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Smaller Airports Face Future Funding Shortfalls

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Mr. Chairman and Members of the Subcommittee:

We are here today to discuss airport funding issues, especially as they apply to smaller airports. For our discussion, small airports include all but the 71 largest airports in the national airport system and range in size from small hub airports like Wichita , Kansas', Mid-Continent Airport to small general aviation airports with only a few aircraft based at them.[1] Today's testimony focuses on three questions important to smaller airports: (1) how much funding has been made available to airports, particularly smaller airports, for their capital development and what are the sources of these funds? (2) if current funding levels continue, how do they compare with the levels small airports plan for future development? and (3) what effect will various proposals to increase or make better use of existing funding have on smaller airports' ability to fulfill their capital development plans?

In summary:

- In 1998, we reported that the 3,304 airports that make up the federally supported national airport system obtained about $7 billion from federal and private sources for capital development.[2] The nation's 3,233 smaller airports accounted for 22 percent of this total, or about $1.5 billion. As a group, smaller airports depend heavily on federal grants, receiving half of their funding from the federally funded Airport Improvement Program and the rest from airport bonds, state grants, and passenger facility charges.[3] By contrast, the 71 largest airports in the national airport system obtained $5.5 billion in funding, mostly from tax-exempt bonds and relied on the Airport Improvement Program for only 10 percent of their funding.
- Small airports planned to spend nearly $3 billion per year for capital development during 1997 through 2001, or $1.4 billion per year more than they were able to fund in 1996. Smaller airports' planned development consists of projects eligible for Airport Improvement Program grants, like

[1]Airports are classified according to the number of passenger boardings, or enplanements, they accommodate in a year. An airport is considered small if it enplaned 1,603,909 or rewer passengers in 1997 (fewer than .25 percent of total scheduled passenger enplanements) and include small hubs, nonbubs, other commerical service, and general aviation airports. Large airports are defined under statute (49 U.S.C. sections 47109(a) and 47114(f)) as having more than .25 percent of total scheduled passenger enplanements and include large and medium hub airports.

[2]Airport Financing: Funding Sources for Airport Development (GAO/RCED-98-71, Mar. 12, 1998). This report was based on airport funding in 1996, the most recent year for which we have conducted an analysis.

[3]Passenger facility charges are fees paid by passengers to an airport. Airports may currently impose a fee of $1, $2, or $3 per flight segment, up to a maximum of four segments per round trip to finance eligible airport-related projects, subject to the Federal Aviation Administration's approval.

runways, and projects not eligible for grants, like terminal retail space. At least $945 million and as much as $1.4 billion of smaller airports' planned development that is eligible for grants may not be funded on an annual basis. The difference between funding and planned development is much greater for smaller commercial and general aviation airports than it is for large airports.

- Several initiatives to increase or make better use of existing funding have emerged in recent years, including increasing the amount of Airport Improvement Program funding and raising the maximum amount airports can levy in passenger facility charges. Under current formulas, increasing the amount of Airport Improvement Program funding would help smaller airports more than larger airports, while raising passenger facility charges would mainly help larger airports. Other initiatives for making better use of federal grant monies, such as Airport Improvement Program block grants to states, have primarily been directed toward smaller airports, but none appears to offer a major breakthrough in reducing the shortfall between funding and the levels airports plan to spend on development. Several initiatives to increase or make better use of existing funding have emerged in recent years, including increasing the amount of funding for the Airport Improvement Program and raising the maximum amount airports can levy in passenger facility charges. Under current formulas, increasing the amount of program funding would help smaller airports more than larger airports, while raising passenger facility charges would mainly help larger airports. Other initiatives for making better use of federal grant monies, such as Airport Improvement Program block grants to the states, have primarily been directed toward smaller aiports, but none appears to offer a major breakthrough in reducing the shortfall between funding and the levels airports plan to spend on development.

Background

Airports are a linchpin in the nation's air transportation system. This is true for both the 71 largest airports, as well as for the nation's 3,233 smaller commercial and general aviation airports. While small airports handle only about 10 percent of scheduled passenger traffic in total , they also serve a majority of the nation's general aviation activity. For many communities, a small airport is their primary access to air transportation. Smaller airports also provide important economic benefits to their communities in the form of jobs and transport. The National Civil Aviation Review Commission—established by the Congress to determine how to fund U.S. civil aviation—reported in December 1997 that more funding is needed, not only to develop system capacity at the larger airports but also to preserve smaller airports.

Funding Sources Vary Depending on Airports' Size

In 1996, tax-exempt bonds, the Airport Improvement Program (AIP), and passenger facility charges (PFC) together provided about $6.6 billion of the total $7 billion in funding for large and small airports. State grants and airport revenue contributed the remaining funding for airports. Table 1 lists these sources of funding and their amounts in 1996.

Table 1: Sources of Funding for Large and Small Airports

Dollars in billions

Funding source	1996 amount	Percentage of total	Source of funds
Tax-exempt bonds	$3,690[a]	53	State and local governments or airport authorities issue tax-exampt bonds.
Airport Improvement Program (AIP)	$1,372	20	The Congress makes funds available from the Airportand Airway Trust Fund, which receives revenues from taxes on domestic and international travel, domestic cargo transported by air, and noncommercial aviation fuel.
Passenger facility charges	$1,114	16	Funds come from passenger fees of $1, $2, or $3 per trip segment at commercial airports, up to a maximum of four trip segments per round trip.
Special facility bonds	$.414	6	Issued on the behalf of beneficiaries other than airports, such as airlines.
State contributions	$.285[b]	4	Funds come from such sources as state aviation fuel and airline property taxes, aircraft registration fees, state bonds, and state general fund appropriations. The extent to which these sources are used varies by state.
Airport revenue	$.153[c]	2	Funds are generated from (1) revenues derived from the operation and landing of aircraft, passengers, or freight and (2) revienues derived from concessions and leases.
Total	**$7,028**	**100[d]**	

[a]Net of refinancing.

[b]State grants only. Amounts for local capital subsidies are unknown but, we believe, are minimal.

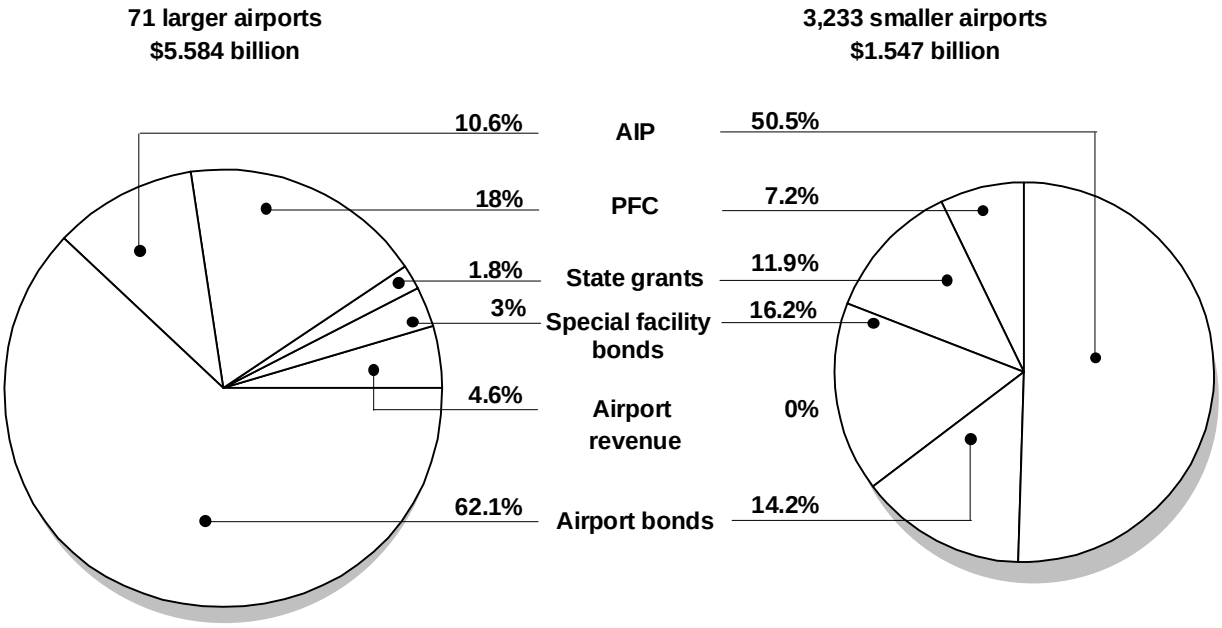
[c]Net operating revenue in excess of a minimum coverage ratio of 125 percent of debt service (principal and interest payments).

[d]May not total to 100 percent due to rounding.

The amount and type of funding varies significantly with airports' size. The nation's 3,233 smaller national system airports obtained about $1.5 billion

in funding in 1996, about 22 percent of the total for 1996. As shown in figure 1, smaller airports relied on AIP grants for half of their funding, followed by tax-exempt airport and special facility bonds,[4] and state grants. PFCs accounted for only 7 percent of smaller airports' funding mix. Conversely, larger airports received more than $5.5 billion in funding, relying on airport bonds for 62 percent of their total funding, followed by PFC collections. AIP grants accounted for only 10 percent of larger airports' funding.

Figure 1: Distribution of 1996 Funding Sources for Large and Small Airports



[4]The entire amount of special facility bond financing is attributable to a single general aviation airport, Forth Worth Alliance Airport, which issued $250 million in special facility bonds in 1996.

Funding Levels Fall Short of Small Airports' Plans for Development

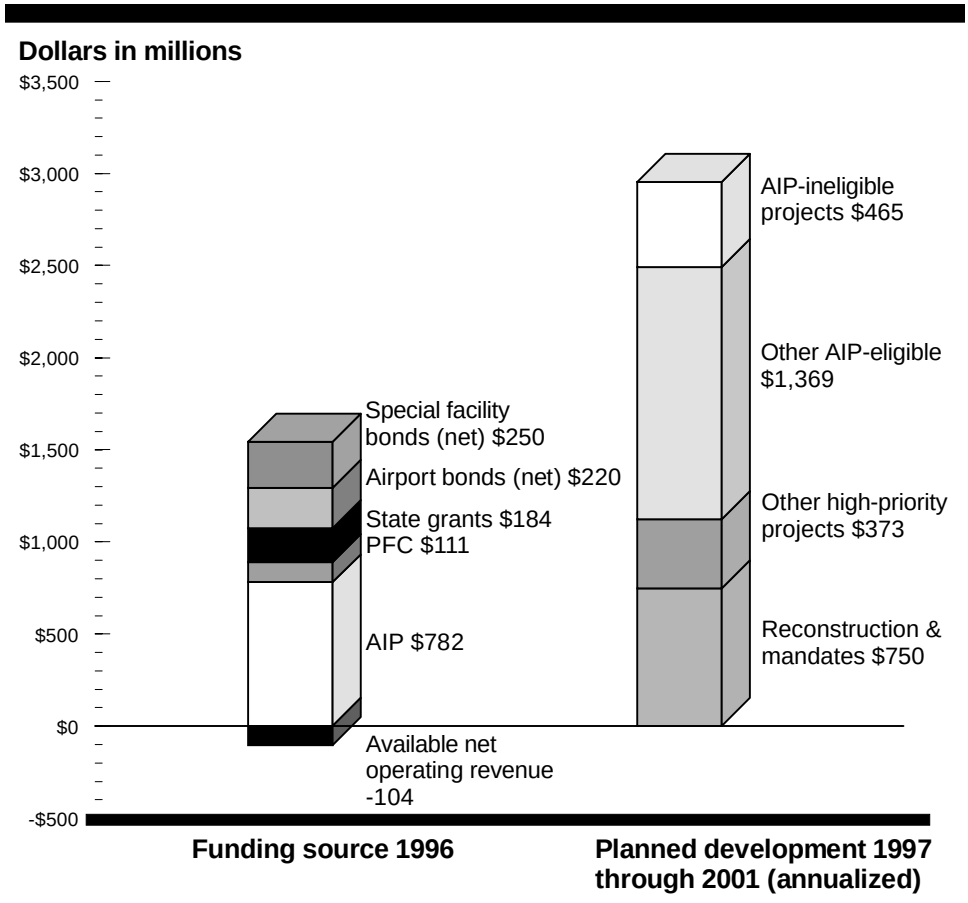
Small airports' planned capital development during 1997 through 2001 may cost nearly $3 billion per year, or $1.4 billion per year more than these airports raised in 1996.[5] Figure 2 compares small airports' total funding for capital development in 1996 with their annual planned spending for development. Funding for 1996, the bar on the left, is shown by source (AIP, PFCs, state grants, and bonds). Planned spending for small airports, the bar on the right, is shown by the relative priority FAA has assigned to the projects, as follows:

- Reconstruction and mandated projects, FAA's highest priorities, total $750 million per year and are for projects to maintain existing infrastructure (reconstruction) or to meet federal mandates, including safety, security, and environmental requirements (including noise mitigation requirements).[6]
- Other high-priority projects, primarily adding capacity, account for another $373 million per year.
- Other AIP-eligible projects, a lower priority for FAA, such as bringing airports up to FAA's design standards, add another $1.37 billion per year, for a total of nearly $2.5 billion per year in projects eligible for AIP funding.
- Finally, small airports anticipate another $465 million per year on projects that are not eligible for AIP funding, such as expanding commercial space in terminals and constructing parking garages.

[5]Estimates of planned development costs are contained in our report entitled Airport Development Needs: Estimating Future Costs (GAO/RCED-97=99, Apr. 7, 1997). As that report noted, estimating future devleopment is fraught with complications. Unanticipated needs and political and financial feasibility affect actual airport development, and the estimates themselves are subject to problems with data accuracy.

[6]These estimates of planned development costs generally do not include the costs of maintaining the nation's airport runways in good condition beyond the next few years. We recently reported that the cost of maintaining just one-third of these runways could reach $1.38 billion over 10 years. See Airfield Pavement: Keeping Nation's Runways in Good Condition Could Require Substantially Higher Spending (GAO/RCED-98-226, July 31, 1998).

Figure 2: 1996 Funding Compared With Annual Planned Development Costs for Smaller Airports



Given this picture of funding and planned spending for development for small airports, it is difficult to develop a precise estimate of the extent to which AIP-eligible projects are deferred or canceled because some form of funding cannot be found for them. FAA does not maintain information on whether eligible projects that do not receive AIP funding are funded from other sources, deferred, or canceled. We were not successful in developing an estimate from other information sources, mainly because comprehensive data are not kept on the uses to which airport and special facility bonds are put. But even if the entire bond financing available to smaller airports were spent on AIP-eligible projects, these airports would have, at a minimum, about $945 million a year in AIP-eligible projects that are not funded. Conversely, if none of the financing from bonds were

applied to AIP-eligible projects, then the full $1.41 billion funding shortfall for smaller airports would apply to these projects.

As a proportion of total funding, the potential funding shortfall for smaller airports is more significant than it is for large airports. For large airports, the difference between 1996 funding and planned development is about $1.5 billion. However, because large airports obtained $5.5 billion in funding in 1996 versus $1.5 billion for small airports, large airports' potential shortfall represents 21 percent of their planned development costs as compared to small airports' potential shortfall of 48 percent. Therefore, while larger and smaller airports' respective shortfalls are similar in size, the greater scale of larger airports' planned development causes their shortfall to differ considerably in proportion.

Effect on Smaller Airports of Proposals to Increase and Better Use Airport Funding Varies

Proposals to increase airport funding or make better use of existing funding vary in the extent to which they would help smaller airports and close the gap between their funding and the costs of planned development. For example, increasing AIP funding would help smaller airports more than larger airports because current funding formulas would channel an increasing proportion of AIP funds to them. Conversely, any increase in PFC funding would help larger airports almost exclusively because they handle more passengers and are more likely to have a PFC in place. Changes to the current design of AIP or PFCs could, however, lessen the concentration of benefits on one group of airports. FAA has also used other mechanisms to better use and extend existing funding sources, such as state block grants and pilot projects to test innovative financing. So far, these mechanisms have had mixed success.

Increasing AIP Would Help Smaller Airports Most

Under the existing distribution formula, increasing total AIP funding would proportionately help smaller airports more than large and medium hub airports. Appropriated AIP funding for fiscal year 1998 was $1.7 billion; smaller airports received about 60 percent of this total.[7] We calculated how much funding each group would receive under the existing formula, at funding levels of $2 billion and $2.347 billion. We chose these funding levels because the National Civil Aviation Review Commission and the Air Transport Association (ATA), the commercial airline trade association,

[7]Fiscal year 1999 AIP funding is $1.95 billion, although AIP is authorized only through Mar. 31, 1999, and therefore, not more than $975 million may be obligated until AIP is further extended. (Title I, section 101(g) of the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 (P.L. 105-277, Oct. 21, 1998)). The President's fiscal year 2000 budget has proposed AIP funding of $1.6 billion.

have recommended that future AIP funding levels be stabilized at a minimum of $2 billion annually, while two airport trade groups—the American Association of Airport Executives and the Airports Council International-North America—have recommended a higher funding level, such as AIP's authorized funding level of $2.347 billion for fiscal year 1998. Table 2 shows the results. As indicated, smaller airports' share of AIP would increase under higher funding levels if the current distribution formula were used to apportion the additional funds.

Table 2: Estimated Distribution of AIP Funds at Different Funding Levels

	Large and medium hub airports[a]		Small, nonhub, other commerical service, and general aviation[a]	
AIP funding level	Amount[b]	Percentage of total	Amount[b]	Percentage of total
$1,700.0	$628.9	39.4	$965.8	60.6
$2,000.0	$718.1	37.9	$1,176.7	62.1
$2,347.0	$821.2	36.6	$1,420.6	63.4

[a]Dollar amounts are based on the number of passengers boarding commercial flights in 1996 and exclude about $105.2 million in estimated carryover amounts.

[b]The distribution of funds is based on the proportional distribution of those funds during fiscal year 1997, the first year under the revised distribution formula established in the 1996 reauthorization.

Increasing PFC-Based Funding Would Aid Larger Airports

Increasing PFC-based funding, as proposed by the Department of Transportation and backed by airport groups, would mainly help larger airports, for several reasons.[8] First, large and medium hub airports, which accounted for nearly 90 percent of all passengers in 1996, have the greatest opportunity to levy PFCs. Second, such airports are more likely than smaller airports to have an approved PFC in place.[9] Finally, large and medium hub airports would forgo little AIP funding if the PFC ceiling were raised or eliminated. Most of these airports already return the maximum

[8]The President's fiscal year 2000 budget has proposed that the current ceiling on PFCs be raised from $3 to $5.

[9]As of Oct. 1, 1998, 273 commercial service airports—about 52 percent of eligible airports—imposed a PFC, but 80 percent of all large and medium hub airports had a PFC.

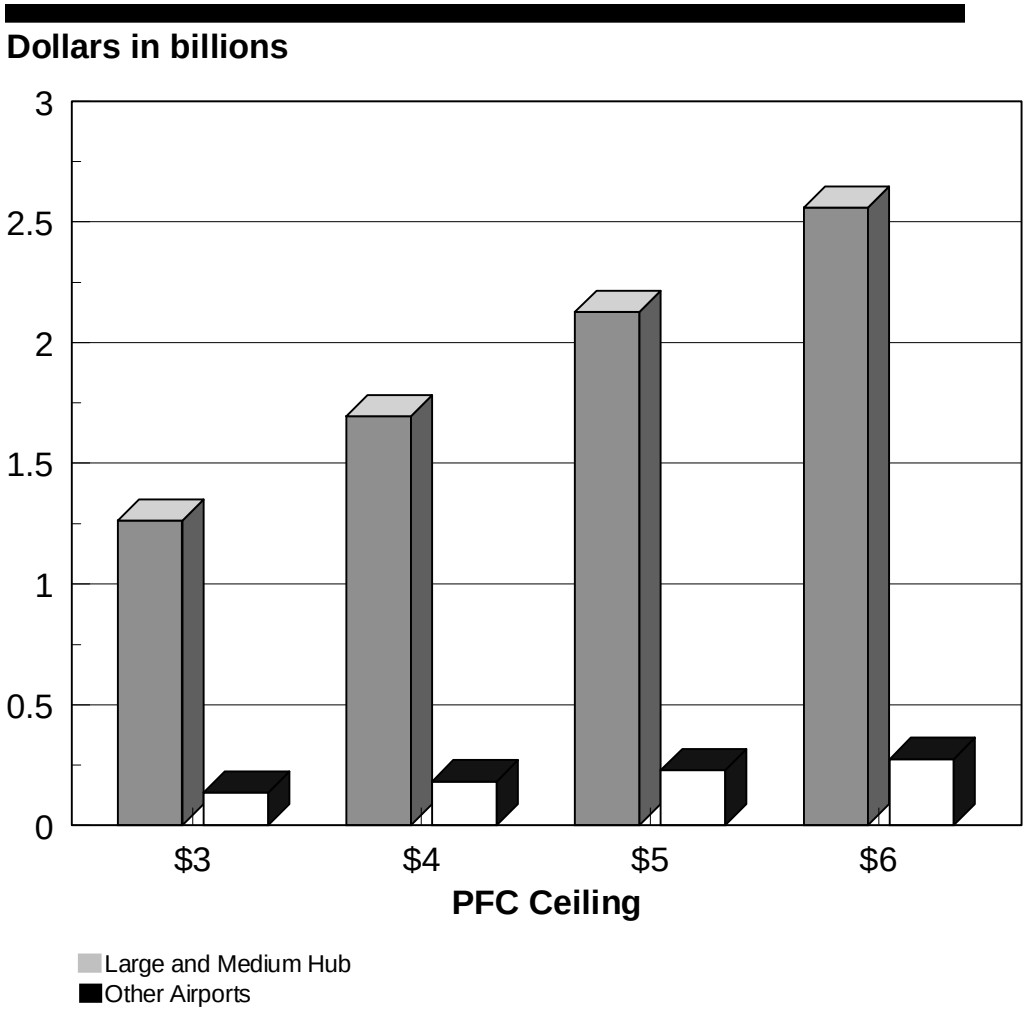
amount that must be turned back for redistribution to smaller airports in exchange for the opportunity to levy PFCs.[10]

If the airports currently charging PFCs were permitted to increase them beyond the current $3 ceiling, total collections would increase from the $1.35 billion that FAA estimates was collected during 1998. Most of the additional collections would go to larger airports. For every $1 increase in the PFC ceiling, we estimate that large and medium hub airports would collect an additional $432 million, while smaller airports would collect an additional $46 million (see fig. 2). In total, a $4 PFC ceiling would yield $1.9 billion, a $5 PFC would yield $2.4 billion, and a $6 PFC would yield $2.8 billion in total estimated collections.[11]

[10]49 U.S.C. section 47114(f) requires that the yearly grants to large and medium hub airports be reduced by 50 percent of their annual collections or 50 percent of their annual apportionment, whichever is less. The foregone grants are redistributed as discretionary grants, primarily to smaller airports. Through fiscal year 1998, $921 million in AIP funding had been redistributed under this provision, $806 million of it to smaller airports.

[11]Estimates are based on FPCs in place as of Oct. 1, 1998, 1997 passenger boardings, and median collection rates for each airport category in 1997. We are currently studying the effects of a PFC increase and plan to report our results later this year.

Figure 3: Projected PFC Collections Under $3, $4, $5, and $6 PFC Ceilings, January 1999



FAA's Efforts to Make Better Use of Existing AIP Grants Have Had Mixed Results

In recent years, the Congress has directed FAA to undertake steps to find ways to extend existing AIP funds, especially for small airports that rely more extensively on AIP funds than do large airports. The airport community's interest in these efforts has varied. For example, the state block grant program, which allows the participating states to direct grants to smaller airports, has been proven successful. Others efforts, such as pilot projects to test innovative financing and privatization, have received less interest from airports and are still being tested. Finally, one idea, using AIP grants to capitalize state revolving loan funds, has not been

attempted but could help smaller airports. Implementing this idea would require legislative changes.

State Block Grant Program Has Helped Smaller Airports

In 1996, we testified before this Subcommittee that FAA's pilot program for state block grants was a success.[12] The program allows FAA to award AIP funds in the form of block grants to designated states, which, in turn, select and fund AIP projects at small airports. In 1996, the program was expanded from seven to nine states and made permanent. Both FAA and the participating states believe that they are benefiting from the program.

Benefits of Innovative Financing Are Being Tested

In recent years, FAA, with congressional urging and direction, has sought to expand airports' available capital funding through more innovative methods, including the more flexible application of AIP funding and efforts to attract more private capital. The 1996 Federal Aviation Reauthorization Act gave FAA the authority to test three new uses for AIP funding—(1) projects with greater percentages of local matching funds, (2) interest costs on debt, and (3) bond insurance. These three innovative uses could be tested on up to a total of 10 projects.[13] Another innovative financing mechanism that we have recommended—using AIP funding to help capitalize state airport revolving funds—while not currently permitted, may hold some promise.[14]

FAA is testing 10 innovative uses of AIP funding totaling $24.16 million, all at smaller airports. Five projects tested the benefits of the first innovative use of AIP funding—allowing local contributions in excess of the standard matching amount, which for most airports and projects is otherwise fixed at 10 percent of the AIP grant.[15] FAA and state aviation representatives generally support the concept of flexible matching because it allows projects to begin that otherwise might be postponed for lack of sufficient FAA funding; in addition, flexible funding may ultimately increase funding to airports. The remaining five projects test the other two mechanisms for innovative financing. Applicants have generally shown less interest in these other options, which, according to FAA officials, warrant further study.

[12]Airport Improvement Program: State Block Grant Pilot Program Is a Success (GAO/RCED-96-86, Mar. 14, 1996).

[13]Section 148 of the Federal Aviation Reauthorization Act of 1996 (P.L. 104-264).

[14]Airport Financing: Funding Sources for Airport Development (GAO/RCED-98-71, Mar. 12, 1998).

[15]There are three exceptions to the 10-percent local matching requirement, each of which entails a higher local contribution: terminal development (25 percent), airport planning and development for large and medium hub airports (25 percent), and noise compatibility programs for large and medium hub airports (20 percent).

State Revolving Loan Funds Could Extend the Use of AIP Grants for Smaller Airports

Some federal transportation, state aviation, and airport bond rating and underwriting officials believe using AIP funding to capitalize state revolving loan funds would help smaller airports obtain additional financing. Currently, FAA cannot use AIP funds for this purpose because AIP construction grants can go only to designated airports and projects. However, state revolving loan funds have been successfully employed to finance other types of infrastructure projects, such as wastewater projects and, more recently, drinking water and surface transportation projects.[16] While loan funds can be structured in various ways, they use federal and state moneys to capitalize the funds from which loans are then made. Interest and principal payments are recycled to provide additional loans. Once established, a loan fund can be expanded through the issuance of bonds that use the fund's capital and loan portfolio as collateral. These revolving funds would not create any contingent liability for the U.S. government because they would be under state control.

Interest in Airport Privatization Pilot Program Is Limited

Declining airport grants and broader government privatization efforts spurred interest in airport privatization as another innovative means of bringing more capital to airport development, but thus far efforts have shown only limited results. As we previously reported, the sale or lease of airports in the United States faces many hurdles, including legal and economic constraints.[17] As a way to test privatization's potential, the Congress directed FAA to establish a limited pilot program under which some of these constraints would be eased.[18] Starting on December 1, 1997, FAA began accepting applications from airports to participate in the pilot program on a first-come, first-served basis for up to five airports, at least one of which must be a general aviation airport. Thus far, two airports—one general aviation and one nonhub commercial service airport—have applied to be part of the program.[19]

[16]Florida has an established revolving loan program. Between 1985 and 1998, the state has provided $75 million in loans to airports for land acquisition and capital projects. While some of the loans are later reimbursed through AIP funding for eligible projects, the state funds the loan program itself. In addition, the Virginia legislature is considering establishing a state airport revolving fund. In total, 39 states have established state infrastructure banks using federal and state grant money fo fund surface transportation projects. This same arrangement could be used if authorized by the state to fund aviation projects, and at least one state—Ohio—has already authorized its state infrastructure bank to fund aviation projects with state funds.

[17]Airport Privatization: Issues Related to the Sale or Lease of U.S. Commercial Airports (GAO/RCED-97-3, Nov. 7, 1996).

[18]Section 149 of the Federal Aviation Reauthorization Act of 1996 (P.L. 104-264).

[19]These airports are Brown Field near San Diego, a general aviation airport, and Stewart International in New York, a nonhub airport, which has submitted its final application to participate in the pilot.

Mr. Chairman, this concludes my prepared statement. I would be happy to respond to any questions that you or Members of the Subcommittee may have.

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