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Report to the Subcommittee on Aviation, Committee on Transportation and Infrastructure, House of Representatives

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AIRPORT PRIVATIZATION

Issues Related to the Sale or Lease of U.S. Commercial Airports

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The Honorable John J. Duncan
Chairman
The Honorable William O. Lipinski
Ranking Minority Member
Subcommittee on Aviation
Committee on Transportation
and Infrastructure
House of Representatives

This report responds to your request that we examine issues relating to airport privatization in the United States.

We are sending copies of this report to other interested congressional committees; the Secretary of Transportation; the Administrator, Federal Aviation Administration; and the Director, Office of Management and Budget. Copies are made available to other interested parties on request.

Please contact me at (202) 512-3650 if you or your staff have any questions concerning this report. The major contributors to this report are listed in appendix III.

Gerald L. Dillingham
Associate Director,
Transportation Issues

Executive Summary

Purpose

The possible sale or lease of commercial airports in the United States to private companies has generated considerable attention in recent years. Such cities as New York and Los Angeles have considered privatizing their airports. Proponents claim that privatization would inject much needed capital into the aviation infrastructure because it would make airports more commercially oriented and financially self-sufficient. Opponents say that local governments favor privatization as a way to divert airport revenue intended for developing aviation infrastructure to other municipal purposes, resulting in increased costs for airlines and passengers.

The Chairman and Ranking Minority Member of the Subcommittee on Aviation, House Committee on Transportation and Infrastructure, requested that GAO examine (1) the current extent of private sector participation at commercial airports in the United States and foreign countries; (2) the current incentives and barriers to the sale or lease of airports; and (3) the potential implications for major stakeholders, such as the passengers, airlines, and local, state, and federal governments, should airports be sold or leased. This report expands on testimony provided to the Subcommittee in February 1996.[1]

Background

Privatization refers to shifting governmental functions and responsibilities, in whole or in part, to the private sector. The most extensive privatizations involve the sale or lease of public assets. Selling or leasing any of the nation's 565 public commercial airports would require the support of local, state, and federal governments. Unlike the air traffic control system, whose assets are owned entirely by the federal government, commercial airports are owned by local governments and, in limited circumstances, states and the federal government. However, commercial airports also receive federal airport development grants, have access to federal tax-exempt financing, and are subject to federal regulatory control. As a result, federal laws can substantially influence whether public owners would choose to sell or lease their airports and whether a private entity would want to be a buyer or lessee.

Besides federal grants, other major sources of funding for airport development are passenger facility charges, bonds, and airport revenue. The Federal Aviation Administration (FAA) administers federal grants that are made available from the Airport and Airway Trust Fund to help support capital development projects that enhance airports' capacity,

[1]Airport Privatization: Issues Related to the Sale or Lease of U.S. Commercial Airports (GAO/T-RCED-96-82, Feb. 29, 1996).

safety, security, and noise mitigation. FAA allocates most grants on the basis of a legislated apportionment formula and set-aside categories earmarked for specific types of airports or projects. FAA also has the discretionary authority to allocate the remaining funds on the basis of needs identified by airports. In 1990, the Congress gave commercial airports another source of development funding—passenger facility charges. With FAA's approval, these airports can collect up to $3 per passenger. A third source of airport financing is issuing bonds, typically with long-term maturities. Most airport bonds, especially those issued by larger airports, are secured by airport revenue. Finally, airports generate revenue internally from such sources as landing fees, parking fees, and concessions. Revenue remaining after paying operating costs is net income that may be used for development.

Results in Brief

Although all commercial airports in the United States are publicly owned, the private sector plays a significant role in their operations and financing. None of the nation's commercial airports has ever been sold to the private sector, and only one has ever been leased. Nevertheless, employees of private companies—airlines, concessionaires, and contractors—account for 90 percent of all employees at the nation's largest airports. Furthermore, the largest source of capital for airport development is long-term bond debt secured by future airport revenue and subject to the scrutiny of credit rating agencies. In other countries, a majority of airports are owned and operated by their national governments. However, 50 countries have sought greater private sector involvement in their airports, though many of these efforts have just begun.

While several factors, such as providing additional private capital for development, are motivating greater interest in privatization, legal and economic constraints currently impede the sale or lease of U.S. airports. Although FAA has permitted and even encouraged some limited forms of privatization, such as contracting for airport management or allowing private companies to develop and lease terminals, it has generally discouraged the sale or lease of an entire airport to a private entity. FAA is concerned that in selling or leasing an airport, the legal obligations that the airport had made to obtain a federal grant may not be satisfied. Chief among these obligations are restrictions on using airport revenue. These restrictions are intended to ensure that revenue is not diverted from the airport for other uses and are interpreted by FAA as not permitting public owners of airports to retain the proceeds from selling or leasing their airports. Also, according to FAA, these legal obligations cannot be

extinguished by repaying past grants to the federal government. FAA's recently proposed policy on the use of airport revenue states that the agency will consider privatization proposals on a case-by-case basis and will be flexible in specifying conditions on the use of airport revenue that will protect the public interest and fulfill restrictions on diverting revenue without interfering with privatization. However, FAA has not specified these conditions, and privatization is discouraged as long as FAA considers sale or lease proceeds to be airport revenue subject to restrictions on diversion.

Predicting how various stakeholders might be affected by the sale or lease of airports largely depends on how such privatization might ultimately be implemented. For example, if sale or lease proceeds are not bound by federal restrictions on the use of airport revenue, then the local and state governments that own airports could receive millions of dollars from these proceeds as well as future tax receipts from privately owned or leased airports. However, airlines and their passengers could incur substantial additional costs if fees charged to airlines by privately owned or leased airports are unregulated or if privately owned airports lose access to some federal grants and tax-exempt bonds. Conversely, continuing to bar privately owned airports from obtaining some federal grants and from issuing federal tax-exempt bonds would have a positive effect on the federal budget if a significant number of airports were sold to the private sector. Recognizing the barriers to and the opportunity to test the potential benefits of privatization, the Congress established an airport privatization pilot program as part of the Federal Aviation Reauthorization Act of 1996. As of October 9, 1996, the Secretary of Transportation can exempt up to five airports from some legal requirements that impede their sale or lease to private entities. The pilot program also requires that a sale or lease agreement meet certain conditions, such as requiring that the private owner or lessee maintain airport safety and security at the highest levels.

GAO's Analysis

Private Sector Participation at U.S. and Foreign Airports Is Extensive

While no U.S. commercial airport has been sold to a private entity, publicly owned airports have extensive private sector involvement. Most services now performed at large commercial airports, such as airline ticketing, baggage handling, cleaning, retail concessions, and ground transportation,

are provided by private firms. For example, GAO's survey found that 90 percent of the people working at 69 of the nation's largest airports are employed by private companies. The remaining 10 percent of the employees are local and state government personnel performing administrative or public safety duties; federal employees, such as FAA air traffic controllers; or other public employees, primarily military personnel. According to airport executives, airports have been increasingly dependent on the private sector to provide services as a way to reduce costs and improve the quality and the range of services offered. In recent years, some public owners have even contracted with private firms to manage their airports; most notably, in 1995 the Indianapolis Airport Authority contracted with a private firm to manage its system of airports, including the Indianapolis International Airport.

Similarly, airports are relying more on private financing for capital development. Airports have sought to diversify their sources of capital development funding, including the amount of private sector financing. Traditionally, airports have relied on the airlines and federal grants to finance their operations and development. However, in recent years, airports, especially the larger ones, have sought to decrease their reliance on airlines while increasing revenue from other sources. For example, in 1994, nonairline revenue, such as concession receipts, accounted for more than 50 percent of the total revenue larger airports received. Also, private sector financing has been used to provide more capital. For example, from 1985 through 1994, the larger airports issued over $42 billion in both new and refinanced bonds.

In most other countries, the national government owns and operates airports. However, a growing number of countries have been exploring ways to more extensively involve the private sector as a way to provide capital for development and improve efficiency. These privatization activities range from contracting out services and infrastructure development, in a role similar to private sector activities at U.S. airports, to the sale or lease of nationally owned airports.

We found airport privatization efforts in 50 countries, although most of these initiatives are in their early stages and results are limited. However, in the United Kingdom, efforts have been in place long enough to provide tangible results. Specifically, privately owned airports have generated large profits for their shareholders because of steady growth in passenger traffic and concession revenue, despite government caps on airline fees and the owner's investment in infrastructure.

While Advocates Cite Several Incentives, Significant Barriers Currently Block the Sale or Lease of U.S. Airports

Several factors are motivating the current interest in expanding the role of the private sector at commercial airports in the United States. First, privatization advocates believe that private firms would provide additional capital for development. Second, proponents believe that privatized airports would be more profitable because the private sector would operate them more efficiently. For example, the productivity of airports in the United Kingdom increased after they were privatized. However, airports' monopoly power could also be a source for increased profits. According to analysts who rate airport bonds, some airports face little competition and, if unrestrained, could charge prices above the levels that would prevail in a competitive market. Lastly, advocates believe that privatization would financially benefit all levels of government by reducing demand on public funds and increasing the tax base.

Despite the growing interest in privatization, various legal obstacles have deterred attempts to sell or lease commercial airports in the United States. The primary obstacle stems from the legal assurances airports agree to meet as a condition to obtain federal grants. FAA maintains that airports must continue to adhere to these assurances as part of any transfer of control. Particularly problematic is the assurance regarding the use of airport revenue. Current law generally requires that revenue generated by public airports must be used exclusively to pay for their capital and operating costs and cannot be diverted for nonairport purposes. Because FAA currently considers airport revenue to include any sale or lease proceeds, local and state governments are entitled to recover only their unreimbursed capital and operating costs from these proceeds. Therefore, the financial benefits to local and state governments from privatizing airports would be diminished.

Even if a sale or lease transfer could overcome legal obstacles, the ability of a private airport to operate profitably under current rules and conditions is uncertain. A privately owned airport would not be eligible for federal airport apportionment grants or tax-exempt debt financing and would have to impose another type of fee to replace passenger facility charges. Losing these funding sources would raise financing costs significantly because they generally constitute the majority of an average airport's capital base. Also, a private airport owner or lessee could encounter constraints on its revenue, making recovering its investment costs more difficult. For example, FAA's rules on the rates airports may charge airlines for using their airfields limit the return on investment from these assets. In some cases, a private buyer or lessee would also have to renegotiate the airport's agreements with its tenant airlines to enable the

private entity to retain the profits generated at the airport. However, airlines would be reluctant to change their agreements if it meant that their costs would increase.

Privatization's Effects Are Contingent on Implementation

Predicting how the sale or lease of airports would affect local and state governments, airlines, passengers, and federal interests requires assumptions about how such privatization might ultimately be implemented. Some general observations and possible examples can be illustrated on the basis of likely scenarios and current trends.

Local and State Governments: Public airport owners are unlikely to sell or lease their airports unless they can share in the proceeds from these transactions. Specifically, if they are not bound by restrictions on the use of sale or lease proceeds, then they could expect a significant financial benefit. Estimating the market value of an airport is extremely difficult, however, because future profits are highly contingent on the regulatory environment that it will operate under. For example, removing restrictions on the landing fees airports charge airlines or selling multiple airports together could increase their potential future earnings and, consequently, their market value.

Airlines: The effects on airlines largely depend on how their landing fees are regulated and if a commercial airport that was sold to a private entity could receive federal apportionment grants and tax exemption on bonds. First, FAA's policy regarding rates and charges prohibits an airport from charging airlines market-based rates for using its airfield. If this policy is waived, an airport facing only limited competition could raise its fees. Other countries have imposed some form of price regulation on the rates privatized airports may charge airlines. For example, in the United Kingdom, airports' charges to airlines for the use of airfield assets are capped at historical rates adjusted by inflation and productivity factors. Second, under current law, a privately owned airport would no longer receive federal apportionment grants or tax-exempt financing, which could increase an airport's costs and, correspondingly, the landing fees and terminal rentals it might charge airlines. Such costs, according to data from airlines, were on average about 6 percent of an airline's total costs in 1995.

Passengers: The effects on airline passengers depend on whether airlines' costs increase and the degree to which airlines adjust their ticket prices and flights in response to any increased costs. Passenger traffic is very

sensitive to changes in ticket prices. Studies have found that a 1-percent increase in ticket prices may lead to more than a 1-percent decline in passengers. Therefore, airlines have been cautious about passing on increased costs through higher ticket prices. Also, with higher costs, airlines might cut back or eliminate flights at some airports.

Federal Government: The effects on the federal government depend on whether privately owned airports continue to be denied tax-exempt status and access to federal apportionment grants. While access to tax-exempt debt significantly reduces financing costs for public airports, it also substantially reduces the federal government's revenue. GAO's analysis determined that the tax exemption for interest on public airport debt costs the federal government about $560 million annually in forgone tax receipts. However, the amount of additional tax revenue resulting from airport privatization would depend on a number of factors, including how many airports were sold to private entities. In addition, federal apportionment grants to commercial airports totaled $450 million in fiscal year 1995. Because privately owned airports are not eligible for these grants, if a significant number of airports were to become privately owned, the Congress could cut airport grant appropriations and still maintain constant funding levels for the remaining public airports or redirect these funds for other airport development needs.

Recommendations

This report makes no recommendations.

Agency Comments

GAO provided the Department of Transportation and FAA with a copy of our draft report for review and comment. Agency officials, including the Acting Manager of the Airports Financial Assistance Division and Manager of the Program Guidance Branch, generally agreed with the facts presented and provided some minor clarifying comments and information, which GAO has included as appropriate. Agency officials also stated that the report was a thorough and balanced representation of the facts.

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Abbreviations

AIP	Airport Improvement Program
BAA	British Airports Authority
BOT	build, operate, and transfer
FAA	Federal Aviation Administration
GAO	General Accounting Office
PFC	passenger facility charge

Introduction

The U.S. aviation system, which accounts for 40 percent of all worldwide aviation activity, is the largest in the world. In 1995, the nation's system of airports served over 580 million passengers.[2] The federal government has financed a considerable portion of this airport infrastructure. However, privatization advocates have suggested that the private sector should assume more of the cost of financing airport development.

Passenger Traffic Is Highly Concentrated at the Nation's Largest Airports

While there are 18,224 airports in the United States, only 4,172 are publicly owned. Most airports are small, privately owned general aviation airports.[3] However, most airline passenger traffic is at the nation's largest publicly owned commercial airports. Table 1.1 compares the number of publicly and privately owned U.S. airports in 1995.

Table 1.1: Ownership of U.S. Airports, 1995

Ownership	Use	Number of airports
Private	Private	12,809
Private	Public	1,243
Public	Public	4,172
Total		**18,224**

Source: FAA.

Of the 4,172 publicly owned airports, 565 (14 percent) are commercial service airports. Commercial service airports (referred to as commercial airports in this report) are legally defined as airports (1) with scheduled passenger service, (2) that annually enplane 2,500 or more passengers, and (3) that are publicly owned.[4] FAA has identified nine additional airports—seven of which are privately owned—that would qualify for commercial status on the basis of the amount of annual passenger traffic but do not qualify because they are privately owned or do not have scheduled airline service.[5]

[2]Total U.S. enplanements include passengers at airports in American Samoa, Guam, North Mariana Isle, Puerto Rico, and the Virgin Islands.

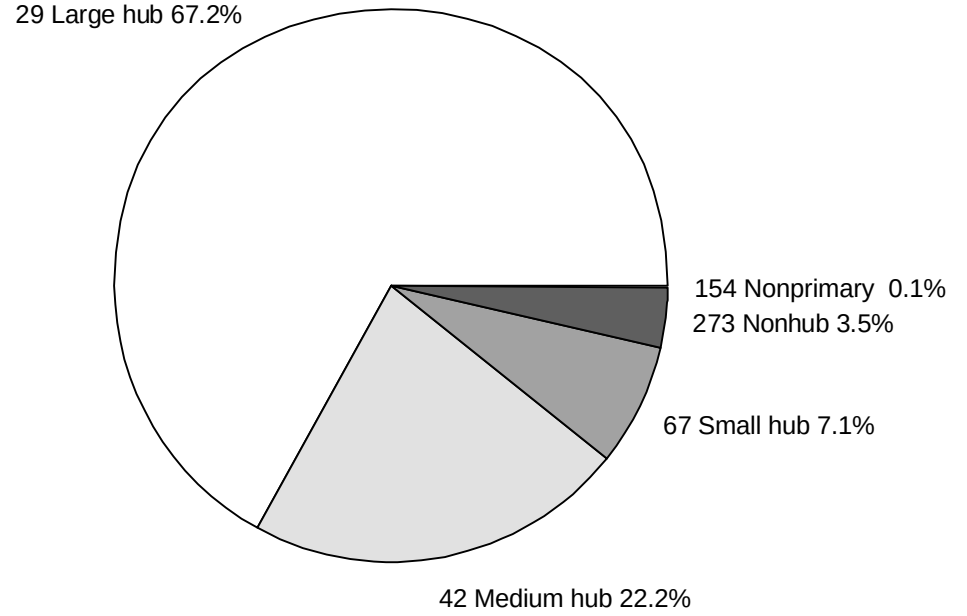
[3]General aviation airports serve nonscheduled aircraft operations.

[4]49 U.S.C. § 47102(7).

[5]The seven privately owned airports are Fajardo Harbor Seaplane Base, Puerto Rico; Griffing Sandusky Airport, Ohio; Kenmore Air Harbor Seaplane Base, Washington; Monument Valley Airport, Utah; Oak Harbor Air Park Airport, Washington; Princeville Airport, Hawaii; and Red Dog Airport, Alaska. In 1995, these airports enplaned from 5,251 to 52,378 passengers.

Airline passenger traffic is highly concentrated at the largest commercial airports.[6] The 29 large hub airports accounted for over 67 percent of all passenger enplanements in 1995, the last year for which figures were available. The 42 medium hub airports accounted for another 22 percent of annual enplanements in the same year. Figure 1.1 depicts the concentration of passenger traffic at the largest commercial airports.

Figure 1.1: Concentration of Passenger Traffic Among Commercial Airports, 1995



Note: The percentages do not add to 100 because of rounding.

Source: FAA.

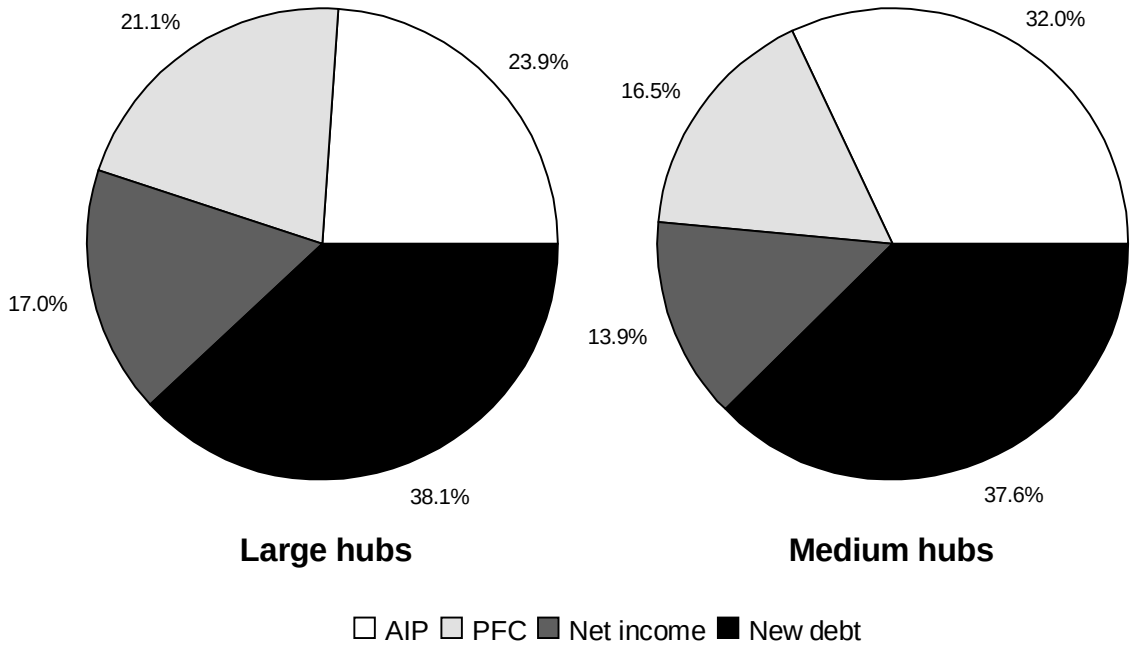
[6]FAA divides commercial airports into two categories—primary and other commercial airports (nonprimary). Primary airports include all airports that enplane more than 10,000 passengers annually and receive scheduled airline service. FAA designates primary airports as large, medium, small, or nonhub airports according to the number of annual passenger enplanements. Large hub airports are those that annually enplane at least 1 percent of all U.S. airline passengers (at least 5,863,268 passengers in 1995), medium hub airports are those that enplane between .25 and 1 percent (at least 1,465,817 passengers), small hub airports are those that enplane .05 to .25 percent (at least 293,163 passengers), and nonhub airports are those that enplane less than .05 percent but more than 10,000 passengers annually. Other commercial airports include all airports that enplane from 2,500 to 10,000 passengers annually.

Public ownership of commercial airports varies. Most public owners are local governments, such as cities or counties. However, in many instances, local and state governments form special governmental entities, such as single-purpose airport authorities or port districts to manage airports as well as other transportation-related infrastructure. The legal and other relationships between a local or state government and a special governmental entity vary, but most local or state governments exert some level of control over them. A few states, such as Alaska, Hawaii, and Maryland, also own airports. For example, Maryland owns the Baltimore-Washington International Airport. The federal government owns two major airports—Washington Dulles International Airport and Washington National Airport—and has leased them to a public entity, the Metropolitan Washington Airports Authority.

The Federal Role in Financing Airport Development

Federal grants have played a critical role in building the nation's airport infrastructure. In addition to receiving grants from the federal Airport Improvement Program (AIP), commercial airports can also impose passenger facility charges (PFC), issue bonds, and generate net income from airport revenue. All of these sources of capital are affected by federal policies. Figure 1.2 depicts the average percentage contribution of each of these sources of capital at 53 large and medium hub airports in 1994.

Figure 1.2: Average Percentage of Total Capital for Large and Medium Hub Airports by Source, 1994



Notes: The percentages are based on financial data from 22 large hub and 31 medium hub airports.

The percentages for large hubs do not add to 100 because of rounding.

Source: GAO's analysis of data from Van Kampen American Capital Management, Inc.

For smaller airports, federal grants constitute a larger portion of their total capital because the other sources are not as accessible. Our prior work has shown that an inverse relationship exists between an airport's size and its reliance on federal grants.[7]

Federal Grants Help Finance Development Needs

Since 1946, the federal government has helped finance airport development with more than $23.5 billion in grants. Since 1970, airport grants have been financed by the Airport and Airway Trust Fund, which is financed from taxes on domestic and international airline travel, domestic

[7]AIP Funding for the Nation's Largest Airports (GAO/RCED-96-219R, July 31, 1996).

cargo transported by air, and noncommercial aviation fuel. AIP, the current federal airport grant program, was established by the Airport and Airway Improvement Act of 1982, as amended, and is administered by FAA. AIP grants help finance projects that enhance airports' capacity, safety, security, and noise mitigation.

There are two categories of AIP grants—apportionment and discretionary. Apportionment grants are distributed by formula to commercial airports (with more than 10,000 annual passenger enplanements) and states. Discretionary grants can generally be used for any eligible airport development project. The Congress has earmarked or "set-aside" some AIP discretionary funding for certain types of projects or airports. About 3,300 (18 percent) of the nation's airports are eligible to receive AIP grants. All airports receiving AIP grants must provide a "matching share", ranging from 10 to 25 percent of a project's total cost, depending on the type of project and size of the airport.

In fiscal year 1995, AIP grants to commercial airports totaled more than $1.2 billion, or about 80 percent of all grant obligations. The remaining 20 percent was directed to general aviation airports. A larger airport would generally receive more in airport grants than a smaller airport because larger airports enplane more passengers and have greater funding needs.[8]

Passenger Facility Charges Augment Grants

To augment grants from the AIP, in 1990 the Congress authorized commercial airports to impose a PFC. This authorization enables airports to charge each passenger a $1, $2, or $3 facility charge per trip segment up to a maximum of four segments per round trip. After determining which projects to fund with PFCs, an airport must apply to FAA for approval. Large and medium hub airports that collect PFCs must forgo up to 50 percent of their AIP apportionment funding, most of which is used to provide additional funding for smaller airports. As of February, 1996, just 4 years after the first PFC was approved, FAA had approved PFC collections at 244 airports. In 1995, PFC collections totaled about $1 billion. In 1996, the first bond that was secured solely by PFC collections was issued.

Tax-Exempt Status Reduces Cost of Airport Bond Debt

Tax-exempt status enables airports to issue bonds at a lower interest rate than taxable bonds, and tax-exempt bonds are an important source of funding for airports. Bond market professionals and a recent FAA study

[8]For more information on AIP grants, see Airport Improvement Program: Update of Allocation of Funds and Passenger Facility Charges, 1992-94 (GAO/RCED-95-225FS, July 17, 1995).

estimate that if airports did not have tax-exempt status, the interest rate on their debt would be about 2 percentage points higher.[9] Bonds are the largest single source of capital for large and medium hub airports. From 1985 through mid-1995, over $42 billion in new and refinanced airport bonds were issued in the United States. According to one credit rating agency, an estimated $25 billion in bonds is currently outstanding. Airport bonds, which are issued by airport sponsors, are one of two types.[10] The most common for larger airports are revenue bonds, which are secured by airport revenue. Less common are general obligation bonds, which are secured by the taxing authority and the full faith and credit of the issuing public airport owner.

Agreements With Airlines and FAA Rules Place Limits on Airport Revenue

Airport revenue is unlike other sources of airport capital for two reasons. First, airport revenue is used to fund both current operating costs as well as capital investment. Second, future airport revenue is typically used to secure outstanding airport debt and, therefore, may not be fully available to secure new debt issues or directly fund capital projects.

Most commercial airports have agreements that define their financial relationship with tenant airlines. These agreements, commonly termed "airport use agreements" are often long-term, sometimes running 20 years or more, although there has been a trend towards shorter-term agreements.[11] Typically, these agreements set airline rates and charges using either a "residual" or "compensatory" cost approach or a combination of both approaches. With the residual approach, the airlines collectively assume significant financial risk by agreeing to pay any costs of running the airport that are not allocated to other users or covered by nonairline revenue. Any surplus revenue is credited to the airlines and any deficit is charged to them in calculating their rates and charges for the following year. With the compensatory approach, the airport operator assumes the major financial risk of running the airport and sets rates and charges to recover the costs of the facilities and services that the airlines use.

[9]In FAA's March 1996 report to the Congress, Innovative Approaches for Using Federal Funds to Finance Airport Development, tax-exempt status was found to reduce large hub airports' interest costs by 1.87 percentage points from 1985 through 1995.

[10]The airport sponsor is responsible for meeting grant obligations and can be a public or private entity and the airport owner or operator.

[11]The term "airport use agreement" is used here to include both legal contracts for the airlines' use of airfield facilities and leases for the use of terminal facilities. At many airports both are combined in a single document. A few commercial airports do not negotiate airport use agreements with the airlines but have their rates and charges set by local ordinance.

Under FAA's rules regarding rates and charges to airlines, landing fees must be based on formulas which only permit an airport to recover the historic costs of its airfield assets (generally the cost to acquire land and develop the airfield), including debt-related expenses. Therefore, an airport may not revalue airfield assets in the absence of modifications or improvements to those assets. Also, that portion of assets acquired with AIP or PFC funds is not considered airport assets for the purpose of cost recovery through airline fees.

Infrastructure Privatization Efforts in the United States

Infrastructure privatization initiatives extend across local, state, and federal governments and include such diverse services as education, housing, utilities, and transportation. Numerous studies, task forces, and initiatives have focused on ways to attract private capital to help provide public goods and services. For example, the Congress included provisions within the Intermodal Surface Transportation Efficiency Act of 1991 that are intended to promote public-private partnerships to meet the nation's surface transportation needs.[12]

In 1992, the President issued Executive Order 12803 outlining the principles executive agencies must use to determine whether to approve a local or state government's request to privatize an asset that had been partly paid for with federal money. Under this order, local and state governments (where permitted by law) would be able to recover the unadjusted dollar amount of their portion of an asset's total costs from sale or lease proceeds. From any remaining proceeds, the federal government would receive its share of grants associated with the asset, less the depreciated value of the asset. In 1994, the President issued a subsequent order on infrastructure investment, Executive Order 12893, which directs executive agencies to minimize regulatory and legal barriers to private participation in providing infrastructure facilities and services.

Despite these executive orders and other federal initiatives, very few sales or leases of federally funded infrastructure assets have occurred. In 1995, the first and only privatization under Executive Order 12803 occurred, with the long-term lease of a waste water treatment plant in Hamilton, Ohio. According to a privatization expert, the federal government waived its share of the lease proceeds because it considered the plant to be fully depreciated.

[12]23 U.S.C. § 129(a).

Legislation was introduced in the 104th Congress to expand the private ownership of public infrastructure. In 1995, bills were introduced in both the House and Senate (H.R. 1907 and S. 1063, "Federal Aid Facility Privatization Act of 1995") that would waive the federal government's claim to any proceeds from privatizing any locally owned or state-owned facility that had received federal aid. Although these bills were not enacted, the Congress did authorize an airport privatization pilot program as part of the Federal Aviation Reauthorization Act of 1996.[13]

Objectives, Scope, and Methodology

Because of continuing widespread interest in airport privatization, the Chairman and Ranking Minority Member of the Subcommittee on Aviation, House Committee on Transportation and Infrastructure, requested that we undertake a study to examine

- the current extent of private sector participation at commercial airports in the United States and foreign countries;
- the current incentives and barriers to the sale or lease of airports; and
- the potential implications for major stakeholders, such as the passengers, airlines, and local, state, and federal governments, should airports be sold or leased.

To determine the current extent of private sector participation at U.S. and foreign airports, we reviewed airports' financial statements, interviewed airport and government officials, reviewed external studies, and surveyed 69 of the nation's largest airports. For U.S. airports, we measured the levels of public and private sector participation in their operations and capital financing. To measure private and public sector participation in airport operations, we surveyed 69 large and medium hub airports and requested the number of private and public full-time-equivalent positions there. We received responses from all 69 airports. To assess the levels of private and public financing, we analyzed several sets of data, including FAA's information on federal grants and airport enplanements, Van Kampen American Capital Management's information on 85 airports' financial statements, and the Securities Data Company's information on all airport bonds issued between 1985 and 1994. While we did not audit the accuracy of the databases, we did some limited cross-checking of information and found that it was accurate. To obtain information on privatization in foreign countries, we relied on a study by the World Bank,[14] a survey by

[13]Public Law 104-264, Oct. 9, 1996, section 149 (to be codified in 49 U.S.C. § 47134).

[14]Anil Kapur, Airport Infrastructure: The Emerging Role of the Private Sector, World Bank Technical Paper Number 313, Dec. 1995.

Public Works Financing,[15] and studies of international airport finance.[16] We also spoke with officials of two foreign countries and four airport management companies concerning planned or completed privatizations and reviewed pertinent studies and documents relating to airport operations and financing.

To assess the incentives and barriers to privatization, we spoke to a broad array of interested parties, including officials representing 13 airports, airport and airline interest groups, airlines, airport management firms, investment banks, credit rating agencies, the Department of Transportation, and FAA. Among the 13 airports we selected to visit are 9 that have at one time considered privatization. At these airports, we reviewed any feasibility studies and legal analyses they had conducted relating to privatization. We surveyed representatives from 13 domestic airlines to obtain their positions on airport privatization and their reasons for supporting or opposing the concept. We also met with representatives of four of the largest airport management firms operating in the United States and airport consultants to discuss impediments they have encountered in structuring privatization bids. Similarly, we met with representatives of three major credit rating agencies and several firms active in municipal finance to discuss economic benefits and impediments to privatization. Finally, we met with lawyers active in airport law and FAA counsel to discuss legal impediments to privatization. We also researched all applicable federal statutes, FAA policies, legal opinions, and court cases to determine how various laws may affect the sale or lease of airports.

We also assessed the possible implications and policy considerations of selling or leasing airports on airlines; passengers; and local, state, and federal governments. To assess privatization's possible effects on public airport owners, we spoke to officials representing airports, airport management firms, airport consultants, investment banks, and FAA. We also reviewed studies of infrastructure privatization in other countries and in the United States. To gauge the possible effects of privatization on airlines and their passengers, we examined privatization studies, airport and airline industry financial trends, and studies of the effects of airlines' prices on passenger traffic. We also spoke to representatives of 13 U.S. airlines. Finally, we assessed privatization's potential effects on the federal budget through estimates of airports' outstanding debt, tax-exempt versus

[15]1995 International Major Projects Survey: Public-Private Partnerships in Infrastructure Development, vol. 89, Oct. 1995.

[16]These include John Vickers and George Yarrow, Privatization: An Economic Analysis, Massachusetts Institute of Technology Press, Cambridge and London, 1988; Rigas Doganis, The Airport Business, Routledge, London, 1992; and Norman Ashford and Clifton A. Moore, Airport Finance, Reinhold, New York, 1992.

taxable bond yield differentials, and grant funding. We also discussed the effect of grant repayment on the federal budget with a representative of the Congressional Budget Office.

We provided the Department of Transportation and the FAA with a copy of our draft report for their review and comment. Officials, including the Acting Manager of the Airports Financial Assistance Division and Manager of the Program Guidance Branch, generally agreed with the facts presented and provided some minor clarifying comments and information, which we included as appropriate. Officials also stated that the report was a thorough and balanced representation of the facts. Our work was performed from July 1995 through October 1996 in accordance with generally accepted government auditing standards.

Commercial Airports, While Publicly Owned, Operate in Partnership With the Private Sector

Even though all U.S. commercial airports are publicly owned, they operate in partnership with the private sector to deliver most services. Airports have also adopted commercial practices in response to regulatory and market demands to become less dependent on federal grants and more self-sustaining. As a result, the private sector provides most employees at the nation's major airports. While federal grants have played a significant role in financing airport development, airport investment is also subject to some market discipline because investment supported by airport bonds must produce sufficient revenue to pay debt service costs. In other countries, private sector participation in airport operations and financing is also becoming more prevalent, including the sale or lease of the airports in some countries.

Federal Policy and Market Pressures Have Prompted Airports to Rely on the Private Sector

Several factors are causing airports to rely on the private sector for airport operations and financing and to adopt more business-like practices. Airports are required by federal statute to operate as self-sufficiently as possible. While budget pressures on the federal government have reduced traditional sources of capital (grants), intense competition in the airline industry has resulted in greater pressure on airports to contain costs. Airport sponsors have also begun to adopt innovative industry practices to increase airports' retail potential.

FAA Requires Airports to Be Self-Sustaining

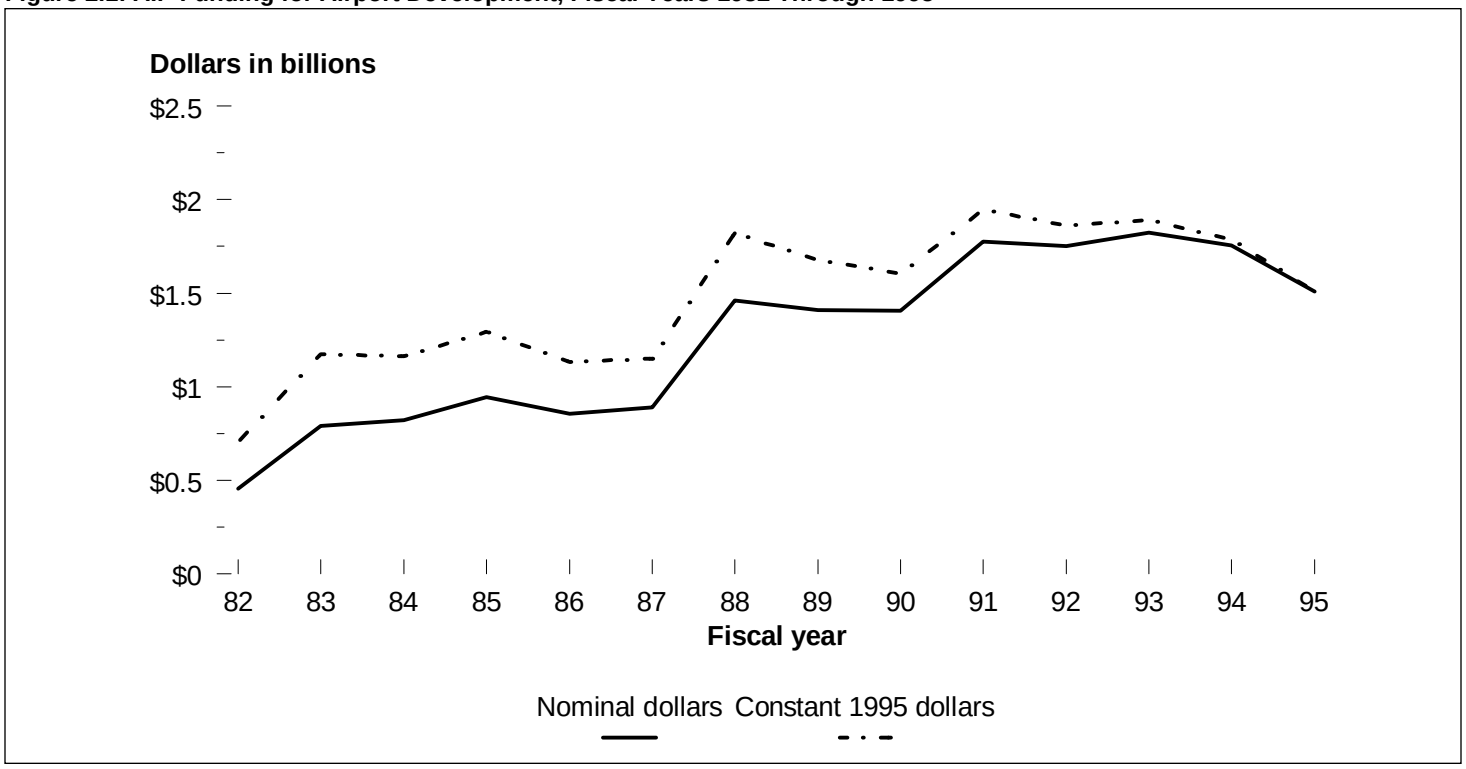
One of the obligations an airport assumes as a condition for receiving federal grants is that its fee and rental structure will make the airport as self-sustaining as possible.[17] This obligation generally requires that an airport charge fair market value for the use of airport facilities, excluding the airfield. In recent years, FAA and the Department of Transportation's Inspector General have emphasized the need for airports to comply with this obligation.

Financial Support From the Federal Government Has Declined

Following substantial growth in the 1980s, AIP funding has declined in recent years. Figure 2.1 depicts AIP funding trends, in inflation-adjusted and nominal dollars, for fiscal years 1982 (the first year of the AIP) to 1995.

[17] 49 U.S.C. § 47107(a)(13)(A).

Figure 2.1: AIP Funding for Airport Development, Fiscal Years 1982 Through 1995



Source: FAA.

Airlines Pressure Airports to Contain Costs

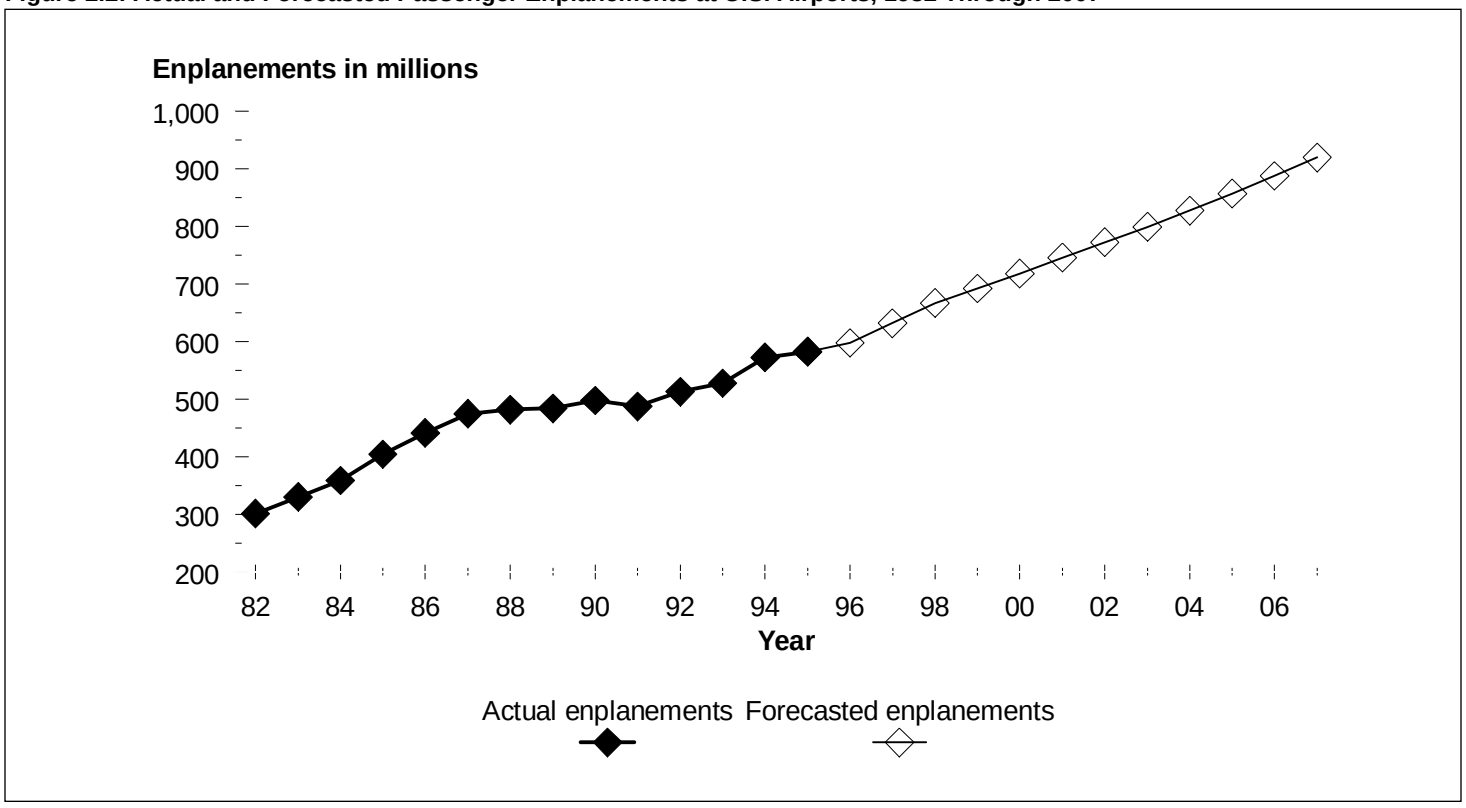
While airline profitability rebounded in 1995, the industry as a whole has suffered substantial losses over the last decade. Our prior work found that the U.S. airline industry had a profit margin half that of the average U.S. company.[18] While intense competition brought on by airline deregulation in 1978 helped to lower passenger fares, it also made airlines less profitable and, accordingly, more cost-conscious. Although the money airlines pay in landing fees and terminal rentals is relatively little—on average 6 percent of their total costs in 1995 according to data from airlines—these costs are not fixed. Therefore, airlines pressure airports to keep these costs low.

[18]Airline Competition: Industry Competitive and Financial Issues (GAO/T-RCED-93-49, June 9, 1993).

Growth in Passenger Traffic Provides Opportunities for Airports to Increase Nonairline Revenue

The growth in passenger traffic helps airports expand nonairline revenue, such as retail concessions. Passenger traffic has nearly doubled, from 300 million enplanements in 1982 to over 580 million enplanements in 1995; and FAA has forecasted that enplanements will increase 3.9 percent each year through 2007, as shown in figure 2.2.

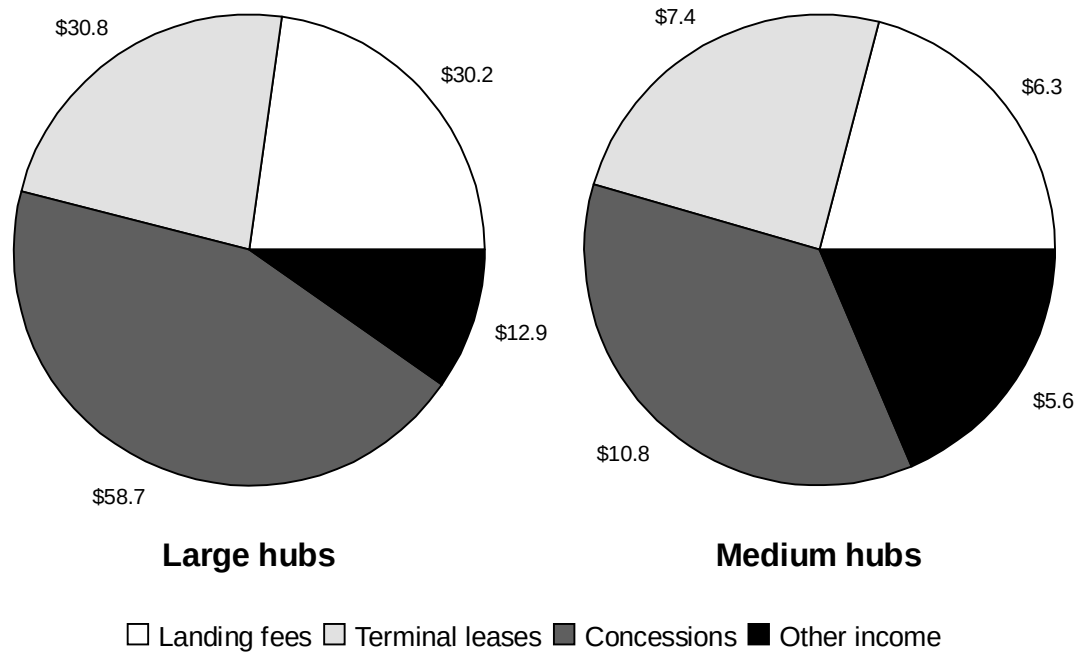
Figure 2.2: Actual and Forecasted Passenger Enplanements at U.S. Airports, 1982 Through 2007



Source: FAA.

Airports obtain revenue from four general sources: landing fees and rentals from terminal leases (both paid by airlines), concessions (such as parking), and other income (such as advertising). As figure 2.3 shows, nonairline revenue from concessions and other income now account for a majority of total revenue at large and medium hub airports.

Figure 2.3: Average Annual Amount of Total Revenue for Large and Medium Hub Airports by Source, 1988 Through 1994



Note: The percentages are based on financial data from 22 large hub and 31 medium hub airports.

Source: GAO's analysis of data from Van Kampen American Capital Management, Inc.

The Airmall terminal at Pittsburgh International Airport illustrates an innovative method to increase an airport's retail potential.[19] In Pittsburgh, a private operator manages the retail facility, which includes over 100 retail outlets, for the public owner, Allegheny County. These retail outlets represent a wider diversity of products and services than U.S. airports generally provide. Between 1992 (when the Airmall opened) and 1995, per passenger retail spending at the airport increased 250 percent.

[19]Airmall is a registered trademark by BAA USA, Inc.

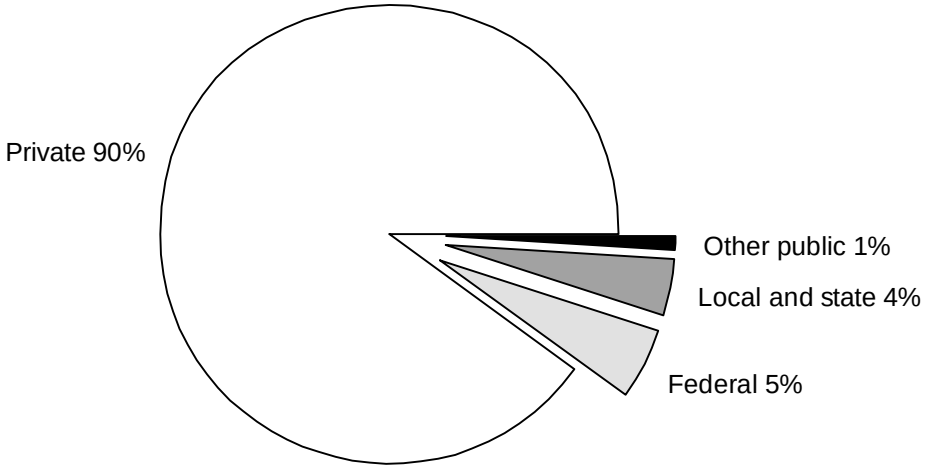
Private Sector Participation at Airports in the United States

U.S. commercial airports have collaborated with the private sector to control costs and improve services. While local governments, and in a few instances states, own almost all of the nation's commercial airports, we found that most employees providing services at airports work for private companies, including airlines, concessionaires, and contractors. Some public owners have also contracted out the management of their airports to the private sector, although such arrangements have tended to be with smaller airports.

At the Largest Airports, Most Services Are Provided by the Private Sector

Most of the people working at the nation's largest airports are employed by the private sector. As shown in figure 2.4, information we obtained from 69 of the nation's largest airports (29 large hub and 40 medium hub airports)[20] showed that 90 percent of the people who work at these airports are private employees and 10 percent are public employees.[21]

Figure 2.4: Percentage of Private and Public Employees at 69 of the Nation's Largest Airports



Source: GAO's analysis of data from 69 large and medium hub airports.

[20]Our survey sample was based on passenger enplanement data for 1994, the latest data available at the time the survey was done. According to the 1994 data, there were 29 large hub and 40 medium hub airports.

[21]The 69 airports that responded to our survey had about 766,500 total employees. The percentage of private employees at each of the 69 airports ranged from 64 percent to 98 percent with the exception of one airport with 28 percent. Also, the median percentage (half of the responding airports were above and half were below the median) at the 69 airports was 89 percent.

Of the nearly 686,000 private employees working at the 69 responding airports, about 437,000 (64 percent) were airline employees, such as pilots, flight attendants, ticket counter attendants, and baggage handlers. The approximately 249,000 (36 percent) nonairline employees were engaged in providing such services as cleaning, retail concessions, and ground transportation.

According to airport executives we spoke with, there are several benefits to using contractors and concessionaires, including improved services, lower costs, and increased revenue. These officials noted that by using private companies to provide these services, airports can rely on the expertise and financial standing of these companies. Contracting can reduce the airports' costs through the competitive bid process, and concession agreements often allow airports to share in the revenue generated by private companies.

Of the nearly 80,500 public employees working at the 69 responding airports, about 32,750 (41 percent) worked for local or state governments, about 38,000 (47 percent) worked for the federal government, and about 9,750 (12 percent) were other public employees, primarily military personnel. Employees of local and state governments were primarily administrative personnel (such as airport directors, financial officers, operations officers, public relations officers, and clerical support), police officers, and firefighters. Federal employees included public safety and security personnel such as FAA air traffic controllers, and agents from the Customs Service, Department of Agriculture, Drug Enforcement Agency, and Immigration and Naturalization Service. Other public employees at airports were primarily military personnel from such services as the U.S. Air Force and Air National Guard.

Few Publicly Owned Airports Are Privately Managed

Despite commercial airports' reliance on the private sector for most services, few of these airports are privately managed. However, in response to increased pressure to reduce costs and the growing number of airport management firms competing for management contracts, the number of publicly owned airports that are privately managed has expanded. The Indianapolis Airport Authority's contract with a private firm to manage its system of airports (1 commercial airport and 5 general aviation airports) is an example of this trend. We found 7 commercial airports (out of 565) that were privately managed under management contracts. Also, in addition to the Indianapolis Airport Authority's five publicly owned general aviation airports, we found 10 such airports that

were privately managed under a management contract and 3 such airports that were privately managed under a lease. (See app. I for information on publicly owned commercial and general aviation airports that are privately managed.)

In 1994, the Indianapolis Airport Authority sought bids to manage its airport system that included Indianapolis International Airport (the nation's 47th largest airport) and five surrounding general aviation airports. The winning bidder won a 10-year contract. Under the contract, the winning bidder has made a guarantee, secured by a letter of credit, to reduce airport costs and increase airport revenue. Airport profits will be split between the contractor and the airport authority, the latter passing on its share of profits to tenant airlines in the form of reduced rates and charges. According to city and airport authority officials, the contractor was selected on the basis of its demonstrated ability to develop and increase retailing profits at airports. While first year financial results are not yet available, estimates are mixed on whether the contractor will achieve the contract's goals.

In most cases, private managers are compensated on a fixed fee basis, sometimes including a performance incentive payment. The Indianapolis contract is different in that the private manager has promised the public authority and the airlines a guaranteed level of cost savings. One other municipality is now exploring the viability of a similar agreement at its airport.

To Attract Private Capital, Airports Must Demonstrate That Revenue Will Be Sufficient to Cover Debt Payments

The use of private investment funds, such as bonds, is subject to the scrutiny of credit rating agencies. While federal grants have played a significant role in developing airport infrastructure, airports' net income and bond financing has also played a key role. For example, in 1994 more than half of the average large or medium hub airports' total capital for development consisted of net income and bond proceeds (see fig. 1.2).

Airport revenue bonds, which are backed by an airport's current and future revenue, provide the greatest single share of total capital at the largest airports. To support continued infrastructure development, large airports have in recent years increasingly relied on debt financing through revenue bonds. For example, accumulated debt levels (in nominal dollars) doubled between 1988 and 1994, rising to an average $889 million, for each of the 22 large hub airports we examined. Despite taking on this additional debt, these airports' financial performance did not deteriorate, as

operating margins remained constant and credit ratings were not impaired.

To issue a revenue bond, an airport must convince credit rating agencies that future airport revenue will be sufficient to cover future interest and principal payments as well as operating costs. Credit rating agencies evaluate the airport's finances, operations, and management before rating a bond issue. The rating agencies also evaluate how the bond proceeds will be invested. An investment grade rating is generally necessary in the municipal bond market before a bond can be issued.

In some cases, airlines and other tenants have privately financed the construction of their terminals, hangars, and other facilities at U.S. airports. For example, major terminals at Chicago O'Hare International Airport, Cincinnati/Northern Kentucky International Airport, and John F. Kennedy International Airport were privately financed. In 1996, the public sponsor completed negotiations with a private developer to finance, build, and operate a new $1.2 billion building for international arrivals at John F. Kennedy International Airport.

Privatization of Airports Is Becoming More Prevalent in Other Countries

While national governments of most foreign countries have historically owned and operated airports, in recent years some countries have begun to privatize all or parts of their nation's aviation system as part of an overall economic restructuring. These countries have privatized many parts of their infrastructure, including airports, railroads, shipping, and trucking.[22] Generally, these countries' privatization policies have been driven by a desire to raise capital, reduce the size of the public sector, and to improve economic efficiency.

Most of the efforts to privatize airports that we identified in 50 countries were in the preliminary stages. For example, Mexico passed legislation in 1995 to lease 58 major airports on a long-term basis. Australia is implementing privatization legislation to allow 22 major airports to be leased on a long-term basis. Most countries' privatization efforts do not transfer ownership of airports to the private sector, but involve long-term leases, management contracts, the sale of minority shares in individual airports, or the development of runways or terminals by the private sector. Only the United Kingdom has sold major airports to the private sector.

[22]For additional information on other countries' privatization efforts, see Budget Issues: Privatization/Divestiture Practices in Other Nations (GAO/AIMD-96-23, Dec. 15, 1995).

Appendix II provides a list of countries and their efforts to privatize airports.

Our findings on the increasing efforts to privatize airports are similar to those in a recent World Bank study, which determined that airports around the world have evolved into multifaceted commercial operations.[23] This study also noted that while most airports are owned and operated by national governments, a trend toward more private sector involvement has been emerging. The study found a great variety of ownership structures, ranging from fully public to fully private with many variations in between. U.S. airports were in the middle of this ownership spectrum—with regional (local and state) governmental ownership but commercial operations.

Privately Owned Airports in the United Kingdom Have Been Profitable

The United Kingdom, which sold its major commercial airports in 1987, is one of the few countries where airports have been privatized long enough to provide measurable results. To privatize, the United Kingdom sold the government corporation British Airports Authority (BAA) and the seven major airports it operated (including London's Heathrow and Gatwick airports) in a $2.5 billion public share offering. Proceeds from this sale were used to reduce the national debt. Even after privatization, the airports have remained subject to government regulation of airlines' access, airports' charges to airlines, safety, security, and environmental protection. The government also maintains a right to veto new investments in or divestitures of airports.

BAA has generated profits every year since it assumed ownership of the United Kingdom's major airports in 1987. As a result of steadily increasing passenger traffic and growth in retail revenue, BAA generated $455 million in profits for its shareholders in 1995. This profit was attained despite government-imposed caps on charges to airlines and $782 million invested in infrastructure improvements, including a rail link to central London from Heathrow International Airport. BAA was valued at over $4.5 billion in 1995.

However, the privatization of BAA has not been without its critics. Some private economists have noted that by selling BAA's seven airports together, instead of separately, the United Kingdom did not allow for greater competition among the airports. These critics charge that as a result, the government converted a public asset into a regulated private

[23]Kapur, Airport Infrastructure: The Emerging Role of the Private Sector.

monopoly that requires regular review and negotiation over the airports' charges to airlines.

Despite Incentives, Numerous Impediments Block the Sale or Lease of U.S. Airports

In recent years, the sale or lease of U.S. airports has generated considerable interest. Supporters of privatization believe that many major U.S. commercial airports can operate on a sound economic basis without government assistance. Airports' funding needs, the desire to improve their efficiency, and the potential financial benefits to all levels of government are also generating interest in privatization. However, considerable legal barriers currently block the sale or lease of U.S. airports. In addition, even if the legal barriers were removed, significant economic barriers could impede privatization.

Reasons to Privatize Vary

Privatization advocates point to three major reasons why the sale or lease of airports should be encouraged. First, they note that private entities would provide additional private capital to help finance airport development. Second, advocates maintain that private operators would more efficiently develop and manage airports and, in the process, reduce airlines' and passengers' costs. Third, if federal requirements on the use of airport revenue are changed, the sale or lease of airports by local or state governments would generate a quick infusion of cash for them, while reducing the need for local, state, and federal grants and eliminating tax subsidies.

Ability to Meet Airports' Capital Needs Is Uncertain

Although there has been considerable investment in the nation's airports, FAA studies indicate that substantial future investment in airport infrastructure will be needed. As of March 1996, FAA estimated that U.S. domestic and international passenger enplanements will grow 3.9 percent annually through 2007. Also, according to FAA's analysis, the number of severely congested airports would increase from 7 in 1995 to 17 in 2002 if capacity is not increased.[24] Congestion results in increased costs and delays for airlines. Airport officials contend that they will need about $60 billion from 1997 through 2002, or $10 billion per year, most of which will be needed for projects to increase airport capacity. FAA estimates that airports' AIP-eligible capital needs will be about $6.5 billion per year over the next 5 years.

Whether existing sources of capital will be adequate to meet future development needs is uncertain. Since 1992, AIP funding has declined to $1.46 billion in fiscal year 1997. PFCs contribute about $1 billion annually for airport capital development. Whether debt financing and internally

[24]FAA considers an airport to be severely congested when average airline delays exceed 9 minutes per operation.

generated revenue will be sufficient to supply the difference in funding needs is uncertain. Privatization advocates believe that the private sector would provide additional capital to meet these needs. For example, private entities could tap the debt equity market (such as by selling stock) that is not open to public entities. A 1995 FAA study indicates that the largest airports generally have been able to obtain sufficient debt financing to meet their capital needs.[25] A prior GAO report also showed that while the debt levels of large hub airports doubled between 1988 and 1994, revenue was available to pay the increased principal and interest amount.[26] However, the same report also noted that airports cannot accumulate unlimited debt to fund capital projects and the ability to finance large amounts of debt may vary substantially among airports.

Advocates Claim That Privatized Airports Would Operate More Efficiently and Profitably

Advocates claim that private firms would operate airports more efficiently and profitably than the public sector. Some studies support the position that the private sector is more efficient than the public sector.[27] Advocates also point to the contract to manage the Indianapolis airport system, where a private firm has promised to reduce operating costs and increase revenue by about $140 million over 10 years, even though some aviation industry officials considered it among the more efficient public airports in the country. The Reason Foundation, a privatization advocate, also points to labor productivity growth at airports in the United Kingdom following their privatization as evidence of private airports' ability to operate more efficiently.

Private airport owners or lessees can generate profits and a return on their investment in two ways—by increasing efficiency and by charging users higher prices. However, whether private firms would operate airports more efficiently than public owners (and pass on some cost savings to users) is uncertain and would likely vary among airports. According to airport management firms, some airports are not good privatization candidates because opportunities to increase revenue or cut costs are limited. In addition, several economists have asserted that competition is a more important factor than the type of ownership in encouraging greater

[25]FAA's March 1996 report, Innovative Approaches for Using Federal Funds to Finance Airport Development.

[26]AIP Funding for the Nation's Largest Airports (GAO/RCED-96-219R, July 31, 1996).

[27]These include David F. Linowes, Professor of Political Economy and Public Policy, University of Illinois, testimony before the House Committee on the Budget, Mar. 1, 1995; Fuat Andic, Privatization Theory and Policy, United Nations Industrial Development Organization, Apr. 1, 1993; John Hilke, Cost Savings From Privatization: A Compilation of Study Findings, Reason Foundation, Mar. 1993; and Jose A. Gómez-Ibáñez and John R. Meyer, Going Private: The International Experience With Transport Privatization, Brookings Institution, Nov. 16, 1993.

efficiency. According to analysts who rate airport bonds, airports in some cities may face little competition and could charge prices above the levels that would prevail in a competitive market.

Advocates Claim That Privatization Would Benefit Local, State, and Federal Budgets

Advocates contend that airport privatization would benefit the budgets for all levels of government for several reasons. First, if current restrictions on the use of airport revenue are changed, privatization would immediately generate sale or lease proceeds that could be used for other than airport purposes. The amount of these proceeds would depend on how privatization might be implemented, but one privatization advocate calculated that the 87 largest airports have a total market value of $29 billion.[28] In addition, local, state, and federal governments would receive a lasting benefit from reduced airport demands for financial assistance. Advocates also point out that private airports would be paying taxes.

Few Public Sponsors Have Sustained Efforts to Sell or Lease Commercial Airports in the United States

As of October 1996, only one of the ten attempts by public owners to sell or lease U.S. commercial airports to a private entity has been successfully implemented (see table 3.1). Very few of the privatizations under consideration were formally proposed to FAA for approval, and some were rejected as infeasible because of legal impediments. In at least three cases, public owners considered selling or leasing their airports to divert the proceeds from the airports for other uses. For example, in 1995, Orange County, California, considered whether it could sell John Wayne Airport to obtain revenue for its general fund after the county had filed for bankruptcy in December 1994. The county abandoned this effort, in part, after concluding that it could not legally divert sale proceeds.

[28]Robert Poole, Revitalizing State and Local Infrastructure: Empowering Cities and States to Tap Private Capital and Rebuild America, Reason Foundation, May 1995.

Table 3.1: Outcomes of Ten Efforts to Sell or Lease U.S. Commercial Airports, as of October 1996

Airport and location	Who led effort	Year	Purpose	Type of privatization	Outcome
Greater Peoria Regional Airport, Illinois	Airport manager	1985	Reduce costs and increase revenue	Sale or lease of the airport terminal	Determined infeasible
Atlantic City International Airport, New Jersey	Mayor	1986-1992	Improve the facility	Sale or lease of the airport terminal	Leased the terminal to a private entity from 1986 to 1992 and sold the terminal to a public entity in 1992
Albany County Airport, New York	County	1989-1991	Recover and reduce operating costs	Lease of the airport	Opted for a private management contract
Los Angeles International Airport, California	Mayor	1992-1996	Divert revenue	Sale or lease of the airport	Ongoing
Baltimore-Washington International Airport, Maryland	State legislature	1993	Reduce costs and increase revenue	Sale or lease of the airport	Two state panels recommended not to sell or lease the airport
Logan International Airport, Massachusetts	State legislature	1993	Reduce costs	Sale or lease of the airport	Contracted some activities and leased a portion of terminal facilities
Kennedy International Airport and LaGuardia Airport, New York	Mayor	1995-1996	Improve facilities and divert revenue	Sale or lease of the airport	Ongoing
John Wayne/Orange County Airport, California	County board of supervisors	1992 and 1995	Divert revenue	Sale or lease of the airport	Rejected by the county as infeasible
Indianapolis International Airport, Indiana	Mayor	1994-1995	Reduce airline fees and improve service	Lease of the airport	Opted for a private management contract
Stewart International Airport, New York	Governor	1995-1996	Improve service, increase tax revenue, and provide additional private financing for development	Sale or lease of the airport	Ongoing

Atlantic City is the only public owner that was able to lease its airport to a private company and collect annual payments to use for nonairport purposes although it had received federal grants. In 1986, the city leased the main airport's terminal and a general aviation field to a private firm for a minimum yearly payment of $400,000, which was diverted to the city's general fund and not used for airport purposes. We could not determine, nor could FAA explain, why this lease was approved, when the agency has subsequently opposed similar proposals. In 1992, Atlantic City sold the terminal to a newly created public transportation authority for $11.5 million and annual payments of $500,000, which have been placed in

the city's general fund. This latter transaction was specifically authorized under the Department of Transportation's 1992 Appropriations Act.[29]

Federal Grant and Other Legal Requirements Are Impediments to Privatization

Under federal grant agreements, FAA approval is required before a commercial airport can be sold or leased, regardless of whether the transfer is to a public or private entity.[30] In opposing proposals to sell or lease airports to private entities, FAA has cited its concern that a private owner or lessee would not be able to satisfy the legal obligations that the public airport sponsor had made as a condition of obtaining a federal grant.[31] Grant agreements currently contain 35 assurances (obligations), including those on the uses of airport revenue, environmental compliance, and public use and access. While many of the assurances would not likely be an obstacle to privatization, some could, especially those concerning the use of airport revenue and reimbursement of federal assets. According to FAA, these legal obligations cannot be unilaterally extinguished by repaying past grants to the federal government. However, according to FAA's recently proposed policy, the agency will be open and flexible on the conditions for the use of airport revenue if it determines that privatization would not harm the public interest or undermine aviation policy.

Prohibition on Revenue Diversion Is the Major Obstacle to Selling or Leasing Airports

The Airport and Airway Improvement Act of 1982, as amended, which established the AIP, requires sponsors to use all of an airport's revenue for its capital and operating costs and not divert revenue for nonairport purposes.[32] The intent of this provision was to ensure that airports receiving federal grants also used the revenue generated at the airport to pay for its costs. In 1987, the restrictions on revenue diversion were tightened to limit the use of airport expenditures to activities that were not only "directly" but also "substantially" related to air transportation. In late 1993 and early 1994, the House Committee on Appropriations and the Department of Transportation's Inspector General issued reports concerning airport revenue diversion and recommended greater oversight

[29]P.L. 102-143, § 335, Oct. 28, 1991.

[30]According to FAA's Airport Improvement Program (AIP) Handbook, Oct. 24, 1989 (Order 5100.38A), for public airport sponsors, grant obligations shall remain in effect for the useful life, up to 20 years, for any facilities that were developed or equipment that was acquired with federal grants and these obligations shall remain in effect indefinitely for any real property that was acquired with federal grants.

[31]See 49 U.S.C. §§ 47101-47131.

[32]49 U.S.C. § 47107(b)(2) allows public airports with preestablished revenue-sharing legislation or debt covenants to legally take some revenue from the airport. We found only a few airports that qualify for this provision.

by FAA. In 1994, the Congress added airport financial reporting requirements and penalties for violating requirements concerning the use of airport revenue. In 1996, the Congress added the penalty that an airport is subject to a fine of three times the amount of revenue that it illegally diverts.

To what extent the public owner of an airport can retain sale or lease proceeds is a crucial issue in the privatization debate. FAA contends that any sale or lease proceeds constitute airport revenue and, therefore, must be used for airport purposes. If a public owner of an airport cannot retain privatization proceeds for nonairport purposes, the financial incentives to privatize are diminished. A 1991 Department of Justice opinion stated that public owners of airports are entitled to unreimbursed capital and operating expenses from the proceeds of an airport's sale or lease.[33] The opinion also stated that no time limits exist on the right to receive compensation for these expenses. However, under the Federal Aviation Reauthorization Act of 1996, any request to recoup capital and operating costs must be made no later than 6 years after the expense occurred.

Grant Repayment and Surplus Federal Property Requirements May Pose Barriers

Another legal issue concerns whether federal grants must be repaid and donations of surplus federal property must be returned if an airport is sold or leased to a private entity. Since 1946, the federal government has awarded over $23.5 billion in airport grants and donated an unknown value of surplus federal property to assist in the development of airports. According to privatization proponents, federal grant and surplus property requirements would pose significant barriers to privatization if FAA requires that grants be repaid and the Secretary of Transportation does not waive surplus property restrictions.

The question of whether federal grants must be repaid has not been officially determined by FAA. According to FAA officials, the statutory restrictions on the use of airport revenue appear to take precedence over Executive Order 12803 that requires FAA to seek grant repayment from sale or lease proceeds.[34] Furthermore, there is no reason for FAA to seek

[33]The opinion was sought by FAA in conjunction with a request by Albany County, New York, to lease its airport to a private entity.

[34]Executive Order 12803 specifies that, to the extent permitted by law, sale or lease proceeds are to be distributed in the following manner: (1) Local and state governments shall first recoup in full the unadjusted dollar amount of their portion of the asset's total costs; (2) if sale or lease proceeds remain, the federal government shall recoup in full the amount of federal grants associated with the asset, less the applicable share of accumulated depreciation on the asset; and (3) finally, local and state governments shall keep any remaining proceeds if they are used only for investment in additional infrastructure assets or for debt or tax reduction.

reimbursement of federal grants if, as the agency has interpreted, revenue diversion restrictions only allow sale or lease proceeds (exclusive of proceeds used to reimburse the public owners' capital and operating costs) to be used for airport purposes.

For any airport property that is deeded as surplus federal property the Secretary of Transportation must approve its sale or lease even if it is used as originally intended.[35] Specifically, the Secretary must determine that in selling or leasing an airport to a private entity, the airport will continue to be used as originally intended. Upon making this determination, the Secretary can then allow the airport to be transferred to a private entity.

According to privatization advocates, grant repayment and surplus federal property requirements impede airport privatization. Specifically, they are concerned that FAA would seek reimbursement of federal grants because the agency has not had to consider whether to apply Executive Order 12803 to an actual public to private transfer of an airport, and FAA has no policy on whether this order would apply. Under bills introduced during the 104th Congress (H.R. 1907 and S. 1063), the Secretary of Transportation could not require local and state governments to repay federal grants if a legal agreement or regulation requires that the privatized asset continue to serve its originally intended purpose. However, these bills were not enacted. Also, according to privatization advocates, surplus property requirements are barriers to privatization because it would take a costly legal effort to determine if the Secretary would allow the airport to be transferred and would also waive certain terms of the original transfer to the public entity, especially the terms allowing the federal government to possess the surplus property during a national emergency or take back the property if any requirements are not met.

Noise, Environmental, and Land-Use Requirements Are Not Significant Barriers

Conformance with noise, environmental, and land-use assurances does not present significant barriers to the sale or lease of an airport. Specifically, these assurances apply equally to both privately and publicly owned airports and meeting these assurances would generally require the same actions. Federal regulations established a system for measuring aircraft noise in communities next to or near airports and for providing information about how land should be used depending on the noise level. Airport operators must also meet applicable environmental requirements such as air and water quality standards. In considering whether to buy or lease an airport, a private entity can determine what the potential costs of

[35]See 49 U.S.C. §§ 47151-47153.

meeting noise and environmental requirements are and how these costs will be met. The land-use assurance requires airport operators to take appropriate action, including the adoption of local zoning laws (to the extent reasonable) to restrict the use of land next to or in the immediate vicinity of the airport to activities and purposes compatible with normal airport operations, including the landing and take-off of aircraft. Private entities do not have zoning authority. Therefore, to satisfy this assurance private owners would either need to control the land within the immediate vicinity of their airports or have the cooperation of local governments. In some cases, local governments that own airports also do not control land next to or in the immediate vicinity of their airport and must have the cooperation of other local governments to meet the land-use assurance.

The exposure of a private owner or lessee to noise and environmental liability arising from lawsuits presents an additional business risk. For example, public owners have been found liable for damages from noise caused by airport operations. Therefore, a private airport owner or lessee could be liable for damages from noise.[36] Determining liability for airport noise and environmental damages is, for the most part, a local issue.

Safety and Security Requirements Are Not Significant Barriers

Although airports must conform to federal safety and security requirements, regardless of their ownership and whether they receive federal grants, these requirements do not pose significant barriers to privatization. Under FAA's safety requirements, airports must be certified by FAA to service various categories of commercial aircraft. Similarly, airports must meet FAA's security requirements.

Because of sovereign immunity,[37] a public owner may have greater protection from lawsuits claiming that the airport failed to adhere to safety or security requirements. A private owner would not have this immunity and would need to obtain private insurance or self-insure against liability unless specifically indemnified as part of any transfer. As a result, a private airport's costs could increase to cover this insurance cost.

[36]Under 49 U.S.C. § 47506, the Congress acted to limit noise suits against airport operators who have prepared a noise exposure map under § 47503 by property owners who acquired property within a noise affected area after February 18, 1980. Essentially, after the map puts the public on notice of a noise exposure level, there is no legal basis for a suit unless aircraft operations at an airport have significantly changed since the property was purchased (such as an increase in the type of certain aircraft and frequency of their use or changes in airport layout or flight patterns).

[37]Under sovereign immunity, a governmental entity cannot be sued without its consent for liability arising from activities that are governmental in nature.

Federal Penalties to Enforce Grant Obligations Are More Limited for Private Airport Owners

In the event a public agency does not abide by its grant obligations, the Secretary of Transportation can pursue several courses of action depending on the nature of the offense. For example, airports that have illegally diverted revenue can be required to make repayment. Also, under some circumstances, the Secretary can impose a civil penalty for failure to take corrective action. At the most extreme, the Secretary could withhold any future transportation grants, including airport apportionment grants and highway funding in accordance with the 1994 and 1995 Department of Transportation Appropriations Acts.

For a private airport owner, the Secretary's ability to enforce compliance with outstanding grant assurances is more limited. A commercial airport that was sold to a private entity would not be eligible for apportionment grants or other transportation grants that a local or state government can receive. Therefore, the federal government's ability to encourage compliance by withholding grants to privately owned airports is reduced.

FAA's Proposed Policy on the Use of Airport Revenue Is Ambiguous

FAA's proposed policy on the use of airport revenue, including the use of sale or lease proceeds, is ambiguous because it provides conflicting advice to airport owners interested in privatizing. On February 26, 1996, FAA issued its proposed policy for public comment.[38] Under the proposal, FAA continues to consider sale or lease proceeds as subject to restrictions on diverting airport revenue. However, the proposal also states that FAA does not intend to discourage privatization and will consider privatization proposals on a case-by-case basis. The proposal further states that the FAA will remain open and flexible in specifying conditions on the use of airport revenue that will protect the public interest and fulfill revenue diversion restrictions without interfering with privatization. However, FAA has not specified these conditions. As a result, the policy effectively discourages privatization as long as FAA considers sale or lease proceeds to be airport revenue subject to diversion restrictions.

Bond Covenants Present Restrictions to Privatization

Covenants in bonds could restrict the transfer of a public airport to private control in certain instances. To protect bondholders, bonds generally contain covenants that require the bonds to be retired if assets are sold or transferred. According to public finance officials, altering these covenants would generally require a vote of bondholders. Recalling existing bonds

[38]Section 112 of the Federal Aviation Administration Authorization Act of 1994, P.L. 103-305 (enacted Aug. 23, 1994), required the Secretary of Transportation to establish revenue diversion policies not later than 90 days after enactment.

and issuing new bonds would mean incurring prevailing interest rates that could be higher.

Economic Factors Place Practical Constraints on Privatization

In addition to the various legal constraints, a privatized airport's ability to operate profitably under current regulations and conditions is uncertain. Privatized airports would lose eligibility for some main sources of capital. Also, a private airport could encounter opposition from airlines and restrictions on its ability to generate an adequate return on investment. Finally, a privatized airport could go bankrupt.

Private Airports' Access to Some Funding Sources Is Reduced

Under current regulations, private airports would lose access to some AIP funding as well as PFCs and tax-exempt status for bonds. First, privately owned airports cannot receive AIP apportionment grants, although they would continue to be eligible for AIP discretionary grants. Depending on how a lease is structured, a privately leased airport could receive apportionment grants. Specifically, the public owner could be the airport sponsor for the purpose of receiving grants. In fiscal year 1995, apportionment funding for commercial airports was one-third of the total $1.45 billion in AIP funds.[39]

Second, privately owned airports could not collect PFCs, but could impose other types of fees. As with apportionment grants, depending on how the lease is structured, a privately leased airport could collect PFCs. Between June 1992 and January 1996, 244 airports were approved to collect an estimated total of $12.5 billion in PFCs through the year 2024. In 1995, airports collected almost $1 billion in PFCs. To replace lost PFCs, a privately owned airport could collect other types of passenger usage fees that are not subject to PFC limits.

Finally, according to public finance officials, for future bond issues at privately owned airports, the loss of tax-exempt status would add about 2 percentage points to the average airport's debt costs. For example, without tax-exempt status, a $100 million bond issue would cost at least $2 million more in additional interest costs each year for a privately owned airport. However, these interest costs are tax deductible. Concerning the status of outstanding bonds at a privatized airport, in 1994, the Internal Revenue Service issued Revenue Procedure 93-17 that sets forth the conditions under which an outstanding bond's tax-exempt status can be

[39]In fiscal year 1995, the Congress provided commercial airports with $729 million in apportionment funding before statutorily required cuts were imposed. After these cuts were imposed, commercial airports' actual apportionment funding was just over $450 million.

protected when the use of that bond's proceeds changes. (This protection is referred to as "safe harbor.") This revenue procedure requires the issuer to take one of several specified remedial actions that are available only if certain conditions are met. To the extent that the requirements and conditions of the revenue procedure are met, safe harbor protection for outstanding tax-exempt bonds might be available if an airport is sold or leased to a private entity.

Private Airports Could Face Airlines' Opposition and Limits on Profitability

A private airport owner or lessee also could face opposition from airlines and could encounter constraints on its revenue that would make it more difficult to earn a return on investment. First, the airline officials that we talked to are almost universally opposed to privatization, especially if it means higher charges to the airlines. In our discussions with officials from 13 domestic carriers, a majority opposed privatization because of concerns that it would lead to revenue diversion and an increase in airport landing fees and terminal rentals. Airlines approved of the contract for the private management of Indianapolis' airport system because they hoped it would lead to lower costs, improved efficiency, and assurances that no revenue would be diverted.

Second, FAA's policy on rates and charges prohibits airports from increasing their charges to airlines to reflect the costs of appreciated or revalued airfield assets. On June 21, 1996, FAA published its new policy on rates and charges, which dictates how airports may charge airlines for aeronautical uses of the airport.[40] Because revenue from fees for using an airfield, generally landing fees, may not exceed actual historical costs, a private airport would not be able to charge landing fees based on revalued airfield assets that reflect its acquisition costs.[41] However, this new policy would allow a private owner or lessee to earn a reasonable rate of return on airfield investments although the policy does not define what constitutes a reasonable return. In addition, it permits airports to earn a return, without constraints, on other assets.

Third, a private owner or lessee may need to renegotiate the airport's agreements with its tenant airlines to retain profits. Often these agreements, which govern how airports charge airlines for using terminals and airfields, restrict how much and in which ways airports can make a

[40]FAA's policy defines aeronautical uses to include services provided by air carriers related directly and substantially to the movement of passengers, baggage, mail, and cargo at an airport.

[41]Privately owned or leased airports are only subject to FAA's rates and charges policy if they must meet grant assurances or have received surplus federal property.

profit. Private owners or lessees of airports would be particularly keen to renegotiate residual agreements because they would not allow the airport to retain any profits. However, air carriers would likely be hesitant to renegotiate their airport agreements if they believed their costs would increase.

Privatized Airports Could Go Bankrupt

Privatized airports could go bankrupt. The outcome from a bankruptcy proceeding would depend on several factors, including whether the insolvent party is the airport's owner, lessee, or a management contractor, and what type of bankruptcy protection, such as protection to reorganize its debts, is sought. It is unclear to what extent an airport's activities might be disrupted by bankruptcy proceedings.

If a private airport owner faces bankruptcy proceedings, the local community or state may have to purchase the airport to ensure it continues to be used as an airport. Executive Order 12803 states that any sale or transfer must contain a mechanism to ensure that the airport continues to operate even if the private owner becomes insolvent. However, the effect of any such mechanism has never been tested in bankruptcy proceedings. As part of a bankruptcy liquidation or reorganization, the airport's assets could be sold to satisfy creditors, without regard to whether those assets would be used for airport purposes. Also, it is uncertain what the courts would decide were the assets of the private airport owner, the airlines, or the local, state, or federal government. For example, air traffic control facilities and equipment might be considered assets of the airport owner for bankruptcy purposes even though they had been funded by FAA.

Certain Bankruptcy Code provisions may, in effect, hinder or prevent a local or state government from cancelling a lease or management contract to protect other creditors, even if the lease or contract contains a default clause. Furthermore, the local or state government's ability to substitute a new operator may be restricted even if the bankrupt operator's performance deteriorates. Moreover, certain Bankruptcy Code provisions authorize the trustee, subject to court approval, to reject certain agreements, which could include a lease or management contract.

Implications of the Sale or Lease of Airports for Various Stakeholders Depend on Several Factors

How the sale or lease of airports would affect local and state governments, airlines, passengers, and the federal government depends on several factors, including how privatization is implemented, how privatized airports might be regulated, and the unique characteristics of each airport, such as its size and future revenue potential. If federal restrictions on the use of airport revenue are changed and local and state governments could retain the proceeds from privatizing airports, then they are more likely to sell or lease them. If airports' costs for capital increase as a result of privatization, the effects on airlines and passengers would depend on whether these increases are passed on to them. The effects of privatization on the federal government will depend on whether the grants and subsidies that are currently extended to public airports are similarly offered to private airports. The Congress recently established a pilot program for airport privatization. Under this program, the public owners of up to five airports could be exempted by the Secretary of Transportation from revenue diversion, grant repayment, and surplus property requirements in leasing commercial airports or selling or leasing general aviation airports.

The Financial Benefits to Local and State Governments Depend on Whether Revenue Diversion and Grant Repayment Requirements Are Changed

Local and state governments could potentially benefit from privatization in two or more ways. First, leasing or selling an airport to a private concern would result in a financial windfall for the public owner if federal restrictions on the use of airport revenue are changed. Second, public owners would accrue a long-term benefit by adding airports to their tax bases. Some public owners have actively sought to privatize their airports specifically to benefit financially from the proceeds of selling or leasing their airports. For example, the Los Angeles and Orange County privatization studies were undertaken, in part, to examine if the proceeds from the sale or lease of an airport could be legally diverted. However, an official of one airport that had sought to privatize told us that if they could legally divert that airport's revenue without selling or leasing it, they would not be as interested in privatizing it.

Estimating how much local or state governments would gain by selling or leasing airports is difficult because the amount largely depends on whether current revenue diversion and grant repayment requirements are changed. Although airports have reported billions of dollars in assets, their market value may be substantially more or less to a prospective buyer. An airport's market value principally depends on the present value of its future earnings, which in turn depends on market forces and the manner

in which it is privatized, especially what constraints are imposed and subsidies are granted by the various levels of government.

While local and state governments could benefit financially from privatization, there is the risk that a private airport operator could go bankrupt. If a private airport owner faces bankruptcy proceedings, the local or state government might have to purchase the airport to ensure that it continues to be used as an airport. Also, bankruptcy proceedings might, in effect, hinder or prevent a public owner from cancelling its lease with a private operator.

The Effects on Airlines Depend on Price Regulation

The effects of the sale or lease of airports on airlines largely depend on whether airlines' airport costs would increase. Currently, airports subject to FAA's policy on rates and charges are required to charge landing fees based on historical costs, thus prohibiting them from charging market-based rates. No such policy applies to airports' other sources of revenue, such as concessions and parking fees. Indeed, the self-sufficiency assurance to obtain a federal grant generally requires an airport to impose market rates. If FAA's current policy on rates and charges is not applied to privatized airports, then airports could raise their landing fees because airports, especially those with large origination and destination traffic, have a strong local demand for air services.[42]

Some economists contend that pricing based on historical costs is inefficient because assets would usually be underpriced and eventually rationing must take place. A few countries are experimenting with various market pricing systems as part of their privatization initiatives. However, it is likely that the federal government would regulate the landing fees privatized airports' charge airlines because of concerns that monopoly pricing would result in fees above the levels that would prevail in a competitive market. Other countries that have privatized airports generally impose some form of price regulation on landing fees. For example, the United Kingdom has capped these fees at historical rates plus an adjustment to account for inflation and increases in productivity. The United Kingdom has also allowed a form of market-based pricing by permitting airports to charge airlines higher landing fees during peak traffic times.

[42]Airport analysts often categorize airports by the nature of their passenger traffic. Airports with a strong local market (a high percentage of origin and destination traffic) are less affected by airline and financial pressures than airports with a high percentage of connecting traffic, where it is easier for an airline to move its operations elsewhere.

Even if FAA's policy on airport rates and charges remains the same and airport landing fees are tied to historical costs, airlines could still face higher costs at a privatized airport. Under current law, a privately owned airport would no longer receive federal apportionment grants or be eligible for tax-exempt financing, which could increase the owner's costs to obtain capital. Accordingly, even if subject to FAA's current policy, a privately owned airport could pass its higher costs—for example, greater interest expenses—on to airlines in the form of higher landing fees and terminal rentals. Such costs, according to data from airlines, were on average about 6 percent of an airline's total costs in 1995.

Economic studies indicate that even relatively small increases in airlines' airport-related costs could have a profound effect on their profitability.[43] Prior to 1995, the airline industry had encountered significant losses and several carriers had gone bankrupt. Substantial increases in airline costs could result in lower profitability and reduced competition.

The Effects on Passengers Depend on Whether Airlines Would Pass on Cost Increases

The effects of the sale or lease of airports on airline passengers depend on the extent to which increases in airlines' costs would be passed on through higher ticket prices or changes in the number of flights. Although small increases in airlines' costs may have a substantial effect on airlines' profitability, airlines may be reluctant to offset this increase by raising ticket prices if they believe that higher prices would reduce passenger traffic. Economic studies have shown that passenger traffic is sensitive to changes in ticket prices and that a 1-percent increase in prices may lead to more than a 1-percent decline in passengers.[44] Also, with higher costs, airlines might cut back or eliminate flights at some airports.

Airline ticket prices could increase if airport privatization reduced airline competition. If privatization lead to higher costs because of a change in FAA's rates and charges policy or reduced subsidies for airports, this increase could also serve to reduce airline competition and increase fares. GAO previously found that reduced competition between airlines in serving various airports had resulted in higher fares.[45]

[43]Report to Congress: Child Restraint Systems, U.S. Department of Transportation, FAA (May 1995), summarizes 25 economic studies on the relation of ticket prices to the demand for air travel.

[44]Report to Congress: Child Restraint Systems.

[45]Airline Competition: Effects of Airline Market Concentration and Barriers to Entry on Airfares (GAO/RCED-91-101, Apr. 26, 1991) and Airline Competition: Higher Fares and Reduced Competition at Concentrated Airports (GAO/RCED-90-102, July 11, 1990).

The Federal Government Would Likely Benefit If Tax-Exempt Status and Apportionment Grants Are Not Extended to Privately Owned Airports

The effect of the sale or lease of airports on the federal government's budget would generally be positive, provided federal laws and FAA's policies remain unchanged. Currently, privately owned airports are not eligible for federal financial assistance in the form of tax-exempt bonds and AIP apportionment grants. In addition, public airports do not pay corporate income taxes. The actual effect on the federal budget, however, would depend on the eventual form and extent of privatization.

A privately owned airport's loss of tax-exempt status would result in additional tax receipts for the federal government. While over $42 billion in airport bonds was issued between 1985 and 1994, we could not identify exactly how much tax-exempt debt is currently outstanding because some of these bonds had been used to refinance existing debt. One credit rating agency estimated that roughly $25 billion in tax-exempt airport bonds is currently outstanding. If all these bonds were taxable and interest costs averaged 8 percent, then an additional $2 billion in annual interest income would be taxed. At a 28-percent tax rate, the tax exemption for interest on airport bonds would cost the federal government $560 million annually in forgone tax receipts.[46] However, the federal government may not be forgoing this entire amount because airports would have likely issued less debt if it were taxable. Also, the amount of additional tax revenue resulting from airport privatization would depend on several factors, including how many airports are sold, the amount of airport bonds issued in the future, and whether existing bonds would continue to be exempt from taxation.

Privately owned airports would not be eligible to receive AIP apportionment grants. In fiscal year 1995, large hub airports received $168 million in AIP apportionment funding, while medium hub airports received $89 million. According to airport management firms and a privatization consultant, large and medium hub airports are generally the most attractive candidates for privatization. Therefore, if a significant number of them were to be sold to private entities, the Congress would have the option of reducing the total AIP funding level by the amount of apportionment funding these airports had received or redirecting these funds for other airport development needs.

[46]An 8-percent interest cost is a conservative estimate of what taxable debt of equivalent risk and maturity would yield. For the period 1985 through 1995, the median interest rate on tax-exempt airport debt was 6.9 percent, the value-weighted median was 7.5 percent. Adding 2 percentage points to the tax-exempt yield offers 8.9 to 9.5 percent. As of August 1996, the average yield on a municipal bond was 5.97 percent verses 7.19 percent for a taxable corporate bond.

The Federal Aviation Reauthorization Act of 1996 Established a Pilot Program for Airport Privatization

The Congress, as part of the Federal Aviation Reauthorization Act of 1996, created an airport privatization pilot program that became effective on October 9, 1996. This legislation acknowledges the current obstacles to privatization and recognizes that the pilot program provides an opportunity to test the potential benefits of privatization to increase funding for airports, improve airport management, improve customer service, and lower costs of operating at airports.

Up to five airports can participate in the pilot program. At least one airport must be a general aviation airport and the other four airports can be commercial airports, although only one of the commercial airports can be a large hub airport. Any general aviation airport in the program may be sold or leased, while the commercial airports can only be leased. A privately leased commercial airport could collect PFCs and receive AIP apportionment grants. A privately owned or leased airport would still be eligible to receive AIP discretionary grants, but the maximum grant amount of a project's total cost would be 40 percent rather than the normal maximum grant amount of 75 to 90 percent.[47]

Under the program, the Secretary of Transportation may exempt the public sponsor and private owner or lessee from revenue diversion restrictions or grant repayment or surplus property requirements. Specifically, an airport owner can retain sale or lease proceeds if 65 percent of the airlines serving that airport approve and would not have to repay federal grants. Also, the Secretary could waive any requirements for the public owner or lessee to return surplus federal property. However, before granting these exemptions, the Secretary must find that approval would not result in unfair or deceptive practices or unfair competition. Also, the Secretary must determine that the sale or lease agreement would meet several conditions, including the following:

- the airport would remain available to public use;
- airport operations would not be interrupted if the operator went bankrupt;
- the private owner or lessee would maintain and improve the facilities;
- airline fees would not increase faster than the rate of inflation, unless a higher amount is approved by 65 percent of the airlines that service the airport;
- general aviation fees would not increase faster than airline fees;
- safety and security would be maintained at the highest levels; and

[47]The pilot program is silent on the issue of access to tax-exempt debt. Although a private owner would not be able to issue tax-exempt debt, the situation is less clear for a privately leased facility. Depending on how the lease is structured it might be possible for the public owner to issue tax-exempt debt to make improvements at the airport.

- noise and environmental effects would be mitigated to the same extent as at a publicly owned airport.

An airport would remain eligible for the pilot program and any associated exemptions to revenue diversion, grant repayment, or surplus property requirements as long as its facilities continue to be used for airport purposes. The Secretary may, however, revoke an exemption upon determining that the owner or lessee knowingly violated any of the conditions set forth in the statute governing the pilot program.

According to FAA and aviation industry officials, it is too early to know which airports might be interested in applying for this pilot program or if any airports could qualify for it and gain the support of their tenant airlines. However, the public owners of two airports—Allegheny County Airport, a general aviation airport in Pennsylvania, and Stewart International Airport, a former military air base in New York—have expressed interest in the program's innovative arrangements.[48] The Department of Transportation and FAA are charged with reporting to the Congress within 2 years after the first application is approved on the pilot program's implementation and are authorized under the program to audit a private owner's or lessee's financial records and operations in order to monitor its compliance with the program's requirements.

[48]H.R. Report 104-848 (1996).

Private Management Contracts and Leases for the Operation of Publicly Owned Airports in the United States

Airport and location	Sponsor	Contractor/lessee	Type of agreement	Compensation	Term
Commercial airports					
Albany County Airport, New York	Albany County Airport Authority	Airport Group International (AGI)	Management contract	Direct and indirect costs, plus a management fee of $331,680 (inflation adjusted)	5-year contract extended to 1998
Atlantic City International Airport, New Jersey	South Jersey Transportation Authority	Johnson Controls World Services, Inc. (JCWS)	Management contract	Expenses, fixed fee, plus a performance incentive payment	5-year contract to expire in 2001
Burbank-Glendale-Pasadena Airport, California	Burbank-Glendale-Pasadena Airport Commission	AGI	Management contract	Expenses, plus a percentage of certain costs	5-year contract to expire in 1998
Indianapolis International Airport, Indiana	Indianapolis Airport Authority	BAA Indianapolis LLC	Management contract	Management fee based on improvement in net airline costs plus a quality bonus	10-year contract to expire in 2005
Rochester International Airport, Minnesota	City of Rochester	Rochester Airport Company	Management contract	Contractor pays certain operating costs and earns a maximum profit or loss of $37,500	5-year contract to expire in 2000 with a 5-year renewal option
Stewart International Airport, New York	New York State Department of Transportation	AGI	Management contract	Total operating expenses, including a management fee	5-year contract through 1993, renewed annually
Westchester County Airport, New York	Westchester County	JCWS	Management contract	Expenses, plus a fixed fee and a capital investment commitment	26-year contract to expire in 2022
General aviation airports					
Addison Airport, Texas	City of Addison	Addison Airport of Texas, Inc.	Lease	3 percent of gross receipts or $75,000, whichever is greater	24-year lease to expire in 2000
Danielson Airport, Connecticut	State of Connecticut	Northeast Air Services	Management contract	Expenses plus a fixed fee	5-year contract to expire in 1997
Fort Worth Alliance Airport, Texas	City of Fort Worth	Alliance Air Services, Inc.	Management contract	Graduated fee based on performance	20-year contract to expire in 2014
Brackett Field, Compton Airport, El Monte Airport, Fox Field, Whiteman Airport, California	Los Angeles County	COMARCO	Management contract	All revenue that exceeds contractor costs, including a $3 million payment to the county	20-year contract to expire in 2011

(continued)

Airport and location	Sponsor	Contractor/lessee	Type of agreement	Compensation	Term
Morristown Municipal Airport, New Jersey	City of Morristown	DM Airport Developers	Lease	All revenue exceeding costs, including a $100,000 annual lease payment to the city	99-year lease
Republic Airport, New York	New York State Department of Transportation	JCWS	Management contract	Expenses plus a fixed fee	5-year contract to expire in 1998
Rickenbacker International Airport, Ohio	Rickenbacker Port Authority	AGI	Management contract	Certain expenses plus an inflation-adjusted management fee	3-year contract to expire in 1998
Teterboro Airport, New Jersey	Port Authority of New York and New Jersey	JCWS	Lease	All revenue exceeding costs, including lease payments to the Port Authority	30-year lease to expire in 1999
Windham Airport, Connecticut	State of Connecticut	Windham Aviation, Inc.	Management contract	Expenses, plus a fixed fee	10-year contract, renewed annually

Examples of Private Sector Participation at Commercial Airports in 50 Foreign Countries

Country	Plans or actions for airport privatization
Albania	Contracted with a private entity to modernize and expand Tirana Airport
Algeria	Plans to contract with a private entity to complete construction of and operate the new international terminal at Houari Boumedienne Airport near Algiers
Argentina	Considering long-term management contracts with private entities to operate 59 airports; the national legislature (Senate) passed a bill allowing for these management contracts
Australia	Implementing 50-year leases with private entities to operate 22 major airports
Austria	Sold shares in Vienna International Airport; 47 percent of total shares are privately held
Bahamas	Transferred ownership of Freeport International Airport to a private entity
Bolivia	Plans a long-term agreement with a private entity to operate three major airports
Brazil	Plans a contract with a private entity to rehabilitate the terminal at Guararapes International Airport in Recife
Bulgaria	Plans (with the municipality of Sofia) a 30-year build, operate, and transfer (BOT) contract[a] with a private entity to modernize Sofia International Airport
Cambodia	Plans a 20-year BOT contract with a private entity for projects at Pochentong Airport in Phnom Penh; plans a 15-year BOT contract with a private entity for projects at Sihanoukville Airport on Naga Island
Cameroon	Plans a long-term lease with a private entity to build and operate a terminal at the airport in Yaoundé
Canada	Implemented a long-term lease with a private entity to build and operate Terminal 3 at Pearson International Airport in Toronto; a regional government implemented a 40-year contract with a private entity to operate and manage Hamilton-Wentworth Airport in Ontario
Chile	Implemented a contract with a private entity to operate the passenger terminal and plans a 15-year BOT contract with a private entity for a second terminal at Arturo Merino Benitez International Airport in Santiago
China	Implementing a joint agreement with a private entity to build and operate a new airport in Haikou; plans to contract with private entities to develop and operate 8 airports, including Beijing International Airport
Colombia	Awarded a contract to a private entity to build a runway at and plans a contract with a private entity to operate the Eldorado International Airport in Bogotá; awarded long-term leases to private entities to operate two airports in Cartagena and Barranquilla; plans long-term leases with private entities to operate two airports in Medellín and one airport in Cali
Costa Rica	Plans a BOT contract with a private entity for a new airport in San José
Denmark	Sold shares in Copenhagen International Airport
Dominican Republic	Transferred ownership of Punta Cana International Airport to a private entity
Ecuador	Plans to contract with private entities to operate two airports in Quito and Guayaquil and plans BOT contracts with the same private entities for two new airports in these cities
Egypt	Plans a BOT contract with a private entity for a new airport near Cairo
Germany	Considering contracts with private entities to develop and lease airports, including a major airport in Berlin
Greece	Implementing a 30-year BOT contract with a private entity for a new airport near Athens
Hong Kong	Implementing a joint development agreement with a private entity for the new Chek Lap Kok Airport on Lantau Island
Hungary	Implementing a joint development agreement with a private entity for a new international terminal at Ferihegy Airport in Budapest
India	Considering contracting with a private entity to construct and operate a new airport in Bangalore
Indonesia	Plans a joint development agreement with a private entity for a new airport in Medan

(continued)

Country	Plans or actions for airport privatization
Italy	Plans to contract with a private entity to manage the airport in Naples; national government-owned airlines are divesting their shares in Rome and Milan Airports
Jamaica	Plans a long-term contract with a private entity to operate Sangster International Airport in Montego Bay and Norman Manley International Airport in Kingston
Japan	Plans (with Chubu regional governments) a contract with a private entity to develop one runway and terminals for the new Chubu International Airport; implemented (with Osaka regional governments) a contract with a private entity to build the new Kansai International Airport
Macau	Implemented a joint development agreement with a private entity to develop and manage a new international airport
Malaysia	Implemented a BOT contract with a private entity for a new terminal and a lease-develop-operate contract with a private entity for nonaeronautical portions of a new international airport in Sepang
Mexico	Considering leasing 58 airports to private entities; national legislature passed a bill to allow these leases
Myanmar	Plans a BOT contract with a private entity for the new Hanathawaddy Airport near Rangoon
New Zealand	Plans to sell three major airports to private entities
Pakistan	Plans to contract with a private entity to build and operate a new terminal at Lahore International Airport
Panama	Plans a 10-year contract with a private entity to expand and maintain passenger and cargo facilities at Tocumen International Airport near Panama City
Peru	Implemented a lease with a private entity to build and operate a terminal and runway at Jorge Chavez International Airport in Lima
Philippines	Plans a long-term agreement with a private entity to build a new terminal at Ninoy Aquino International Airport in Manila; plans a 25-year contract with a private entity to convert the former Clark Air Base into an international airport
Qatar	Plans a BOT contract with a private entity for a new international airport in Doha
Russia	Plans a contract with a private entity to manage nonaeronautical activities at the airport in Moscow; plans a 25-year contract with a private entity to upgrade a runway and modernize the terminal at Kazan International Airport; plans contracts with private entities to expand Khabarovsk Airport and modernize Tolmachevo Airport
Singapore	Implemented private sector participation in the development of Changi International Airport
Slovakia	Plans to sell Bratislava Airport to a private entity
Switzerland	Sold shares in Zurich International Airport; 50 percent of the shares are privately held; a private firm operates the airport
Thailand	Plans to contract with a private entity to build a second international airport in Bangkok
Trinidad and Tobago	Implementing a BOT contract with a private entity for a new terminal at Piarco International Airport
Turkey	Plans a BOT contract with a private entity for a new terminal at Ataturk International Airport near Istanbul; plans a joint development agreement with a private entity for a new international airport near Sanliurfa
United Kingdom	Sold shares in seven airports (BAA); local government sold Belfast International Airport to a private company formed by the airport employees; regional government plans to sell shares in Birmingham International Airport and sold East Midlands International Airport to a private entity
Uruguay	Plans a 20-year contract with a private entity to expand the terminal, build a new runway, and make other improvements at Laguna del Sauce International Airport near Maldonado
Venezuela	Plans a long-term contract with a private entity to build, operate, and manage a new airport between Bolívar City and Guayana City in eastern Venezuela

(continued)

Country	Plans or actions for airport privatization
Vietnam	Plans a BOT contract with a private entity for a new international passenger terminal at Tan Son Nhat International Airport in Ho Chi Minh City

[a]Under a BOT contract, a private entity finances, builds or modernizes, and operates a facility and obtains revenue from its operation. After a certain period, ownership of the facility transfers to the government.

Sources: World Bank and Public Works Financing.

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