers at its U.K. airports in 2007 (of which 126.8 million were handled at Heathrow, Gatwick, and Stansted). The BAA group has projected realistic traffic growth prospects into its future forecasts and benefits from the ownership and operation of a portfolio of the three key London airports catering for a diverse mix of airlines, traffic, destinations, and passengers; sound traffic growth prospects in the U.K.; and from generally supportive regulation and government

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policies. In addition, the key strategic position of its main asset, Heathrow, as a hub airport, supports the BAA group's competitive position.

However, the business risk profile also recognizes management turnover since the 2006 takeover, the current capacity constraints at Heathrow and Gatwick, and operational challenges, including the opening of Heathrow's Terminal 5 and the execution of a lumpy capital expenditure program. In particular, the capital expenditure program will result in longer negative free cash flow generation, and higher absolute leverage over the next 10 years than previously anticipated.

As an operating business, the BAA group will continue to face challenges and reliance will therefore be necessary on the management of the BAA group to perform to maintain its excellent business risk profile. The successful execution of the capital expenditure program is a key challenge as will be the management of the BAA group's competitive position as the aviation market changes, such as through initiatives as the "Open Skies" treaty which may increase competitive pressure for Heathrow on transatlantic routes; other medium- to long=term competitive threats also stem from other airports pursuing an expansion and hub strategy in Europe or in the Middle East. Operational issues that should have eased gradually following the opening of Terminal 5 at Heathrow have not disappeared, however, and actually led British Airways to extend the timing of the move of its long-haul services from Terminal 4 to Terminal 5.

Competitive position

The BAA group handled around 150 million passengers at its U.K. airports in 2007 of which 126.8 million passed through the securitized assets. The BAA group's strong passenger potential derives from its large and wealthy catchment area and London's position as Europe's major financial center and as a leading tourist destination. The growth in 2007 was helped by the continued expansion in European scheduled services (up 2.9%), growth on North Atlantic traffic (up 2.9%), and increases in other long haul operations (up 5.2%). However, European charter traffic dipped 5.5%.

The BAA group's main hub, Heathrow, is Europe's largest airport, with 67.9 million passengers handled in 2007 but, equally, Gatwick is also a significant sized airport as it handled 35.2 million passengers in the same period. Local competitors exist with mainly London City airport and Luton, but in total, Heathrow, Gatwick, and Stansted handle around 90% of southeast England's air traffic.

BAA's Heathrow competes mainly with Europe's other major international hub airports for connecting passengers only, most notably Frankfurt, Amsterdam Airport Schiphol, and Paris-Charles de Gaulle (CDG). Capacity constraints at Heathrow have somewhat affected its competitive position. In addition, the number of destinations served by Heathrow lags behind that of CDG, Frankfurt, and Schiphol. BAA, however, has higher frequency service to major destinations, which is an important factor for both travelers and airlines because it gives a choice of connections. In addition, Heathrow is less exposed than its peers to competition for transfer passengers.

Aeronautical activity

Importantly, the historical trends demonstrate the stability of passenger traffic at Heathrow, Gatwick, and Stansted and the resilience of passenger demand behavior to external shocks. For example, the BAA group has a record of more than 40 years of almost continual traffic growth with only the years following the first oil crisis in 1974, the 1991 Gulf War, and the period after Sept. 11, 2001 showing decreases in passenger traffic. Nevertheless, with the exception of 1991, when traffic decreased by 7%, the rate of passenger volume decline was in the low single digits and was short lived.

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The U.K. Aviation White Paper The Future of Air Transport (the "white paper"), published in December 2003, proposes the construction of a third runway and additional terminal capacity at Heathrow. These goals are expected to be achieved only in the long term and are dependent on whether environmental conditions are met and requisite planning approvals received. Additionally, the U.K. government remains committed to the delivery of a second runway at Stansted.

Table 2

BAA 2007 Traffic Summary

Terminal passengers (Mil.)	Calendar year January-December 2007	% change
Heathrow	67,855.1	0.8
Gatwick	35,168.3	3.2
Stansted	23,759.0	0.3
London area total	126,782.4	1.3
Southampton	1,966.6	2.8
Glasgow	8,732.2	(1.1)
Edinburgh	9,039.3	5.0
Aberdeen	3,433.4	7.9
Scottish total	21,204.9	2.8
U.K. total	149,953.8	1.6
Naples	5,735.3	13.2

In 2007, BAA's London airports handled a total of 126.8 million passengers, a rise of 1.3% over 2006. All individual airports recorded increases. Heathrow and particularly Gatwick continued to benefit from the comparison with results in the latter part of last year when traffic was affected in the aftermath of the August 2006 security rule changes. Although operations were disrupted in the immediate run up to Christmas 2007 as a result of fog the scale of cancellations and lost traffic was less than experienced over the same period in 2006. Stansted traffic rose a mere 0.3% due to some cutbacks in the winter schedule of both Ryanair and Air Berlin.

Over the year as a whole cargo tonnage fell by 1.8% to 1.7 million tonnes.

Heathrow, Gatwick, and Stansted handled 59.6 million passengers in the first half of 2008, a decrease of 0.5% from the same period of 2007. Over a 12-month period (July 2007 to June 2008), traffic growth was 1.1%.

Implications of the EU–U.S. "Open Skies" aviation treaty

Airlines have been allowed to fly from anywhere within the 27 member states of the EU to any point in the U.S. and vice versa since the end of March 2008. Currently, the bulk of traffic between the U.S. and Europe goes through the U.K., and most of that through slot-constrained Heathrow; this means additional traffic will have to be spread over different airports. That said, BAA estimates an additional 1.5 million passengers from Open Skies in the designated airports between 2007/2008 and 2008/2009.

Traffic diversity

A diversified airline, destination, traffic, and passenger mix all support traffic stability at Heathrow, Gatwick, and Stansted. Although the BAA group's four largest customers contribute about half of the airports' passenger traffic (the revenue contribution is lower), customer concentration is not perceived as a credit risk, particularly at Heathrow, where demand for slots for landing and take off exceeds supply. Of the hub airport operators we rate, the BAA group has the lowest exposure to its flag carrier. In 2007, 27.3% of Heathrow, Gatwick, and Stansted's

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total passenger traffic came from British Airways PLC (BBB-/Negative/--) (Heathrow 41%, Gatwick 19%). Ryanair alone represents nearly 60% at Stansted and easyJet 17% at Gatwick. In comparison, Air France-KLM represented more than 50% of passengers at Aeroports de Paris (AA-/Stable/--) and more than 60% at Schiphol (N.V. Luchthaven Schiphol and Schiphol Nederland B.V.; A/Stable/--).

Heathrow, Gatwick, and Stansted cater to different segments of the aviation market. This diversification is supportive of the BAA group's business profile because the negative effects of a downturn in one segment can be offset by strong performance in others. Heathrow is the largest hub in Europe, and almost all carriers are scheduled rather than charter, while Gatwick is the main U.K. charter airport, with a growing low-cost carrier presence. The existing capacity constraints at Heathrow and Gatwick have somewhat affected their competitive positions and the smaller number of destinations served by Heathrow and Gatwick may also erode their competitive position over time. That said, both Heathrow and Gatwick offer higher frequency of service to major destinations and are less exposed to competition for transfer passengers or to any one particular airline, as both constitute a smaller proportion of traffic. Stansted is an origin and destination airport and the U.K. center for the low-cost airline business. Stansted's rapid growth rates over the past 10 years result from the rapid expansion of low-cost carriers Ryanair and easyJet.

BAA's traffic base is relatively diversified across different markets (see table 3). At the three London airports, the major destinations are Europe and North America, which accounted for 70% and 13% of total traffic in 2007, respectively. A balanced breakdown of business and leisure travel between U.K. and overseas residents supports diversification of the passenger mix.

Table 3

Market Comparison—Calendar Year 2007

	BAA total January-December 2006 (Mil. £)	BAA total January-December 2007 (Mil. £)	Change (%)
U.K. plus Channel Islands	26,725.40	26,214.60	-1.9
Ireland	6,874.90	6,695.20	-2.6
European scheduled	60,247.70	62,000.30	2.9
European charter	10,421.70	9,846.50	-5.5
North Atlantic	19,073.30	19,626.80	2.9
Other long-haul	24,308.20	25,570.50	5.2
Total	147,651.10	149,953.80	1.6

The growth in 2007 was helped by the continued expansion in European scheduled services (up 2.9%), growth on North Atlantic traffic (up 2.9%), and increases in other long haul operations (up 5.2%). European charter traffic dipped 5.5%.

Revenue diversity and stability

BAA's revenue stability is directly linked to the stability of traffic and a tested tariff-setting regime (see "Regulation and government policy" below). In line with other airports, revenue breaks down between aeronautical and commercial revenues, which account for about 50% each. With the increase in fees in QQ5, the relative contribution of aeronautical revenues will increase through QQ5.

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Regulation And Government Policy: London Airports

Aviation strategy

The BAA group benefits from strong government support for its business as it provides key infrastructure for economic growth in the U.K. We do not expect that the U.K. government will fund airport infrastructure or bail out the BAA group in times of distress. We expect that the BAA group, the CAA, and the Department for Transport will continue to create conditions for longer-term investment in the expansion of aviation capacity in southeast England (the location of the securitized assets) even though the practical undertaking of this investment may be challenging, e.g., in view of the need for extensive planning consideration for airport capacity expansion projects.

Overview of regulation

Aviation policy in the U.K. is determined by the DfT. Airport regulation is established under the Airports Act 1986 with the CAA being the primary economic regulator of U.K. airports. The CAA is required to make a mandatory reference to the Competition Commission before it sets price controls. The regulatory responsibility of CAA includes a duty to encourage timely investment in new facilities at airports to satisfy anticipated passenger demand. However, unlike other U.K. regulators, such as those in the water industry, the CAA has no current responsibility to ensure that the BAA group retains a specified credit rating level. It must, however, ensure that the BAA group is able to promote the efficient, economic, and profitable operation of its airports.

The CAA is required to set a five-year price control formula, fixing the price cap on each of Heathrow, Gatwick, and Stansted. The airports each have a CAA-determined RAB, which is the primary input into the price cap calculation. Capital expenditures that enhance the value of the asset base are added to the RAB. The charges within the price cap include runway landing, aircraft parking, and the departing passenger charge. The CAA does not have the power to de-designate an airport—that is to say remove any of Heathrow, Gatwick, and Stansted from the price control regulation. The ability to do this is held by the DfT.

The price cap is set with reference to forecasts for traffic volumes, capital investment, operating costs, and operating revenues, as well as allowing the BAA group a reasonable return and is designed to offset the designated airports' monopoly characteristics. The formula follows a "single-till" approach, where retail and property activities subsidize aeronautical activities. To determine the price cap, required revenues are calculated based on the sum of net expenditures, regulatory depreciation of remunerated assets, and required returns on the average value of remunerated assets.

Although CAA has demonstrated flexibility by allowing the BAA group to offset revenue losses caused by external events, such as the loss of duty free revenues in 1999, the BAA group does not benefit from regulatory protection due to financial shortfalls caused by financing decisions.

CAA price control review for QQ5

In March 2008, CAA completed its regulatory price control review for QQ5 (commencing April 2008). This review has established the regulatory framework for the period April 2008 to March 2013 at Heathrow and Gatwick. A decision in relation to Stansted is outstanding and is expected by March 2009 for the period April 2009 to March 2014.

The headline conclusions of the review are important in setting the financial framework for each of Heathrow, Gatwick, and Stansted. The BAA group will be able to raise its passenger charges by 23.5% at Heathrow and by

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21.0% at Gatwick for the fiscal year 2008/2009, which is £2.45 and £1.19 extra per passenger, up to £12.8 and £6.79 per passenger—higher than previous expectations and which facilitates a growth in the revenue base of the securitized assets. In the remainder of QQ5, the passenger fee increase will be capped at inflation plus 7.5% for Heathrow and inflation plus 2.0% for Gatwick. According to the CAA, these increases contribute to the funding of £6 billion of investments scheduled between now and the end of 2013 at Heathrow and Gatwick. The airlines do not share this view and are highly critical of what they consider to be too generous increases.

Reflecting the requirement for the BAA group to undertake a significant future capital expenditure program, CAA has maintained the "price profiling" (or revenue advancement) approach, which allows a proportion of the costs associated with a future investment (in effect, depreciation) to be recovered before that new investment comes into operation. In addition, assets are remunerated during the course of construction at the regulatory cost of capital. The CAA has allowed a weighted-average cost of capital (WACC) of 6.2% for Heathrow and 6.5% for Gatwick, a marked reduction from the 7.75% allowed in QQ4.

To provide an incentive to the BAA group to deliver the various capital projects on time, the potential delay and other penalties payable by the BAA group in QQ5 have been increased, although they are still relatively limited. The penalties are (i) a maximum payment of 7% of airport charges per year or approximately 3.5% of overall revenues for insufficient service quality, or (ii) 5% of QQ5 airport charges or approximately 2.5% of overall revenues should the capital projects not be delivered.

Despite an earlier recommendation by CAA to "de-designate Stansted" (i.e., remove the airport pricing from the regulatory regime) the DfT has not accepted this point. As a result, the final pricing determination for Stansted is delayed until March 2009 to take effect for the following quinquennium commencing in April 2009. The CAA is considering up to six different regulatory pricing alternatives, indicating that the cost of capital should be at least in line with that of Gatwick (i.e., a minimum regulatory WACC pre-tax of 6.5%).

Competition Commission ''Emerging Thinking'' report

During 2008 and 2009, the BAA group will continue to be reviewed as part of the Competition Commission's investigation of the structure of the U.K. airport market. This review is focused on whether the BAA group's airport ownership, U.K. airports, and capacity constraints adversely affect competition.

The initial findings of this review—as set out in the "BAA Market Investigation--Emerging Thinking" report of April 22, 2008— suggest an increasing possibility of at least a partial divestiture of Heathrow, Gatwick, or Stansted. However, the Competition Commission also states that divestiture would not, in the short term, increase competition, which is considered to remain limited until at least 2015 given the current London airport capacity constraints. The report does not also set out a possible timetable for divestiture.

We believe that the effect of airport divestiture on the overall business risk profile of the borrower group would range from "neutral" to "negative", as this would reduce the portfolio diversification provided by Heathrow, Gatwick, and Stansted with their respective airline mix, traffic types, and capital cycles. In particular, we believe a decision requiring the BAA group to divest itself of Stansted would be seen as not material while a divestiture of Gatwick or of both Gatwick and Stansted would weaken the overall business risk profile of the borrower group to "strong" ('A' rating category). This would principally be a result of the likely increased medium term competition. However, in 2009 Heathrow alone is projected to maintain 53% of current London area traffic (i.e., around 48% of the southeast England air traffic) while 71% (at £717 million) and 77% (at £10 billion) of Heathrow (including the HEX Opco), Gatwick, and Stansted's adjusted EBITDA (pre-exceptionals) and RAB would remain to support the

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payment of principal and interest on rated debt in such a divestiture scenario.

The potential effect of an airport divestiture on the issuer's or borrower group's rated debt would depend on how any weakened business risk profile of the borrower group would be offset by potential improvement of its financial profile or other mitigating strategy proposed by the BAA group. Key considerations in this evaluation include: The methods and timing of the divestiture; the amount and application of the sale proceeds; the revised capital expenditure plans for the remaining securitized assets; and the level of borrower group debt following such divestiture.

For the avoidance of doubt, the preliminary ratings on the financing group obligations are based on the assumption that all three airports will be included in the transaction at financial close. We believe that divestiture would not occur until 2010/2011 at the earliest as a result of the expected issuance by the Competition Commission of its final report before March 2009 and the subsequent timing of any appeals and the sales process.

The Competition Commission appears to be currently undecided as to whether Heathrow, Gatwick, and Stansted should be regulated in the event of a required divestiture. As a result, this leaves open the possibility of deregulation of Heathrow, Gatwick, and Stansted if evidence suggests that deregulation might foster competition although the review of regulation proposed by the DfT (see below) also indicates that regulation continues to be contemplated as an effective means of ensuring continued investment in airport infrastructure.

If regulation continues, the Competition Commission proposes the introduction of "economic licenses" (similar to those held by other U.K. regulated utilities) that may be revoked upon a breach of regulatory obligations such as the provision of specified service levels. U.K. regulated airports do not currently operate on this basis and the CAA's sanctions for poor service are limited to penalties and revenue claw-backs at the time of quinquennial reviews. The move to economic license program could increase the regulatory risk exposure of the securitized assets although we believe this is a very remote scenario.

Other Competition Commission considerations include: Ringfencing individual airports so that following an event of default of a particular airport, other airports can continue operating; the appointment of a special administrator by the CAA (this is the case for water companies in case of insolvency); and introducing the requirement that asset disposals be approved by the regulator.

We view certain of these proposed changes as positive to the extent they provide an incentive to operators to perform properly and maintain sound credit profiles. There are many similarities between the proposals under consideration and the regulatory regime governing the U.K. water and electricity sectors, which suggest that the final Competition Commission review will not result in a radical departure from existing established regulatory practices within the U.K.

DfT review of regulation

In April 2008, the SoS announced a regulatory review of the U.K. airport system focusing on passenger satisfaction, appropriate and timely infrastructure investment, as well as the wider environmental effects of aviation on airport development.

The SoS has also indicated a new policy goal of regulation to provide incentives for investment, especially by airport owners, and referencing successful regulatory frameworks in other industries. The SoS noted that changes will not be made to the current price caps at Heathrow and Gatwick that have been established for QQ5. This also applies

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to the Stansted cap taking effect on April 1, 2009.

Operations

A key credit driver for the company is its significant capital expenditure program, which is expected to span over the next 10 to 15 years at high levels to increase capacity and quality of service. In that respect, meeting the operational and capital objectives agreed with the regulator and airlines will depend on the company's ability to keep strong monitoring over a variety of projects, while improving the quality of services. BAA has a relatively good track record for capital projects—Terminal 5 was delivered on time and in line with budget—although the size of the capital spending in the next 10 years, particularly in QQ6, is unprecedented and raises the risk of construction overruns and/or delays.

The security group's forecast capital expenditure programme £7.1 billion in QQ5 and £11.0 billion in QQ6 will present the BAA group with a significant challenge to execute on time and within budget, but is also fundamental to the improved operating performance, customer service quality, and capacity of the securitized assets. The BAA group has a relatively good track record for capital projects.

2007 operations were affected by the heightened security measures imposed by national and European authorities. The company invested in a program of immediate delivery introduced by the management with the objective of improving passenger experience by reducing queues and improving facilities and cleanliness.

Additional resources—by the end of March 2008 there were over 60% (2,250) more officers and over 30% more security lanes plus a further 22 lanes (18%) for terminal 5 than in August 2006—have increased security capacity and reduced waiting times for passengers. In December 2007, security queues at Heathrow and Stansted were below 10 minutes for 94% of the time and Gatwick achieved queue times of less than 10 minutes for 97% of the time. BAA expects to be able to comply with the QQ5 Heathrow requirement of 95% of passengers going through security checks in fewer than five minutes.

The BAA group's operating performance has been below expectations in recent years and management must address this issue in order that the BAA group's market position is maintained. Passengers at Heathrow and Gatwick, for example, suffered the worst flight delays in national European airports in 2007 according to the Association of European Airlines: Over 2007, 36% of Heathrow departures were delayed by an average of 33 minutes, compared with 30% of flights at Gatwick, 30% at Rome, 28% at Dublin, and 27% at Paris-Charles de Gaulle. It should be noted, however, that an airport operator is not solely responsible for delays as airlines; ground handling, catering, and air traffic control can all contribute to delays.

In addition, the opening of Terminal 5 caused significant operational disruption at Heathrow and has continued to create a credibility problem in relation to management's ability to perform under challenging airport conditions. We understand that there is no contractual liability or litigation in connection with the problems at Terminal 5 for the BAA group although certain penalties and bonuses associated with new service standards starting April 1, 2008 might be affected. However, this is not anticipated as being a material amount.

The Group is clear that significant additional investment will also be needed to replace and renew existing terminal facilities. Heathrow's first four terminals were built to handle around 45 million travelers annually but today process almost 68 million.

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In the spring of 2007, the Group gained planning permission for a new terminal at Heathrow—Heathrow East—to replace the fifty year old Terminal 2 and adjacent Queen's Building. In the latter part of the year, the Government also launched a public consultation on the future development of the airport including plans to build a third runway and sixth terminal.

The public inquiry into the expansion of Stansted to a 35 million passenger airport was completed during 2007, although the results are not yet known. The Aviation White Paper Progress Report was published by the DfT at the end of 2006 and re-stated the Government's commitment to the delivery of a second runway at Stansted as the first new runway in the southeast of England. BAA has continued to develop plans for a second runway and associated facilities throughout 2007 and planning applications were submitted in March 2008.

Profitability

Profitability and budgetary performance

Airport operators such as the security group are characterized by high operating margins due to their increasing revenues, mostly fixed costs, and relatively low staff levels. Table 4 sets out the EBITDA margin to demonstrate the profitability of the various securitized assets.

Table 4*

EBITDA Margin

	BAA group	Heathrow	Gatwick	Stansted	Others
Sales (£ Mil.)	2,247	1,274	407	242	324
EBITDA (£ Mil.)	956	596	153	115	92
Margin (%)	42.5	46.8	37.6	47.5	28.4

*Consolidated information extracted from the BAA annual accounts, December 2007.

Passenger numbers, tariff changes, and retail activities are the main drivers of revenue growth. The passenger trends and pricing mechanisms have been set out in the previous section. Nonaeronautical revenues are also related to the passenger numbers and, therefore, are forecast to grow by a compound average growth rate (CAGR) of 5% per year over the next regulatory period. Spending per passenger, already good at Heathrow, Gatwick, and Stansted, are forecast to increase at an aggressive rate—being above U.K. inflation and long-term retail spending rates.

The BAA group's operating expenditures are mostly fixed and linked to the number of operating terminals. Terminal 2 at Heathrow is scheduled to close in 2009 to make way for the East Terminal and, consequently, the forecast expenditure includes the likely staff reduction following on from its restructuring.

The BAA group's financial projections have, historically, been credible, although it has not consistently met its overall financial performance. For example, although the BAA group has met or exceeded operating cost forecasts assumed in QQ4, it underperformed its financial projections by £350 million at Heathrow and £159 million at Gatwick. Some of this operational underperformance (such as the one related to security costs) is partly recoverable under QQ5. At both Heathrow and Gatwick, passenger revenues were short of expectations, and costs higher due to new legal security requirements, utilities and taxes, and compliance costs regarding noise and blight, but commercial revenues were better.

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2008 margins to weaken

The EBITDA margin will weaken in 2008 over 2007. Heathrow's Terminal 5 entered into service in March 2008 which, together with other capital expenditures, will mean €350 million additional depreciation. Higher operating and security costs are also expected.

Financial Profile: Highly Leveraged Due To High Debt, Weak Credit Ratios, And Significant Refinancing Risk

BAA is seeking to implement a corporate securitization of the London airports in the course of Q3 2008. Assuming a ratio of debt to RAB of 85% for the class A and class B bonds, the ringfenced vehicle could accommodate all BAA's debt and refinance the senior acquisition and capex facility debt, leaving about £1.6 billion junior subordinated debt outside the ringfence. The payment in kind and toggle facilities incurred at the time of the takeover of BAA are not part of the refinancing.

BAA will likely become one of the largest corporate utility issuers, and one of the largest issuers in the sterling debt capital markets. Hence, it is imperative to maintain flexibility of tenor, coupon, and market to continue to fund the capex program and critical to diversify funding sources to optimize issuance and to seek out the most liquid and efficient capital markets, both on day 1 and going forward.

To that end, the security group may issue both short and long dated capital market debt in fixed, floating, and index-linked coupons, with U.K., European, and U.S. placements (BAA has filed and completed registration to tap the US 144A market).

Financial profile under the refinancing

The BAA group's financial profile under the corporate securitization remains aggressive, reflecting the high degree of leverage within the BAA group and is characterized by low interest coverage ratios. However, the BAA group performs relatively robustly against sensitivities over many of the key variables, such as traffic volumes, capital expenditure execution, and operating costs.

Table 5 sets out illustrative financial ratios. The underlying operating and financial assumptions within this scenario are that of the management base case.

Table 5

Management Base Case		
	Average Q05*	Average Q06*
ND/RAB class A (%)	67.5	69.2
ND/RAB class A and B (%)	76.8	80.9
ND/EBITDA class A (x)	7.7	7.4
ND/EBITDA class A and B (x)	8.7	8.7
ICR (interest paid) class A (x)	2.2	2.3
ICR (interest paid) class A and B (x)	1.9	1.8
ICR (interest expense) class A (x)	1.8	1.7
ICR (interest expense) class A and B (x)	1.5	1.4
FFO/ND class A (%)	8.5	8.5
FFO/ND class A and B (%)	6.7	6.3

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Table 5

Management Base Case(cont.)

*Ratios have neither been adjusted for leases nor for guarantees or pensions. ND-Net debt. EBITDA-Earnings before interest taxation and depreciation & amortization. FFO-Funds from operations ICR-Interest coverage ratio (based upon interest paid) is calculated as EBITDA – 2% of RAB – tax/interest paid. The ICR (interest expense) ratio is not part of the covenant package but is included within the table for information purposes as it incorporates interest expense (e.g., capitalized interest) as well as the indexation of any index-linked bonds. - FFO/ND ratio with FFO calculated as EBITDA – tax.

Credit And Cash Flow Evaluation

Base case

Although Heathrow, Gatwick, and Stansted all underperformed their regulatory traffic assumptions in QQ4 2007, the BAA group achieved 95% accuracy in terms of traffic forecasting. Future changes in the aviation market—such as different aircraft types, the effect of "Open Skies'', and customer behavior—may make this more challenging in the future.

The BAA group's medium- to long-term base case traffic forecasts for Heathrow and Gatwick are 2.8% and 1%, respectively (rising to 78.2 million passengers and 37.4 million passengers, respectively, to March 2013, on a C.A.G.R. basis). This is below the expected long-term growth average in the U.K. and for other European hubs, reflecting the capacity constraints and also other factors such as the assumptions of underlying oil prices, likely changes to the fleet mix, etc.

Forecasts for Stansted (28.5 million passengers in 2013 up from 23.5 million passengers in March 2008) take into account the fact it is constrained by market conditions:

- Low cost carriers represent more than 80% of the airport's traffic;
- The airport charges are expected to be set to the maximum level permitted; they were below the allowable yield determined by the CAA until April 2007; and
- Stansted's passenger profile is price-sensitive.

Although they are constrained by the current restricted capacity, we believe BAA business plan's main operating assumptions are very buoyant.

There are four principal structural "step-changes" considered within the BAA group's passenger growth forecasts for the securitized assets:

- The opening of Terminal 5, which increases passenger capacity to 90 million (an additional 32.5% of capacity);
- "Open skies", resulting in replacement of short-haul by long-haul flights at Heathrow as cross-Atlantic flights increase. Together with the introduction of larger aircraft, this development will increase passenger traffic despite the number of arrivals and departures remaining constant;
- A second runway and new terminal at Stansted (operational in 2015); and
- Conversion of existing two runways at Heathrow to mixed-mode (simultaneous take-offs and landings) by 2015, which with the new East Terminal and additional aircraft parking would provide an additional 12.5% plane movement capacity.

To realize each and all of these step-changes will present a challenge: the Terminal 5 benefits are dependent upon Terminal 5 moving to effective operations as soon as possible; the pattern of traffic changes following the introduction of "open skies" will evolve over time; the second runway at Stansted depends not only on the BAA

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group progressing its capital plan but on the associated planning approval process being timely completed and the performance by the BAA group of its obligations.

Although BAA's traffic growth forecast is achievable, it could be further challenged by industry events, erosion of passenger confidence, and a weak economic climate, which could result in lower-than-expected passenger growth.

In addition, non-aeronautical revenues (around 50% of total) are forecast to grow by a CAGR of 5% per year over the period. Once we consider the 1.0% to 2.8% traffic growth, the spending per passenger would grow at or above forecast inflation and long-term retail spending in the U.K. This also appears ambitious, as spending per passenger is already at good levels in the London airports, and as ongoing capital spending in and around the existing terminals may affect commercial revenues.

The operating expenditures are mostly fixed, as linked to the number of terminals being open. Terminal 2 will close at Heathrow in 2009, to make way for the future East Terminal. No other terminal closure is expected or likely. Most of the costs are fixed and predictable. Some staff costs may be adjusted in line with passenger flow, but these costs are relatively minor. The forecasts include the benefit of an ongoing restructuring, leading to relative staff reduction.

The capital spending used in the business plan is mainly linked to the structural projects and leaves BAA with significant ability to delay spending under stress scenarios. Arguably, the company would opt for paying some (limited) penalties for nondelivery of projects on time rather than going into financial distress.

The financing has been assumed as successful, beyond the initial issuance: The incremental debt requirements (on average £1 billion per year) are met through public issuance.

Sensitivity testing

We requested that various sensitivities be run over key input variables to enable an assessment of the resilience of the proposed financial structure. Highlights of this testing are set out in table 7 and, in general, demonstrate that the refinancing performs relatively strongly against key operating variables, including traffic, capital, and operating expenditure.

The relative good performance, even under the mild stresses assumed in our case, is mostly due to the company being able to reduce its capital expenditure in line with the lower expected passenger level. This explains in particular the narrowing of the difference between the two cases over QQ6, where the lower revenues are more than compensated by the lower incremental debt. BAA's base case debt levels are in QQ6 on average 50% higher than our case levels, mostly due to Heathrow's capacity increase and refurbishment expenditures. Although ratios are comparable, the sheer amount of debt, which makes the potential impact of stresses or downturn more meaningful, induces greater risk in the BAA case.

Overall, however, the relative resilience, under mild assumptions, of the cash flows for the company appear to indicate that the most severe challenges to the structure would arise from a one-off material downturn, as opposed to a lower but predictable pace in revenue increase.

Harsher stresses can easily be achieved should capital expenditures not be followed by a subsequent increase in passenger levels, necessary to reach the allowed return on capital. We did not consider those stresses as the most likely, however, due to the existing regional capacity constrains.

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The relative good performance of the models benefits also from the assumption of continuous access to market. Financing risk is not addressed by those sensitivities. This risk may be significant, considering the low level of amortization built in, and the amount of, the current and expected financings in the forecasts.

This lack of amortization reduces the quality of the coverage levels reached throughout the period of analysis. Interest paid coverage levels reach a minimum of 1.18x at the A and B level under our base case in 2016 (vs. 1.24x at the same low point for the BAA case). Although low, this coverage is still appropriate for the level of ratings, considering the quality of the assets and the stability of the regulatory regime.

To devise our sensitivity case, we have assumed:

- That no new runway would be approved due to environmental concerns. Passenger growth is consequently constrained within existing infrastructure, although capital expenditures are accordingly significantly reduced. After having adjusted for this constrain, incremental passenger forecasts have been haircut by about 5%, the historical inaccuracy rate achieved by BAA, and capped at the level reached on 2015.
- The non-aeronautical revenues to evolve in line with inflation. Inflation has been itself conservatively assumed at 1% per year over the course of the analysis.
- The operating expenses have also been increased by 10% as compared with BAA's base estimate, in line with its track record in QQ4.
- An increasing cost of debt.

In consideration of the developments of the Competition Commission, we ran these sensitivity cases using both the current scope of the operations and with only Heathrow being retained within the structure.

Table 7

Sensitivity Results Of The Proposed Transaction

	BAA base case scenario		Standard & Poor's scenario	
	Average QQ5	Average QQ6	Average QQ5	Average QQ6
ND/RAB class A (%)	67.9	67.4	67.0	67.2
ND/RAB class A and B (%)	79.6	81.3	80.7	83.4
ND/EBITDA class A (x)	7.7	7.2	8.8	6.3
ND/EBITDA class A and B (x)	9.0	8.7	10.6	7.8
ICR (interest paid) class A (x)	2.1	1.8	1.6	1.7
ICR (interest paid) class A and B (x)	1.7	1.4	1.3	1.3
ICR (interest expense) class A (x)	1.7	1.4	1.5	1.5
ICR (interest expense) class A and B (x)	1.4	1.1	1.2	1.2
FFO/ND class A (%)	13	13	12	15
FFO/ND class A and B (%)	11	11	10	12
Debt outstanding class A (Mil. £)	10,901	16,964	9,801	11,108
Debt outstanding class B (Mil. £)	1,895	3,486	2,020	2,688

The results in table 8 are based on the disposal of Gatwick and Stansted airports taking place at a value close to 100% of RAB. All net proceeds have been assumed as allocated to reducing debt as the refinancing facility is assumed to be drawn. These assumptions may not be reached.

Any potential excess proceeds, following the full redemption of the bank facilities, are expected to be allocated to

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allow for upstreaming outside the security group to the extent allowed by the observance of the covenants included in the financing. Ratio outcomes may then be less favorable than in the case shown in table 8.

Table 8

Sensitivity Results Of The Proposed Transaction Assuming Heathrow Only

	BAA base case scenario		Standard & Poor's scenario	
	Average QQ5	Average QQ6	Average QQ5	Average QQ6
ND/RAB class A (%)	66.9	69.9	67.2	69.6
ND/RAB class A and B (%)	74.9	80.5	75.9	82.9
ND/EBITDA class A (x)	7.8	7.7	9.3	6.8
ND/EBITDA class A and B (x)	8.8	8.8	10.4	7.9
ICR (interest paid) class A (x)	2.4	2.1	1.8	1.9
ICR (interest paid) class A and B (x)	2.0	1.8	1.5	1.6
ICR (interest expense) class A (x)	1.8	1.6	1.6	2.2
ICR (interest expense) class A and B (x)	1.6	1.4	1.4	1.8
FFO/ND class A (%)	8.7	8.1	6.6	8.7
FFO/ND class A and B (%)	7.1	6.2	5.1	5.9
Debt outstanding class A (Mil. £)	8,366	13,407	7,585	9,037
Debt outstanding class B (Mil. £)	1,133	2,431	1,166	1,771

Although the sensitivity analysis in a Heathrow-only scenario, based on the assumptions described above, provides average ratios and outcomes similar to the current three airports case, these results do not indicate that the rating would remain unchanged. As already emphasized in this analysis, we see the reduced portfolio diversification and increased competition as potentially negatively affecting the business risk profile of the remaining security group.

Legal And Accounting Issues

The legal opinions are expected to confirm that the issuer will be—but the borrower companies will not be—entitled to the benefit of the tax treatment for securitization companies introduced by the U.K. Taxation of Securitisation Companies Regulations. However, the borrower companies are at the moment able to continue to produce accounts on the basis of old U.K. GAAP. So, at present, the borrowers can avoid potential tax charges on phantom income or phantom gains as a result of moving to new U.K. GAAP fair value accounting, for so long as they are entitled to continue to produce their accounts on the old U.K. GAAP "authorized accruals" basis.

The tax opinion is expected to confirm that, under the law as at present, when the time comes that they are required to move to some form of U.K. GAAP fair value accounting, the borrowers should be able to take the benefit of the "disregard regulations" as presently structured, so as to achieve substantial tax neutrality resulting from that migration. But there are the usual risks that the disregard regulations may no longer be in place, or may have been amended in such a way that the borrowers would no longer qualify to benefit under them, if and when it becomes relevant for them to do so.

Thus, while proposals are under discussion, which, just as with any securitization, could result in adverse tax and balance-sheet accounting treatment for the borrowers as a result of being required to move to new U.K. GAAP fair value accounting, there are as yet no specific proposals that are sufficiently certain to enable an assessment to be made of the actual, or any, effect that such a transition would necessarily have on the borrowers.

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Proposed abolition of the "industrial buildings allowances"

The U.K. government announced in the March 2007 Budget that the industrial buildings allowances (IBAs) would be abolished over three years from April 1, 2008. BAA could be obliged to recognize an exceptional accounting loss in the form of a charge for deferred tax in the year in which the IBAs abolition is substantively enacted. This accounting effect will be neutral in the long term as the loss will be offset in the following years in the form of reduced charges for deferred tax. If these changes were substantively enacted, the deferred tax liability that the security group would have had to provide at Dec. 31, 2007 amounts to £1.3 billion. However, the cash affect of the proposed abolition of IBA on the group in QQ5 is not material due to the transitional period regime applicable to 2011 and the low taxable income base of the group. The impact of the proposed abolition on future periods is uncertain due to the potential regulatory change to a post-tax allowed return (as is the case in other regulated industries), following the Competition Commission's comments on its report to the CAA dated Sept. 28, 2007. Under the existing regulatory framework, and assuming no further changes, the present value on the reduced cash flows for the existing assets would be approximately £500 million.

The U.K. tax code gives relief for the cost of "industrial buildings" by allowing a deduction against profits chargeable to corporation tax. The deduction is called IBA and relief is given at an annual rate of 4% of cost for 25 years. The major claimants of this relief are in the transport and communications, energy and water supply, and business services sectors. For BAA, abolition would mean that tax relief will not be available on approximately £5 billion that the group will have spent on core infrastructure assets at its 7 U.K. airports.

This section assumes that IBAs are enacted in full.

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