

2006-2010 DRAFT PLAN OF FINANCE

A. Introduction

The operating and financial improvements experienced in 2004 have continued into 2005. The Port's key operating measures of Airport passenger traffic and Seaport container volumes are projected to increase 2% and 15% respectively for the year and the cost reduction measures implemented over the past three years have resulted in improved financial performance as well; improvements are expected to continue into 2006.

The focus of the Airport continues to be on managing airline costs while completing the Airport expansion program. In order to accomplish this, the Airport has developed a new rate setting methodology to be incorporated into the new agreements which are expected to be adopted in 2006. The Airport expects to charge the airlines 100% cost recovery for all aeronautical costs with the ability to charge up to 125% of aeronautical debt service in the event that coverage on all Airport related debt service drops below 125%. This change reduces airline costs while preserving the Port's flexibility to increase airline charges in order to meet financial targets. The Airport would retain all non-aeronautical net revenues and the Port is in the process of increasing its working capital balances to maintain the equivalent of at least nine months of operating and maintenance expense in order to provide a liquidity cushion and mitigate the anticipated lower overall debt service coverage. In addition, the Airport continues to look for opportunities to effectively manage both operating and capital costs. The Airport capital program is on schedule. The Central Terminal was completed this year and the new runway will be in use by the end of 2008.

Seaport continues to improve its net income through a combination of cost cutting and revenue enhancement. The Seaport successfully completed the improvements at Terminal 25 to bring that facility back into operation as a container terminal. This increase in leased container terminal acreage and an increase in container volumes harbor-wide resulted in the growth of container revenues for the Port. The Port also experienced revenue growth in the cruise business, with a 22% increase in cruise passengers in 2005, and grain exports. In addition, the Seaport has successfully leased more than 90% of its commercial properties and is experiencing high occupancy of its marinas. This coupled with careful management of growth in operating and maintenance expenses has resulted in a strong increase in net income for the Seaport. The Seaport continues to look for ways to make the Port a competitive option for shippers by aggressively marketing the Port's facilities and by participating in regional initiatives to improve landside transportation of cargo. The Seaport continues to invest in container terminal improvements in order to provide competitive facilities and to invest in renewal and replacement of other Seaport facilities including Terminal 91, Terminal 115, Fishermen's Terminal and Shilshole Bay Marina. In addition, the Seaport capital plan includes future renewal projects in its capital program. Although the nature of these projects is not yet known, it allows for funding to be reserved in anticipation of renewal need. The Seaport continues its attention to security and the 2006 budget reflects significant operating expenses related to security improvements; most of these costs are expected to be off-set by security grants.

The Economic Development Division has three main areas of responsibility: real estate development focusing on underutilized Port property, regional transportation and regional economic development. The Division has engaged in planning the development of approximately 57 acres of uplands north of Terminal 91 (North Bay) that is mostly vacant and is no longer needed for maritime use. The division also manages the Port's participation in regional transportation initiatives including potential participation in a regional effort to replace the State Route 99 Alaskan Way Viaduct that runs near a number of Port properties and is a major regional transportation artery. During the budget process, the Commission expressed interest in preserving future capital spending capacity to potentially fund up to \$200 million of costs associated with the Viaduct replacement of which \$40 million is anticipated to be funded during the 2006-2010 period. While there is no funding commitment at this time, the Plan of Finance was developed to anticipate this project.

As part of the capital management process, each year the Port prepares the Draft Plan of Finance (the Plan). This provides a plan for funding the Port's currently anticipated capital spending. The Plan is designed as a flexible tool, providing guidance to the Commission and Port staff as planning and investment decisions are made during the coming year. The Plan is based on a five-year capital plan in order to provide better guidance on long-term funding.

Once a year, the Commission is presented with the Port's capital plan along with a funding analysis. By final budget action the Commission approves the capital plan and establishes the level of the Port's tax levy for the coming year. The first year of the capital plan forms the basis of the Port's Approved Capital Budget. Each quarter the capital plan is revised and progress is measured on capital spending; this is reviewed quarterly by the divisions and Senior Management and periodically by the Port Commission.

B. Overview of the Funded Capital Plan

The capital plan is the result of an iterative process that begins with updated business plans developed by each division and approved by division management. The plan is then reviewed in the context of the Port's projected capital capacity and further reviewed by Port Executive staff. Changes to the capital plan are incorporated into the final business plans and budgets and into the Plan of Finance. For information on the Port's Capital Improvement Program see Section IX "Capital Budget."

Within the capital plan, projects are divided into several categories that determine their funding priority.

- **Committed:** Committed projects are those necessary to implement the divisions' business plans and are well scoped, have undergone financial analysis and at least division level review. They include projects that are already underway and authorized as well as projects not yet authorized, but ready for Commission level review. These projects receive a specific funding commitment in the Capital Plan.
- **Prospective:** Prospective projects may also be part of business plans, but are not yet well-scoped and analyzed and therefore are less certain as to timing or funding requirements. Prospective projects can be re-classified as Committed once they have met the necessary criteria, so it is important that capital funding be flexible enough to accommodate these projects as well as other changes to the Capital Improvement Program (CIP). Prospective projects are further subdivided into two categories as follows:
 - **Business Plan Prospective:** Projects that are prospective because of uncertainty of scope and timing, but are deemed to be critical for achieving business plan goals. This category includes projects that are contingent obligations associated with leases or other agreements.
 - **Other Prospective:** Projects that are still in preliminary planning or that are not currently deemed critical in meeting business plan goals.

In addition to the CIP, the Port participates in several public projects, particularly in the area of regional transportation. Because these projects do not result in Port owned assets, they are accounted for separately as Public Expense Projects, but they use the same funding as capital projects and are included in the funding analysis for the Plan of Finance.

Committed projects are designated for funding and are the basis of the Plan of Finance. This year's Plan of Finance also includes the Business Plan Prospective projects and two additional projects, not in the Committed or Business Plan Prospective CIP -- a potential \$40 million out of a total \$200 million participation the Alaskan Way Viaduct replacement and development of the North Bay property. Consistent with last year's Plan, the Port continues to target a minimum 1.8x debt service coverage on its First Lien Revenue bonds. New for 2006, the Plan targets debt service coverage by division with the Airport meeting a 1.25x coverage on Airport revenue bond debt and the Seaport and Economic Development collectively meeting 1.5x coverage on their revenue bond debt. Simultaneously the Port continues to implement plans to increase the minimum fund balances in the Port's working capital funds. The Plan is developed so that these targets are met in most years; temporary, minor dips below the targets can be tolerated if the long-term coverage is expected to rebound to at least the target coverage.

Consistent with past years since 1991, the Port has authorized its property tax levy below the maximum levy allowable, thus preserving the flexibility for the Port to increase the levy if needed. For 2005, the Port maintained the same levy rate of \$0.25 per \$1000 of assessed value from 2004 which resulted in a levy amount of \$62.7 million. For 2006, the Port will maintain the same levy amount as 2005 at \$62.7 million, reducing the levy rate to an estimated \$0.23 (see IV Tax Levy); the Plan examined two scenarios for the tax levy from 2007 through 2010: 1. the levy rate is reduced by maintaining the levy amount at a constant at \$62.7 million (increases in assessed value allow the rate to drop) and 2. the levy rate is held constant at \$0.23 per \$1000.

Also consistent with last year, the Plan retains at least 25% of the tax levy for general purposes and uses no more than 75% for General Obligation (G.O.) bond debt service. As of January 4, 2006, the Port could issue an additional \$226 million of non-voted G.O. bond debt (see section IV "Tax Levy").

C. 2006-2010 Funding Plan

AIRPORT

The Airport's operating forecast is based on the proposed new airline lease agreement described above. During the forecast period, the Port expects to generate sufficient net income from non-airline sources to maintain Airport related debt service coverage at 1.25x without increasing airline charges above 1.0x coverage.

The funding Plan for the Airport includes Airport net income, the use of existing bond proceeds, future revenue bonds and commercial paper proceeds including bonds expected to be issued in 2005. In 2004 The Port received an increase of \$61.9 million to the Letter of Intent (LOI) granted by the Federal Aviation Administration (FAA) for the Third Runway project bringing the total LOI to \$278.4 million; the Airport expects additional Federal grant money for capital improvements including noise mitigation and security projects. Passenger Facility Charge (PFC) collections (net of PFC bond debt service) also provide capital funding and the Plan anticipates issuing additional bonds secured by PFC receipts. In addition, the Plan anticipates the use of the tax levy to fund the portion of Highline School District noise mitigation costs that are ineligible for Airport funding and to fund environmental planning for the widening of State Route 518 near the Airport.

The current funding Plan includes all of the Airport's Committed and Business Plan Prospective projects including completion of the third runway; relocation of the north expressway; continuation of infrastructure improvements and noise mitigation; baggage screening and other security improvements, design and construction of a new rental car facility and portions of the Comprehensive Development Plan (CDP) to further expand Airport capacity. The timing of the CDP projects is uncertain and will depend in part on demand for air travel. The Plan for the Airport also includes the Airport's share of the corporate Professional and Technical Services (P&TS) Projects, which totals \$26 million and represents the difference between the \$1,970 million CIP and the \$1,996 million in funding sources.

TABLE X-1: 2006-2010 AIRPORT ⁽¹⁾ PROJECT FUNDING
(Millions of Dollars)

PFCs (net of PFC bond debt service)	\$ 149
Net Income	238
Federal Grants	324
Tax Levy	14
Existing Bond Proceeds	274
Additional Bonds & Commercial Paper	997
Total	\$1,996

(1) Includes the Airport portion of P&TS Projects.

Note: Bond funding represents project costs funded with debt, which differs from par amount of bonds.

SEAPORT AND ECONOMIC DEVELOPMENT

The Seaport and Economic Development (ED) Divisions share the same funding sources. The 2006-2010 Plan is intended to fund both the Seaport and ED Committed and Business Plan Prospective projects. In addition, the Plan assumes funding for participation in the Alaskan Way Viaduct replacement and development of the North Bay property. The Plan also assumes that a portion of the tax levy is used to fund the Port's participation in public expense projects for freight mobility and relocation of the Waterfront Streetcar maintenance shed. The Seaport and ED funding Plan is based on the income projections associated with the existing facilities, new projects and the sale or lease revenues from improved property utilization and on achieving 1.5x debt service coverage on Seaport and ED revenue bond debt. The Plan was developed with two scenarios: 1. the tax levy rate is reduced by maintaining a constant amount of \$62.7 million and 2. the tax levy rate is held constant at the 2006 rate of \$0.23 per \$1000 assessed value. Based on these assumptions, the Plan requires that an estimated \$201 million in capital spending be deferred under the reduced rate scenario and \$69 million be deferred under the flat rate scenario.

Seaport funding includes Seaport net income and excess General Fund balance, proceeds from General Obligation (G.O.) bonds issued in 2004 and future revenue bonds and commercial paper. The Plan also assumes Seaport and Economic Development Division funding from the tax levy. The Plan includes \$16 million for a portion of P&TS projects.

TABLE X-2: 2006-2010 SEAPORT AND ECONOMIC DEVELOPMENT ⁽¹⁾ PROJECT FUNDING
(Millions of Dollars)

	Reduced Levy Rate	Constant Levy Rate
Tax Levy	47	\$ 54
Net Income and General Fund Balance	65	65
Federal Grants	2	2
2004 General Obligation Bonds	8	8
Future Bonds	249	374
Total	371	\$503

(1) Includes the Seaport and Economic Development portion of P&TS projects.
Note: Bond funding represents project costs funded with debt,
which differs from par amount of bonds.

FINANCIAL IMPLICATIONS AND RISKS

The funding Plans above include the Airport projects currently identified as Committed and Business Plan Prospective and some portion of Seaport and ED projects. In addition, the Plan is designed to accommodate development of North Bay and the Port's participation in the Viaduct replacement. The Plan meets the First Lien Revenue Bond coverage target of at least 1.8x coverage and in fact results in First Lien coverage between 2.2 and 2.6x under either scenario. The Plans were also designed to meet the targets of Airport revenue bond coverage of 1.25x and Seaport and Economic Development coverage of 1.5x. The result is that under either scenario, total revenue bond coverage for the Port ranges from a low of 1.38x to a high of 1.49x. In order to meet the Seaport and ED target, some capital spending will need to be deferred as noted above.

There are a number of risks that should be considered with regard to the above funding Plan. While the Committed projects are fairly certain, the Business Plan Prospective projects are still uncertain with regards to scope and timing; an increase in costs or acceleration of schedule for these projects could change the funding forecast. In addition, the Plan does not include Other Prospective projects or projects that are not currently contemplated but may be required for security, renewal and replacement or to address changes in the business environment. In addition, the forecast is based on a number of assumptions related to operating income and tax levy collection; changes in these assumptions could affect the Plan results as well. To minimize coverage impacts, the Port could employ a number of options:

- delay or reduce project spending

- further reduce operating costs or identify additional revenues
- utilize alternative financing for appropriate projects
- seek additional grant funding
- increase airline rates and charges
- increase the tax levy, subject to statutory constraints
- implement the Industrial Development District levy

Prior to implementation, the above mechanisms would be further evaluated in the context of business planning, asset liability management goals and Port policy objectives. Given potential costs or risks associated with each of the mechanisms, it is likely that a balanced approach would be pursued that utilized them in some combination.

The Plan of Finance assumes a levy amount of \$62.7 million in 2006, well below the Port's actual statutory authority of \$77.8 million. The Port can access additional funding sources including remaining non-voted G.O. bond capacity and voted G.O. bond capacity, assess the tax levy at the maximum amount or assess an Industrial Development District (IDD) levy (subject to limitations described in section IV "Tax Levy"). There are no plans to use these resources at present, but they are available should the Port Commission deem them appropriate.

D. Financing Initiatives

In 2005, the Port developed and approved the terms and covenants of a new intermediate lien to be used primarily for the Airport. The Port sold \$454 million Intermediate Lien Revenue Bonds Series A, B and C to fund various Airport project costs and to refund \$192 million of First Lien Revenue bonds for a present value savings of approximately \$13 million. Series 2005 C for \$40 million was sold as a delayed delivery and will be issued in 2006. The Port also issued \$63 million of Subordinate Lien Revenue Bonds to fund various Airport Projects.

In 2006, the Port will issue \$61.6 million General Obligation Bonds sold on November 17, 2005. These bonds refund \$59.7 of Special Facility Revenue Bonds (Terminal 18 Project), Series 1999A and General Obligation Bonds Series 2000A. The Port anticipates issuing bonds to fund an estimated \$125 million of Seaport capital costs. In addition the Port will continue to evaluate the use of interest rate payment contracts (swaps) and develop a funding strategy for the new remote rental car facility

E. Capital Planning Resources

The following information on funding guidelines and financial model assumptions are resources for better understanding the 2006 Draft Plan of Finance.

PORT OF SEATTLE FUNDING GUIDELINES

The following guidelines have been prepared to assist the Commission, Port management, and staff in decisions regarding the allocation of Port capital funds.

Tax Levy

Projects should meet two criteria to be eligible for tax levy funding: 1) a long lag exists between capital costs and project revenues or the project's financial return will not support revenue bond financing (i.e. the internal rate of return, or IRR, is less than the current cost of debt); and 2) the project generates significant economic or other community benefits for taxpayers. Each year, a tax levy request will be made for the funding of specific capital projects, certain environmental expenses, and other community investments. Once designated as levy funded, projects may be levy funded through completion. Information regarding the use of levy funds can be found in section IV Tax Levy.

General Obligation Bonds

Projects eligible for general obligation (G.O.) bond financing should meet three criteria: 1) a long lag exists between capital costs and project revenues or full payback from other sources of capital, or financial return is insufficient to support revenue bond financing (Internal Rate of Return ["IRR"] less than the current cost of debt); 2) the project generates significant economic benefits for taxpayers; and 3) the project is critical to the Port's core business. Because General Obligation Bonds are paid from the tax levy, many projects that qualify for levy funding may also be G.O. bond funded.

Revenue Bonds

Projects should earn the current cost of debt (in IRR terms) or fund projects that can be included in the airlines' rate base to be eligible for revenue bond financing. A target senior lien revenue bond coverage ratio of 1.8 times and 1.4 times coverage on all revenue bond debt will be maintained for capital planning purposes, but will be reviewed annually in light of changing circumstances such as critical funding needs or changes in the airport-airline operating agreement. An adequate cash flow margin (cash flow after debt service) will also be maintained for planning purposes.

Industrial Development District (IDD) Levy

In order to be considered for IDD levy financing, projects should be critical to core Port business or other major strategic initiatives, and should generate significant economic benefits for taxpayers. Additionally, projects must comply with all applicable legal requirements governing the use of the levy.

Airport Improvement Program (AIP) Grants and Passenger Facilities Charges (PFCs)

Projects eligible for AIP grant and PFC funding should be consistent with airport investment strategies and must comply with the regulations of the grant-making agency. High priority safety, security and capacity projects will be stressed.

Funding vs. Asset Life

Project funding should in all cases closely match the life of the particular asset financed. For example, long-term financing in the form of 20-30 year revenue or general obligation bonds should only be used for assets having economic lives in a similar range or longer. Shorter-lived assets should be funded through pay-as-you-go or other short-term financing structures.

2006 DRAFT PLAN OF FINANCE ASSUMPTIONS

Capital Budget

Capital budget projections are based on the CIP presented to the Port Commission during November, 2005, and are included in Section IX "Capital Budget."

Capital Capacity Calculations

The Port's capital capacity calculations combine projections of operating revenues, expenses, non-operating items, debt service, and capital spending to determine Port debt financing requirements. Assumptions used in the financial analysis of the 2006 Plan include:

- Interest on unrestricted funds equal 3.0%.
- Interest on restricted funds equals 3.0%.
- Interest on general obligation debt is equal to 5.4%.
- New First Lien revenue bonds are issued at 5.6% for 25 years.
- New Intermediate Lien revenue bonds are issued at 5.7% for 25 years.
- Interest on variable rate bonds is equal to 4.0%.
- 2005 capital spending estimates are based on estimated actuals as of July, 2005.
- 2006 operating revenue and expense projections are based on the preliminary operating budget as of October, 2005 and may vary slightly from the final budget.

Tax Levy

The Port's tax levy projections are based on estimates of King County assessed valuation and inflation. 2006 figures are based on preliminary projections obtained from the King County Assessor's Office as of November, 2005.

A tax levy projection model is used to forecast future year assessed value amounts. Projections of assessed value are based on actual historical data.

Revenue and Expense Assumptions

Airport

- Expense projections are based on estimates developed as part of division business planning.
- In 2006, Airport revenues are expected to be determined according to the proposed new airline agreement; landing fees and terminal rents are set to recover all airline related terminal and airfield operating costs and to recover all aeronautical capital costs at 100% debt service coverage on aeronautical debt. The remainder of the Airport operates in a businesses-like fashion, with the Port responsible for all costs and revenues. If non-airline net revenues are insufficient to generate 125% of all Airport related revenue debt service, the Port may increase airline charges up to 125% of aeronautical debt service.
- Environmental costs are included in O&M expense.
- Federal Airport Improvement Program (AIP) grant reimbursement projects are based on estimated spending on eligible projects and standard reimbursement rates of 75%-80%. Letter of Intent (LOI) receipts for third runway construction and security grants from the Transportation Security Administration (TSA) are included in the total grant amounts.
- Passenger Facilities Charges (PFCs) are estimated based on projected enplanement levels, net of debt service payments on PFC bonds.

Seaport and Economic Development

- Revenue and expense projections are based on the division's long-range operating forecast. Revenues generated from new investment were included if the related capital project is part of the committed CIP.
- Estimated security grant receipts for operating grants are included in gross revenues and the associated expenditures are included in operating expenses
- Environmental costs are included in O&M expense.
- Revenues and expenses from Economic Development are included in the forecast period.

Services

- Expenses for Port Professional and Technical Services are distributed to the Airport, Seaport and Economic Development divisions as corporate overhead.