

2007-2011 DRAFT PLAN OF FINANCE

A. Introduction

The Port has generally continued to build on the operating and financial improvements it has made since 2002. The Port's key operating measure of Airport passenger traffic for 2006 is projected to increase 3% over 2005. The Seaport container volumes, after growing 40% in the last two years, are projected to drop 4%. Financial results continue to improve with the 2006 forecast of net operating income before depreciation (net income) for both divisions expected to exceed both 2005 and the 2006 budget. The 2007 budget anticipates net income similar to the 2006 budget, but lower than 2006 forecasted net income. This is in part due to the implementation of GASB 45 which requires the establishment of a reserve beginning in 2007 for other post employment benefits (OPEB); the Port currently estimates that the OPEB reserve in 2007 will be \$12.9 million.

2006 was the first year of a new airline agreement designed to minimize airline costs while providing financial stability to the Airport. Under the agreement the Airport charges 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%. The Airport retains non-aeronautical net revenues and the Port has been 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. The 2006 forecast indicates better performance in both revenues and expenses compared to budget. The 2007 budget anticipates increases in revenue, particularly non-airline revenue, and expense, especially the funding of the OPEB reserve, resulting in net income similar to the 2006 budget, but below the 2006 forecast. The Airport capital program is on schedule with the new runway on track to be in use by the end of 2008. In October, the Port and King County announced a cooperative effort to explore a land exchange that would transfer ownership of King County International Airport (Boeing Field) to the Port. Any financial implications of such agreement are not yet known and therefore not included in the financial forecast.

Seaport net income continued to improve in 2006 through a combination of cost management and revenue growth, particularly in bulk cargo and cruise. The 2007 budget anticipates some increase in operating costs, especially the funding of the OPEB reserve, which will affect net income. Although much of the Seaport's revenues and net income are derived from the Port's container terminal leases, this income is based on terminal acreage rather than container volumes; therefore, neither the sizable increases in container volumes in 2004 and 2005, nor the decline in 2006 significantly affect Seaport financial performance. Container revenue grows either through the regularly scheduled increase in the terminal lease rates or through the increase in terminal acreage. The Port is planning on increasing container terminal acreage by converting Terminal 30 back to container use and moving the cruise operations currently located there to Terminal 91. In addition, the Seaport is making improvements at Terminals 18 and 25 and continues renewal and replacement efforts at Shilshole Marina, Fishermen's Terminal, Terminal 115 and Terminal 91.

The Economic Development Division (EDD) 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. The Commission has expressed interest in preserving future capital spending capacity to potentially fund up to \$200 million of costs associated with the Viaduct replacement of which \$60 million is anticipated to be funded during the 2007-2011 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.
 - **Public Expense.** In addition to the CIP, the Port participates in several public projects, particularly in the area of regional transportation and contributions to Highline School District noise mitigation. 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 \$60 million out of a total \$200 million participation in 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 and 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 has been implementing 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 Commission 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 2006, the Port levied \$62.7 million or \$0.233 per \$1000 of assessed value. For 2007, the Port will reduce the levy rate to \$0.232. Due to an increase in the assessed value for King County property, the levy amount will increase to \$68.8 million (see IV Tax Levy). The Commission has expressed interest in reducing the levy rate in the future, so the Plan assumes that the levy rate in 2008 is maintained at \$0.232 then drops by one half cent per year beginning in 2009.

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. This policy is more restrictive than the Port's statutory authority for G.O. bond debt. Based on statute, as of December 31, 2006, the Port could issue an additional \$326 million of non-voted G.O. bond debt (see section IV "Tax Levy").

C. 2007-2011 Funding Plan

AIRPORT

The Airport's operating forecast is based on the 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 2007. 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.

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 Public Expense related to Highline School District in the amount of \$3 million and the Airport's share of the corporate Professional and Technical Services (P&TS) Projects, which totals \$35 million and represents the difference between the \$1,608 million CIP and the \$1,646 million in funding sources.

TABLE X-1: 2007-2011 AIRPORT ⁽¹⁾ PROJECT FUNDING
(Millions of Dollars)

PFCs (net of PFC bond debt service)	\$ 127
Net Income	257
Federal Grants	187
Tax Levy	19
Existing Bond Proceeds	161
Additional Bonds & Commercial Paper	895
Total	\$1,646

(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 2007-2011 Plan is intended to fund both the Seaport and ED Committed and Business Plan Prospective projects. Seaport funding includes Seaport net income and excess General Fund balance, proceeds from General Obligation (G.O.) bonds, future revenue bonds and commercial paper including bonds expected to be issued in 2007. The Plan also assumes Seaport and Economic Development Division funding from the tax levy and Federal grants for eligible portions of Seaport Security projects. 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 funds development of Terminal 30 for container operations, relocation of the Terminal 30 cruise operations, additional container terminal improvements and renewal and replacement of various harbor facilities. In addition, the Plan assumes potential funding for participation in the Alaskan Way Viaduct tunnel project 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 for funding future Seaport environmental expenses not captured in the Seaport operating forecast. The Plan includes \$21 million for a portion of P&TS projects. Based on the assumptions described above, the funding plan requires the deferral of an estimated \$62 million of capital spending. The inclusion of these costs less the \$62 million deferral account for the difference between the \$523 million five year CIP for Seaport and EDD and the \$595 million in funding sources.

TABLE X-2: 2007-2011 SEAPORT AND ECONOMIC DEVELOPMENT ⁽¹⁾ PROJECT FUNDING
(Millions of Dollars)

Tax Levy	97
Net Income and General Fund Balance	85
Federal Grants	2
Future Revenue Bonds	180
Future G.O. Bonds	231
Total	595

(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 EDD projects. In addition, the Plan is designed to accommodate development of North Bay and the Port's potential participation in the Viaduct tunnel project. 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 2.4 and 2.6x. 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 total revenue bond coverage for the Port ranges from a low of 1.43x to a high of 1.57x. 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. Specifically, it does not include any costs that might be associated with the acquisition of Boeing Field. 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 \$68.8 million in 2007, well below the Port's actual statutory authority of \$80.4 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 2006, the Port issued \$61.6 million in General Obligation refunding bonds and \$124.6 in Intermediate Lien Revenue Refunding bonds. The Port also closed \$40.1 million of Intermediate Lien Revenue Refunding bonds, sold in 2005. The present value savings totaled \$17.8 million.

In 2007, the Port will issue an estimated \$250 million in First Lien Revenue bonds to fund Seaport projects and an estimated \$250 million in Intermediate Lien Revenue Bonds to fund Airport projects. A Special Facility Revenue Bond for a new rental car facility will be developed in 2007 with issuance most likely in early 2008. The Port is also expecting to use interest rate swaps to synthetically refund AMT debt that is not currently refundable.

E. Capital Planning Resources

The following information on funding guidelines and financial model assumptions are resources for better understanding the 2007 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.

2007 DRAFT PLAN OF FINANCE ASSUMPTIONS

Capital Budget

Capital budget projections are based on the CIP presented to the Port Commission during November, 2006, 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 2007 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% for 25 years.
- 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 4.5%.
- 2006 capital spending estimates are based on estimated actuals as of July, 2006.
- 2007 operating revenue and expense projections are based on the preliminary operating budget as of October, 2006 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. The Plan of finance assumptions are based on preliminary projections obtained from the King County Assessor's Office as of October, 2006.

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.
- Airport revenues determined according to the 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 and business plan prospective 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.