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LaGuardia Overhaul Could Kick-Start PPP Deals: Experts

By **Liz Hoffman**

Law360, New York (January 30, 2012, 8:02 PM ET) -- As planning continues for the long-awaited, multibillion-dollar update to LaGuardia International Airport’s central terminal, regional transportation officials are considering opening the project to private investors, a move experts said could kick-start a new wave of private development in airport financing.

This week, the Port Authority of New York and New Jersey, which oversees LaGuardia, will begin reviewing proposals from developers for the $3.6 billion project to replace the airport’s entire 1.3-million-square foot terminal. Construction is expected to start in 2014.

Experts said the project is a perfect fit for a private stakeholder group, which might be willing to pay for construction if it has the opportunity to earn back the investment by overhauling the airport’s day-to-day operations.

Whether the Port Authority embraces such a proposal remains to be seen, but it seems open to the possibility. In its request for information last month, the cash-strapped agency looked flexible, saying it wants to limit its own use of bond financing and asking developers to suggest “alternative financing mechanisms.”

“There's always been a sense that the Port Authority wasn't interested in giving up control to a private operator … but they've extended an invitation here” said John Schmidt, a Mayer Brown LLP partner working on airport privatizations in Chicago and San Juan. “They're basically saying to the private sector, 'Come in with ideas and you can be a big part of this.' And that only does good things for the industry.”

Airport privatization has taken off nearly everywhere except in the United States, where transit authorities still rely heavily on one-off construction contracts and authority bonds. But shrinking budgets and a growing reluctance to take on more debt are driving projects into the private market, where sophisticated developer teams are eager to sign long-term leases for a slice of future airport revenues.

In Puerto Rico, San Juan is close to becoming the first privatized commercial airport in the U.S. in a $1 billion, 40-year deal that could close this year. A similar deal for Chicago's Midway hit financing snags during the worst of the financial crisis, but is still alive.

If the Port Authority opts to take a similar route for LaGuardia, a lot more transportation officials could be looking to that model, experts said.

“The industry is sort of waiting for a big metro authority to get this done,” said Deborah McElroy of the Airports International Council, a trade group.“It could get the ball rolling down the hill a bit.”

LaGuardia offers strong upside potential for private investors, provided they know enough about the business of running an airport, experts said.

Narrow taxiways and cramped gate space have hampered airline revenue; new construction could fix both. The airport has trailed its peers in squeezing profits from shopping, dining and car rentals, industry data shows; an experienced retail operator could boost sales.

“LaGuardia is a perfect candidate" for private investment, said Joseph Schweiterman, a public policy and infrastructure expert at DePaul University in Chicago. “There aren't many places you could see 5 percent annual growth, but it's on the list.”

If private investors agree to front the cash for the project, they'll rely on a mix of revenue streams to get repaid. Any scenario will likely include fees levied on every ticket, known as passenger facility charges, and some increases to the fees airlines pay for landing rights, gate space, ticket counters, baggage belts and more.

But there are some potential risks to those options. Passengers have seen the cost of air travel rise 17 percent since 2009, according to the U.S. Department of Transportation, and probably won't take additional fees quietly. The Port Authority also sparked public backlash last fall with toll hikes on its bridges and tunnels.

And getting airlines on board won't be a snap, even though the plan will likely benefit them by easing runway congestion. In Philadelphia, where the city is embarking on a $5.2 billion renovation, US Airways, its biggest tenant, is balking at the proposed fee hikes for airlines.

“Those are easy revenue streams logistically, but politically, less so,” said Paul Dempsey, head of McGill University's Air and Space Law program. “The real opportunity, if it exists, is in non-airline revenue.”

That's the broad category applied to everything passengers do in an airport before they board the plane. And with travelers arriving earlier to beat security and airlines cutting food service, it's becoming an increasingly lucrative source of revenue.

LaGuardia has lagged behind the industry leaders in this category. The airport got just 29 percent of its revenue from non-aviation sources in 2010, according to a study released in August by the University of British Columbia. That was the second-lowest among 62 North American airports and miles behind leaders like Nashville (62 percent), Atlanta (59 percent) and Kansas City (61 percent).

There are smaller revenue streams that could be tapped as well, like in-terminal advertising or rental car charges. Wireless internet is full of creative, though likely small, potential, according to a study from the Airport Cooperative Research Program, an industry adviser.

“Under a private company, retail can produce revenues that are way beyond what we see from public operators,” Schmidt said. “It's just a different set of motivation and skills.”

The benefit to potential investors is clear, but the Port Authority also stands to gain. For starters, the agency can't afford the project on its own. After slashing its proposed 10-year, $33 billion capital plan earlier this year, it had to raise tolls at its bridges and tunnels to make ends meet. Megaprojects like the Word Trade Center rebuild dominate capital concerns and the agency's finances remain tight through 2012, according to the preliminary budget.

A public-private partnership also allows officials to pass off credit risk for the project to a financial backer with better access to debt investors and secondary markets. While the agency has all but nixed the use of significant public bonds, private bond investors may well be interested, Schmidt said.

“Whether the private operator gets bank financing, if it's available, or uses bonds or some combination is up to them,” Schmidt said. “Creative and aggressive financing is one thing you get from private sector, as they are the ones taking the risks.”

But transportation officials don’t want just any financial player getting involved in the ownership and management of the terminal, and Tuesday's proposals will likely come from a small pool of players, experts said.

The project itself sets a high bar. A new 1.3-million-square-foot terminal is to be built piece by piece around the existing one, which will stay operational during the work. Plans also include a 4,000-car parking garage; frontage roads to other terminals; upgrades to utilities and taxiways; and the ability to add a rail connection later, should New York City ever make that a priority.

And any bidders must have worked on a public transit project of at least $250 million and made an equity investment of at least $100 million, according to the RFI.

That's a small group, says Orrick Herrington & Sutcliffe LLP partner Young Lee. "Anything over $1 billion narrows down the field pretty quickly," she said.

The most likely scenario is a consortium with three key elements: a construction firm, an infrastructure equity investor and a strategic backer, like another airport operator,

Finalists for San Juan's privatization include a handful of strategic-financial power couples: Goldman Sachs & Co. and the operator of Germany's Frankfurt airport; Canadian pension giant PSP Investments, Brazilian engineer Camargo Correa and Zurich's airport operator; ASUR, which operates nine airports in Mexico, and infrastructure investor Highstar Capital LP.

“You need someone to build it, someone to pay for it and someone who knows how to run it,” Schmidt said. "But those players are already out there."

The Port Authority will have to meet any investor group halfway, experts said. That means ceding unprecedented operating control, something the agency has been reluctant to do at its other airports, bridges and tunnels.

But it has looked increasingly warm to the idea. Its $1 billion plan to replace the Goethals Bridge, which links Staten Island and New Jersey, is expected to include PPP elements. And a $183 million redo of a Manhattan bus station includes 119,000 square feet of retail space, which will be operated by a private developer.

“There are all these innovative financing models out there, but to date, not a lot of industrywide experience in actually using them,” said McElroy, of the Airports International Council. “The Port Authority should be applauded for at least asking the question, 'How can we do this better?'”

--Editing by Sarah Golin.

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