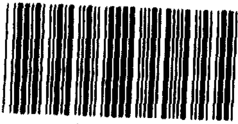

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UNITED STATES GENERAL ACCOUNTING OFFICE
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STATEMENT OF

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RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION

U.S. GENERAL ACCOUNTING OFFICE

BEFORE THE

SUBCOMMITTEE ON GOVERNMENTAL EFFICIENCY

AND THE DISTRICT OF COLUMBIA

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

ON

ALTERNATIVE METHODS FOR DETERMINING A VALUE FOR NATIONAL AND DULLES AIRPORTS FOR TRANSFER TO A LOCAL AIRPORT AUTHORITY

Mr. Chairman and Members of the Subcommittee:

We welcome your invitation to testify on Senate Bill 1017. Over the last 3 decades, numerous commissions have identified ownership and control of Washington National and Washington Dulles International Airports as an appropriate local government responsibility. This bill makes a similar finding and proposes transferring federal ownership and control from the Department of Transportation to an independent airport authority. Section 5 of the bill provides the framework for the valuation method that would be used to determine the payment received for the two

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airports. In summary, over a 35-year lease period, the authority would repay the federal government the amount of federal investment in the airports not yet recovered through airport revenues.

Mr. Chairman, on May 21, 1985, you asked us to identify alternate methods for valuing the two airports either separately or as a combined entity. During our limited review we found that there are many methods for valuing the airports. The method eventually used will depend on the valuation option the Congress selects for the transfer. We identified three potential valuation options.

--Obtain for the government the fair market value of the airports.

--Recover what the airports cost the government.

--Transfer the airports at no cost.

We are not recommending any specific option. All three have been either proposed or used in the past for similar transfers. To assist the Congress in evaluating these options I will discuss

--the methods that support each option,

--where the methods were proposed or actually used, and

--observations on the pros and cons of applying the methods.

Any of the methods can be used to estimate the value of the airports, either separately or as a combined entity. There will, however, be complications associated with applying either fair market value or cost-recovery methods.

CONGRESS COULD REQUIRE TRANSFER AT FAIR MARKET VALUE

Fair market value is the monetary value that the federal government could reasonably expect to receive for the airports in a sale between a willing buyer and a willing seller. Using fair market value to price the airports recognizes their productive nature. The value to the potential buyer reflects the buyer's judgment about the future revenues and other benefits to be gained from ownership, while the value to the federal government reflects the benefits that could be gained by retaining ownership or selling the airports to the buyer who valued them most highly.

Often, prior to a sale, sellers attempt to estimate the fair market value of an asset in order to establish a "reservation" price--a price below which they are unwilling to sell. There are several traditional methods for making such estimates. They include

--estimating the discounted stream of future earnings flowing from the airports for the remainder of their useful lives,

--analyzing market transactions involving similar airports, and

--estimating the current replacement cost of the land and any building improvements at the airports.

Establishing fair market value is complicated by restrictions on the airports

Traditional fair market value methods may be difficult to apply to the proposed transfer of National and Dulles Airports

because of existing and proposed restrictions on airport operations and earnings.

The bill requires the airports to continue to be used as airports. This restriction can affect their value. Specifically, it prevents National from being sold to anyone who might be interested in developing the site for alternative uses. The bill also requires the airports' property to be used for "airport purposes." While it is not clear how restrictive this requirement is, to the extent that it does restrict the use of airport property, it will be particularly important to valuing Dulles which has unused land.

The current restriction on hours of operation at National can reduce its value to a potential buyer. On the other hand, this restriction can be important to protect the interests of National's neighbors and, by forcing planes to land elsewhere, may actually enhance the value of Dulles.

A more critical restriction to establishing fair market value is the current limitation on earnings, or profits. Section 6(f) of the bill requires that all revenues generated by the airports be used to pay their capital and operating costs. That is, the airports must collect no more revenues from landing fees, terminal leases, and concession fees than are sufficient to cover their current and anticipated capital and operating costs. This restriction on earnings, however, is consistent with the current break-even operation of National, Dulles, and

all other major commercial airports in the United States. Public airports receiving federal grants under the Airport and Airways Improvement Act of 1982 must certify that all revenues that they generate will be expended for their capital and operating costs.

An open sale of the airports may not be possible

As the definition of fair market value implies, one way to determine the fair market value of the airports is to conduct a sale. In May 1972 the Office of Management and Budget proposed that the airports be sold to "the highest bidder." This approach did not receive much support. Furthermore, there is a major institutional impediment to its application. Specifically, a sale to a private operator would represent a major shift in the historical pattern of airport ownership and operation since all major U.S. commercial airports are owned and operated either by cities, counties, states, or airport authorities.

Estimating the discounted future earnings would be complicated by the earnings restriction

The federal government could determine a fair market value for the airports by estimating their future earnings and then calculating the present discounted value of those earnings. The United States Railway Association used this method to determine the fair market value of the Alaska Railroad for the 1983 sale of the railroad by the United States to the state of Alaska. However, the earnings restriction complicates using this method for the airports. Specifically, since the future stream of

earnings, or profits, would be zero, the present discounted value of those earnings would also be zero, thereby suggesting a zero value for the airports.

This result appears paradoxical for several reasons. First, airlines and air travelers use the airports every day; therefore, the airports must have value to these parties. Second, airports can provide an important economic stimulus to an area, making them valuable to the residents, businesses, and governments in the region. Third, even though under the earnings restriction the airports technically may have zero value, a buyer should be willing to pay a positive price for the airports because the price the buyer pays would become part of the airports' capital costs, which can be recovered through revenues.

In our view, the present discounted value method could be modified to adjust for the effect of the earnings restriction. If the government wished to receive a positive price for the airports, it could employ one of several potential approaches to estimate an earnings stream for each of the airports. The present discounted value of this earnings stream could become the price charged for the transfer of the airports.

For example, in the case of National Airport, where the demand for landing slots currently exceeds the supply, the government could estimate the increase in fees that would be necessary to balance demand and supply. The earnings flowing from these increased fees could be discounted to a present value and form the basis for a transfer price. This approach would have the benefit of encouraging economically efficient pricing of National's airspace. There are, however, ways to encourage

efficient pricing other than through the sale of the airports. Further, such an estimate could be difficult to make.

Demand for landing slots at Dulles does not currently exceed supply. Consequently, this same approach would not produce a positive price for Dulles. Dulles, however, does have land with development potential. If it wished, the government could estimate the earnings that might be available from leasing this land and use the discounted present value of this earnings stream as the basis for the transfer price. However, as I suggested earlier, the price produced by this approach would depend on the restrictions placed on the use of land at Dulles.

Another approach is available that could be applied to either National or Dulles. This approach would involve identifying other airports that are comparable to National or Dulles and determining the fees charged there. These fees would indicate what users are currently paying for similar services at other airports and could be used to estimate the revenues of National or Dulles. After subtracting each airport's costs from the estimated revenues, the estimated earnings could be discounted to the present to form the basis of a transfer price. In employing this method it is important to recognize that it may be difficult to establish the proper basis for identifying airports that are comparable to National or Dulles.

Complications exist for other fair-market-value methods

Another method of estimating market value is on the basis of comparable market transactions. We were able to identify

only two transactions involving airports similar in size to National or Dulles--the 1972 sale of Baltimore-Washington International (BWI) Airport by the city of Baltimore to the state of Maryland and the 1978 sale of Hollywood-Burbank Airport by Lockheed Aircraft Corporation to the city of Burbank, California. Given how long ago these transactions occurred and their limited number, this method, in our judgment, is unlikely to establish a satisfactory value for the airports.

Finally, the fair market value of the airports could be estimated on the basis of the airports' replacement costs. Appraisers hired by Lockheed Aircraft Corporation and the city of Burbank used replacement cost to establish a value for Hollywood-Burbank Airport. The appraisers used the replacement cost method because they felt the earnings restriction and the lack of similar market transactions made the use of the other two traditional methods inappropriate.

Similar concerns led the President's Private Sector Survey on Cost Control to use ratios and indexes to update earlier appraisal information on National and Dulles in order to estimate a sale price for the two airports.

In summary, if the Congress decides that it wishes to obtain fair market value for the airports, there are, in our view, two methods that could be employed. Fair market value could be estimated by using either the modified discounted future earnings method or the replacement cost approach.

CONGRESS COULD CONSIDER A COST RECOVERY METHOD

In transferring the airports, the Congress could recover what the airports cost the government. Costs reflect the value of an asset when it was either purchased or built. Since many assets increase in value over time, some economists and appraisers would argue that original costs may understate the current value of an asset. However, in the opinion of members of the Advisory Commission on the Reorganization of the Metropolitan Washington Airports, in selling the airports, the federal government should only seek to "make itself whole" by recovering the airports' costs.

We have identified two methods to measure the cost of the airports

--the book value of the airports, and

--the government's hypothetical indebtedness to itself for the airports.

Book value is the original purchase cost of the land, plant, and equipment of the airports less accummulated depreciation of the plant and equipment. Book value has been proposed in the past as a transfer value for the two airports. Federal Aviation Administration (FAA) accounting records indicate that as of May 31, 1985, the combined book value of the two airports was $111.4 million. The book value of National was $29.4 million, and the book value of Dulles was $81.8 million. The book value of the consolidated facilities shared by both airports, that provide, for example, accounting and personnel functions, was about $180,000.

According to BWI and Maryland Department of Transportation officials, the book value of BWI formed the basis for the 1972 transfer of the airport from the city of Baltimore to the state of Maryland. Although there are limited records on how the transfer price was determined, these officials told us that the $36 million price was arrived at by adding the $30 million book value of the airport's assets to a $6 million adjustment factor that was intended to reflect a "rate of return" to the city of Baltimore for its ownership of the airport.

The bill before you proposes that the government recover its hypothetical indebtedness to itself for the airports. Hypothetical indebtedness is the difference between federal appropriations from past years for the airports' capital and operating costs and the fees and charges FAA has collected for airport services and deposited in the Treasury's general fund. In essence, the hypothetical indebtedness represents the federal government's investment in the airports that it has not recovered through airport revenues. According to FAA accounting records the hypothetical indebtedness as of May 31, 1985, was about $52 million.

Hypothetical indebtedness is different from book value. Book value does not take into account the costs of operating the airports or the revenues the airports have generated. Hypothetical indebtedness, on the other hand, includes both the airports' capital and operating costs and reduces them by the amount of revenues the government has collected at the airports. It represents the amount the government has spent on the airports that it has not yet collected in revenues.

We have two general observations on the proposed application of hypothetical indebtedness as a valuation method.

First, some of the costs expended by the government on the airports are not included in FAA's calculation of the hypothetical indebtedness. For example, FAA has designated the cost for the land and construction of the Dulles access road as a nonrecoverable cost. FAA has excluded these costs because in the agency's view, if National and Dulles were public airports they would have received funds for the excluded items through federal grants and would not have tried to recover these costs through their fees. FAA accounting records indicate that about $61.6 million has been designated as nonrecoverable. We did not review the appropriateness of FAA's determinations on nonrecoverable costs. However, if it selects the hypothetical indebtedness method, the Congress may wish to conduct such a review.

Second, if the airports are considered separately, the hypothetical indebtedness method results in an unusual valuation. Since National has collected revenues that have exceeded its recoverable costs by about $59 million, this method could result in National being assigned no value. On the other hand, Dulles has not collected enough revenue to recover its costs. On the basis of this method, Dulles would be valued at about $71 million. This separation, however, does not include about $40 million spent to operate the consolidated facilities that serve both airports.

THE FEDERAL GOVERNMENT HAS TRANSFERRED SOME AIRPORTS AT NO COST

In closing, let me note that the federal government has, in the past, transferred former military airports to state and local governments at no cost. The Federal Property and Administrative Services Act of 1949, in combination with the Surplus Property Act of 1944, allows an agency to transfer any properties that it has determined are surplus to its needs and responsibilities. While primarily used to facilitate the disposition of excess property acquired during World War II, these acts have been used over the last 40 years to transfer 634 airports to state and local governments at no cost. While most of these transfers occurred in the 1940's and 1950's, the most recent transfer was in Ohio during 1983.

While a similar transfer could be accomplished for National and Dulles, it is not clear that these airports could be designated surplus; this approach, then, may have limited applicability.

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Mr. Chairman, this concludes my prepared statement. I would be pleased to answer any questions you might have.