

1998

Financing Airport Capital Development: The Aviation Industry's Greatest Challenge

Christopher R. Rowley

Recommended Citation

Christopher R. Rowley, *Financing Airport Capital Development: The Aviation Industry's Greatest Challenge*, 63 J. AIR L. & COM. 605 (1998)
<https://scholar.smu.edu/jalc/vol63/iss3/5>

This Comment is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in Journal of Air Law and Commerce by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

FINANCING AIRPORT CAPITAL DEVELOPMENT: THE AVIATION INDUSTRY'S GREATEST CHALLENGE

CHRISTOPHER R. ROWLEY

TABLE OF CONTENTS

I. SYSTEM IN CRISIS: THE CURRENT SYSTEM FOR FINANCING AIRPORT CAPITAL DEVELOPMENT.....	606
A. THE CAPACITY CRISIS AND THE NEED FOR AIRPORT CAPITAL DEVELOPMENT	606
B. SUMMARY OF CURRENT AIRPORT CAPITAL DEVELOPMENT DEBATE.....	607
C. ASSESSING THE PROBLEM: THE FAA REAUTHORIZATION ACT OF 1996 AND THE NATIONAL CIVIL AVIATION REVIEW COMMISSION.	608
D. THE DISPUTED COST OF SUFFICIENT AIRPORT CAPITAL DEVELOPMENT	610
E. RECENT REDUCTIONS IN FEDERAL FUNDING OF AIRPORT CAPITAL DEVELOPMENT	613
F. TRADITIONAL SOURCES OF FINANCING: LESS THAN THE NEEDED EXPENDITURES?	614
1. <i>Airport Revenue</i>	615
2. <i>Airport Bonds</i>	616
3. <i>Airport Improvement Program Grants</i>	616
4. <i>Passenger Facility Charges</i>	618
5. <i>State and Local Grants</i>	619
II. SEEKING A SOLUTION: OPTIONS FOR OVERHAULING THE CURRENT FINANCING SYSTEM.....	619
A. FINANCING OPTIONS AVAILABLE TO THE NCARC	619
1. <i>FAA Study of Innovative Financing Options</i> ...	620
2. <i>PFC-Backed Bonds</i>	621
3. <i>Authorizing Airports to Collect More Income from PFCs</i>	623
4. <i>Airport Privatization</i>	624

a.	Introduction to the Privatization Debate	624
b.	Legal Obstacles to the Sale or Lease of Airports	626
c.	Will Privatization Work?	627
d.	1996 Reauthorization Act Privatization Pilot Program	628
III.	RECOMMENDATIONS OF THE NATIONAL CIVIL AVIATION REVIEW COMMISSION	629
A.	NCARC FINAL REPORT AND RECOMMENDATIONS	629
B.	CONCLUSION	631

I. SYSTEM IN CRISIS: THE CURRENT SYSTEM FOR FINANCING AIRPORT CAPITAL DEVELOPMENT

A. THE CAPACITY CRISIS AND THE NEED FOR AIRPORT CAPITAL DEVELOPMENT

AMID CONTINUED PROJECTIONS of strong growth in the volume of airline passenger traffic in the United States,¹ there is serious concern in the aviation industry about the strain this growth will place on the capacity of the nation's airport system.² In 1995, according to the Federal Aviation Administration (FAA), twenty-five airports in the United States suffered more than 20,000 hours of annual flight delays due to insufficient airport capacity, costing each of these airports at least \$32 million in annual delay costs.³ Without improvements in airport system capacity, the FAA expects that the number of airports exceeding

¹ The Federal Aviation Administration expects aviation activity in the United States to continue to grow through the next decade. See FEDERAL AVIATION ADMINISTRATION, 1996 AVIATION CAPACITY ENHANCEMENT PLAN REP. NO. DOT/FAA/ASC-96-1, 15 (1996) [hereinafter 1996 CAPACITY PLAN]. Passenger enplanements (boardings by passengers) increased 22% between 1991 and 1995, from 491.5 million to 598 million. See *id.* The FAA projects enplanements will increase to 953.6 million by 2007, a 59% increase over 1995. See *id.* For further information on projected aviation demand through the twenty-first century, see FEDERAL AVIATION ADMINISTRATION, AVIATION FORECASTS, FISCAL YEARS 1995-2006, FAA-APO-95-1 (1995); FEDERAL AVIATION ADMINISTRATION, NATIONAL PLAN OF INTEGRATED AIRPORT SYSTEMS (NPIAS), 1993-1997, 13-14 (1995); and NATIONAL RESEARCH COUNCIL, TRANSPORTATION RESEARCH BOARD, FUTURE DEVELOPMENT OF THE U.S. AIRPORT NETWORK 11-14 (1988).

² See 1996 CAPACITY PLAN, *supra* note 1, at 23.

³ See *id.*

20,000 hours of flight delay will grow to twenty-nine by the year 2005.⁴

Development of the nation's airport infrastructure is essential if the United States is to meet this forthcoming capacity demand.⁵ Managing this demand will require a variety of infrastructure projects, including the construction of new runways and taxiways, the extension of existing runways, and the development of new airports.⁶ With budget restraint overtaking the federal government, however, simply identifying airport development projects is not the problem. As the FAA warned in its 1995 Aviation Capacity Enhancement Plan, airport capital development projects will meet the future capacity demand only if "they continue to be *funded and built*" and are "completed on time."⁷

B. SUMMARY OF CURRENT AIRPORT CAPITAL DEVELOPMENT DEBATE

Just as the strain on the airport system's capacity has reached a critical level, the system for financing the airport capital development necessary to relieve that strain is crumbling.

Since 1992, Congress has cut by nearly \$500 million per year the Federal funding of airport capital development on which airports have come to rely. At the same time, airports estimate that they will require \$10 billion per year through the year 2002 for necessary airport capital development. Airports appear to have access, on average, to only slightly more than \$6 billion per year for that purpose.

Airlines, on the other hand, which ultimately pay for a large portion of airport capital development via excise taxes, passenger charges, and various rates and charges for the use of airport facilities, dispute the airports \$10 billion figure. The airlines estimate that airports will require only \$4 billion per year for airport capital development during a comparable time period.

⁴ See *id.*

⁵ The FAA identifies airport capital development as one of the primary actions that will increase airport system capacity and decrease flight delays. See *generally id.* at ch.2. Other actions that will increase airport system capacity include implementing new air traffic control procedures, restructuring the use of airspace (airspace development), and implementing new technologies. See *generally id.* at chs. 3, 4, and 5.

⁶ See *id.* at 29-30.

⁷ FEDERAL AVIATION ADMINISTRATION, 1995 AVIATION CAPACITY ENHANCEMENT PLAN, Rep. No. DOT-FAA-ASC-95-01, ch. 2-1 (1995) (emphasis added).

The FAA, the General Accounting Office (GAO), and an independent auditor have also estimated future airport capital development requirements. The FAA estimates capital development requirements at \$6.5 billion. Coopers & Lybrand, an independent accounting firm, estimates the future requirements at between \$7 and \$8 billion. The GAO, developing econometric models based on varying assumptions, estimates airport capital development requirements at a range between \$1.4 billion and \$10.1 billion per year.

The result is a rancorous policy debate about how the United States should finance airport capital development. Policymakers are considering a wide array of financing options, including granting airports authority to increase charges to passengers traveling through airports, the privatization of existing public airports, and various other innovative financing techniques.

Discussions of airport capital development finance are now part of a larger debate reassessing the entire financing system for the FAA in light of serious problems in the agency's efficiency. In October 1996, beginning serious efforts to solve the funding problem, Congress formed the National Civil Aviation Review Commission to study and propose comprehensive legislation to overhaul the FAA, including the system for financing airport capital development.

C. ASSESSING THE PROBLEM: THE FAA REAUTHORIZATION ACT OF 1996 AND THE NATIONAL CIVIL AVIATION REVIEW COMMISSION

In 1996, confronted with the myriad of problems facing the FAA, Congress passed the Federal Aviation Reauthorization Act of 1996 ("1996 Reauthorization Act" or the "Act").⁸ The Act provides for a comprehensive review of the troubled FAA. The two most significant provisions of the Act require the FAA to contract with an independent entity "to conduct a complete independent assessment of the financial requirements of the Administration through the year 2002,"⁹ and to establish the twenty-one member National Civil Aviation Review Commission ("NCARC" or the "Commission") which, among many other responsibilities, must make recommendations on how to meet

⁸ See Federal Aviation Admin. Reauthorization Act of 1996, Pub. L. No. 104-264, §§ 121-149, 110 Stat. 3213 (1996) (codified at 49 U.S.C. §§ 40101, 40149) [hereinafter FAA Reauthorization Act of 1996].

⁹ *Id.* § 274(a).

“the airport infrastructure needs for large, medium, and small airports.”¹⁰ The Act also requires the GAO to perform an “independent assessment of airport development needs.”¹¹

The independent accounting firm of Coopers & Lybrand completed its comprehensive independent assessment of the FAA in March 1997.¹² The NCARC, in a report appointed in early 1997, published its final recommendations on December 11, 1997, entitled *Avoiding Aviation Gridlock and Reducing the Accident Rate: A Consensus for Change*.¹³ The NCARC also published two other important and detailed reports during the course of its work: a background paper entitled *Airport Development Needs and Financing Options*, published on June 4, 1997 (Airport Development Background Paper);¹⁴ and a preliminary report by the Aviation Funding Task Force entitled *Avoiding Aviation Gridlock: A Consensus for Change*, published on September 10, 1997 (Preliminary Funding Report).¹⁵

The Commission faces a great challenge. Developing solutions to the squeeze on airport capital development funding is immensely important to the vitality of the aviation industry in the United States—an industry maintaining the most sophisticated airport network in the world and accounting for forty percent of worldwide aviation activity in 1995.¹⁶ FAA Administrator David Hinson has recognized the importance of the issue. While speaking before Congress in 1996 and proposing a select committee on airport finance (which became the NCARC), Hinson urged that “we are at a crossroads that requires a critical reassessment of the future direction of . . . [the Airport Improve-

¹⁰ *Id.* § 274(b).

¹¹ *Id.* § 274(e).

¹² See REVIEW OF COOPERS & LYBRAND, INDEPENDENT FINANCIAL ASSESSMENT OF THE FEDERAL AVIATION ADMIN.: HEARING BEFORE THE SUBCOMM. ON AVIATION OF THE COMM. ON TRANSP. AND INFRASTRUCTURE, 105th Cong. (1997).

¹³ See NATIONAL CIVIL AVIATION REVIEW COMMISSION, AVOIDING AVOIDING AVIATION GRIDLOCK AND REDUCING THE ACCIDENT RATE: A CONSENSUS FOR CHANGE (1997) [hereinafter NCARC FINAL REPORT].

¹⁴ See NATIONAL CIVIL AVIATION REVIEW COMMISSION, AIRPORT DEVELOPMENT NEEDS AND FINANCING OPTIONS (1997) [hereinafter AIRPORT DEVELOPMENT BACKGROUND PAPER].

¹⁵ See NATIONAL CIVIL AVIATION REVIEW COMMISSION, PRELIMINARY FUNDING TASK FORCE REPORT, AVOIDING AVIATION GRIDLOCK: A CONSENSUS FOR CHANGE (1997) [hereinafter PRELIMINARY FUNDING REPORT].

¹⁶ See GENERAL ACCOUNTING OFFICE, AIRPORT PRIVATIZATION: ISSUES RELATED TO THE SALE OR LEASE OF U.S. COMMERCIAL AIRPORTS, DOC. NO. GAO/RCED-97-3, 12 (1996) [hereinafter AIRPORT PRIVITIZATION 1996].

ment Program] . . . as we proceed toward a balanced budget.”¹⁷ In 1994, Hinson recognized the widening gap between the airport capital development that airports “need to do” and what airports “have the money to do,” and asserted that “the question of how to bridge this gap is one of the major challenges of our time.”¹⁸ In testimony before Congress in 1996, Hinson said that the FAA

believe[s] that virtually everything associated with AIP and airport financing should be laid on the table by the Panel—passenger facility charge levels, AIP formula distributions, airport capital requirements, the extent to which the availability of private capital could or should replace or supplement Federal Funding, to name but a few.¹⁹

D. THE DISPUTED COST OF SUFFICIENT AIRPORT CAPITAL DEVELOPMENT

One of the greatest problems facing the Commission is determining exactly how much future airport capital development the nation’s airports will require. As discussed in the Summary, each organization has its own estimate of the airport capital development requirements necessary to manage forthcoming capacity demand. Organizations representing the nation’s airports, the American Association of Airport Executives (AAAE) and the Airports Council International-North America (ACI) estimate that there will be a consistent need for \$10 billion in airport capital development annually between 1997 and 2002.²⁰ AAAE and ACI estimate that spending from all airport capital development funding sources totaled only \$5.738 billion in 1995—far short of their \$10 billion in estimated requirements.²¹

On the other hand, the Air Transport Association (ATA), representing the nation’s largest airlines, strongly criticizes the air-

¹⁷ HEARING ON THE REAUTHORIZATION OF THE AIRPORT IMPROVEMENT PROGRAM BEFORE THE SUBCOMM. ON AVIATION OF THE HOUSE COMM. ON TRANSP. AND INFRASTRUCTURE, 104th Cong. (1996) (statement of David R. Hinson, Federal Aviation Administrator) [hereinafter Hinson Statement].

¹⁸ Barbara Cook, *A New Solution to an Old Problem—What to Do When the AIP Well Dries Up*, AIRPORT MAG., Nov.-Dec. 1994, at 51.

¹⁹ Hinson Statement, *supra* note 17.

²⁰ See GENERAL ACCOUNTING OFFICE, AIRPORT DEVELOPMENT NEEDS: ESTIMATING FUTURE COSTS, Doc. No. GAO/RCED-97-99, 7 (1997) [hereinafter ESTIMATING FUTURE COSTS]; see also Charles M. Barclay, *America’s Future in Airport Infrastructure*, AIRPORT MAG., July-Aug. 1996, at 6.

²¹ See Barclay, *supra* note 20, at Table D.

port's \$10 billion estimate as an airport "wish list."²² The ATA estimates airport capital development requirements at only \$4 billion per year between 1996 and 2000, far short of the airport's estimate.²³ Further complicating the issue, the FAA, in its own study, estimated annual airport capital development requirements for the period 1996 to 2000 at \$6.5 billion—almost directly between the estimates of the airports and the airlines.²⁴

Attempting to resolve the confusion surrounding the level of airport capital development spending, which will be required to maintain the national airport system, pursuant to the 1996 Reauthorization Act, both the accounting firm of Coopers & Lybrand and the GAO performed independent studies of airport capital development requirements into the next century.²⁵ Coopers & Lybrand estimated that during the period 1997 to 2002 between \$7 and \$8 billion will be needed for airport capital development.²⁶ The GAO estimated airport capital development requirements at a range between \$1.4 billion and \$10.1 billion, based on four different econometric models.²⁷ The GAO used different definitions of what constitutes required airport capital development to create four different estimates.²⁸ By defining the term broadly, as defined by airports, to include "all projects, regardless of priority or [government] grant eligibility, at all airports that are, or are currently planned to become, eligible to receive federal or state support," as the airports did, the GAO estimated airport capital development requirements at \$10.1 billion.²⁹ With the narrowest possible definition, including "only projects eligible for federal grants to meet safety, security, and environmental needs as well as to maintain the existing infrastructure at the airports in the national system, but [not to] include the bulk of other needs, such as projects to improve or expand airport infrastructure," the GAO estimated requirements at only \$1.4 billion.³⁰

²² See HEARING ON THE REAUTHORIZATION OF THE AIRPORT IMPROVEMENT PROGRAM BEFORE THE SUBCOMM. ON AVIATION OF THE HOUSE COMM. ON TRANSPORTATION AND INFRASTRUCTURE, 104th Cong. (1996) (testimony of Carol Hallet, President, Air Transport Association).

²³ See ESTIMATING FUTURE COSTS, *supra* note 20, at 7.

²⁴ See *id.* at 3.

²⁵ See FAA Reauthorization Act of 1996, *supra* note 8, § 274(a), (c).

²⁶ See AIRPORT DEVELOPMENT BACKGROUND PAPER, *supra* note 14, at 3.

²⁷ See ESTIMATING FUTURE COSTS, *supra* note 20, at 2.

²⁸ See *id.*

²⁹ *Id.*

³⁰ *Id.*

Both the GAO and Coopers & Lybrand studies discuss why the various estimates differed so drastically. Each agreed that the estimates differed primarily due to a general lack of available data and differences in data collection, which included the use of different data sources—particularly differing data time periods and differing data regarding federal grant eligibility of airports.³¹ Additionally, the different organizations conducted their studies for different purposes: for instance, the FAA's purpose was to determine the needs of the national airport system, while the airport's purpose was to secure maximum government funding.³²

In its synthesis of the various airport capital development studies, the NCARC lamented that there is presently "no independent means of estimating airport capital [development] requirements."³³ The Coopers & Lybrand study indicated that the value of having such an independent analytical model to determine airport capital development requirements would be outweighed by the cost necessary to develop it.³⁴ As its only solution to the problem, the NCARC encouraged the FAA to develop "performance measures" in order to aid in the understanding of the infrastructure requirements of the national airport system.³⁵

The NCARC also recognized that in addition to quantifiable (although disputed) airport capital development requirements, airports may require additional capital development in the future for certain emerging industry costs, including: costs associated with new airport security requirements; costs associated with the increased size of next generation aircraft; costs associated with future airport certification requirements for some non-hub and non-primary airports; the shifting of costs for facilities, equipment, operating, and maintenance from the FAA to airports as part of a cost savings scheme for the FAA; costs associated with possible changes in regulatory environmental requirements; and planning and equipment costs for FAA programs designed to continue "surface operations in very low visibility weather conditions."³⁶ According to the NCARC, there are pres-

³¹ See NATIONAL CIVIL AVIATION REVIEW COMM'N, AIRPORT DEVELOPMENT NEEDS AND FINANCING OPTIONS 3 (1997) [hereinafter AIRPORT DEVELOPMENT NEEDS].

³² See *id.* at 4.

³³ *Id.* at 5.

³⁴ See *id.* at 4.

³⁵ See *id.*

³⁶ *Id.* at 5-6.

ently no figures available indicating the extent of these future costs to airports.³⁷

E. RECENT REDUCTIONS IN FEDERAL FUNDING OF AIRPORT CAPITAL DEVELOPMENT

Although the cost of future airport capital development requirements is disputed, it is clear that congressional cutbacks in federal funding of airport capital development—funded through the Airport Improvement Program (AIP)—strain the ability of airports to fund sufficient airport capital development.³⁸ Between 1992 and 1995, Congress reduced annual federal funding of airport capital development by \$450 million dollars, from \$1.9 billion in 1992 to \$1.45 billion in 1995 and 1996.³⁹ Airports, airlines, and federal, state, and local governments are struggling to find new methods to finance airport capital development in the face of a loss of federal funding that may not be reversed in the foreseeable future. As the NCARC states, “[t]he current, frugal outlook for the Federal budget has put severe downward pressure on AIP spending, as evidenced by the Administration’s original proposal of a \$1 billion AIP funding level in [fiscal year 1998].”⁴⁰ The NCARC recognizes that “[t]he instability of funding greatly complicates the ability of local airports to formulate multi-year capital financial plans, which must estimate Federal support as part of the total financing package.”⁴¹ In its Preliminary Funding Report, the Commission stated that “[c]urrent airport revenue sources have not provided the funding to meet the needs identified in the Coopers & Lybrand and GAO reports.”⁴²

³⁷ See *id.* at 5.

³⁸ See *id.* at 10.

³⁹ See *id.* at 10; see also FEDERAL AVIATION ADMIN., THIRTEENTH ANNUAL REPORT OF ACCOMPLISHMENTS UNDER THE AIRPORT IMPROVEMENT PROGRAM, FISCAL YEAR 1994, 6 (1995) [hereinafter THIRTEENTH ANNUAL REPORT 1994]. Federal funding of the AIP will be \$1.46 billion for 1997. See FAA Reauthorization Act of 1996, *supra* note 8, §§ 121-149.

⁴⁰ AIRPORT DEVELOPMENT BACKGROUND PAPER, *supra* note 14, at 8. Airports also recognize the possibility that federal funding of airport capital development will continue to dwindle. See Jean M. DeLuca et al., *Airport Finance Challenges for the Next Decade*, AIRPORT MAG., May-June 1995, at 72-73.

⁴¹ AIRPORT DEVELOPMENT BACKGROUND PAPER, *supra* note 14, at 8.

⁴² PRELIMINARY FUNDING REPORT, *supra* note 15, at 57.

F. TRADITIONAL SOURCES OF FINANCING: LESS THAN THE
NEEDED EXPENDITURES?

The federally funded AIP is one of several sources of airport capital development funding that the Commission is studying in its effort to recommend a modernized and viable financing system. Airport capital development in the United States historically has been financed by a combination of the AIP, administered by the FAA, and tax-exempt municipal bonds issued by municipal airport operators.⁴³ In the Aviation Safety and Capacity Expansion Act of 1990,⁴⁴ Congress authorized airports to collect the Passenger Facility Charge (PFC), a charge imposed by commercial service airports on each passenger that travels through the airport.⁴⁵ Use of the PFC now provides airports with a significant source of additional funding for airport capital development—a total of approximately \$1.113 billion in 1996.⁴⁶ Airport cash reserves earned from airport revenue, commercial loans, and grants from state governments finance a smaller portion of airport capital development.⁴⁷

Although the actual amount of airport capital development financed by these sources can be estimated, just as there is no independent means of assessing airport capital development requirements, according to the NCARC “[t]here is no well defined, widely accepted, and comprehensive database on airport capital expenditures.”⁴⁸ Also, according to the NCARC, during the period 1990 to 1996, airport capital development funding from “known sources” provided “on average, fairly constant capital spending at slightly over \$6 billion [per] year.”⁴⁹ In 1996, these sources provided approximately \$4 billion from airport revenue bonds, \$1.450 billion from AIP grants, \$500 million

⁴³ See FEDERAL AVIATION ADMIN., INNOVATIVE APPROACHES FOR USING FEDERAL FUNDS TO FINANCE AIRPORT DEV. 2-1 (1996) [hereinafter INNOVATIVE APPROACHES]. For an introduction to the various methods for financing airport capital development and infrastructure, see Michael Bell, *Airport Financing*, in AIRPORT REGULATION, LAW, AND PUBLIC POLICY: THE MANAGEMENT AND GROWTH OF INFRASTRUCTURE 93-106 (Robert M. Hardaway ed., 1991).

⁴⁴ See Aviation Safety and Capacity Expansion Act of 1990, Pub. L. No. 101-508, § 9110, 104 Stat. 1388-353 (1990) (codified at 49 U.S.C. § 40117).

⁴⁵ See GENERAL ACCOUNTING OFFICE, AIRPORT IMPROVEMENT PROGRAM: UPDATE OF ALLOCATION OF FUNDS AND PASSENGER FACILITY CHARGES, 1992-1994, Doc. No. RCED-95-225FS, 1 (1995) [hereinafter 1995 AIRPORT IMPROVEMENT PROGRAM].

⁴⁶ See AIRPORT DEVELOPMENT NEEDS, *supra* note 31, at 9.

⁴⁷ See INNOVATIVE APPROACHES, *supra* note 43, at 2-1.

⁴⁸ AIRPORT DEVELOPMENT NEEDS, *supra* note 31, at 9.

⁴⁹ *Id.*

from state and local grants, and \$1.113 billion from PFC revenue—a total of \$7.063 billion.⁵⁰ Following is a brief description of the various methods of financing airport capital development available to airports.

1. *Airport Revenue*

Airports receive revenue from their rates and charges on commercial airlines in the form of landing fees, terminal rentals, maintenance and operation charges, and fuel surcharges, as well as from airport concessions.⁵¹ Airport revenue generally pays an airport's operating and maintenance expenses, its principal and interest payable to bondholders, as well as some airport capital development.⁵² At most commercial service airports, an airport's use of its revenue for airport capital development is often subject to the approval or disapproval of the airlines using the airport.⁵³ Airports and airlines generally enter into legally binding "airport use agreements"—contracts specifying the rates and charges that airlines pay for use of the airport facilities and identifying the airline's rights and privileges.⁵⁴ These agreements often provide the airlines with significant control over any airport capital development, which they may ultimately finance via increased rates and charges.

Airlines defend strongly against small increases in rates and charges by airports, and fight to avoid passing cost increases on to passengers.⁵⁵ Airport costs actually only average about five percent of an airline's total costs—a relatively small percentage—however, because of the competitiveness of the airline industry, its profit margin historically has been one-half the average of companies in other industries and therefore the airlines' profitability is sensitive to even the slightest increase in costs.⁵⁶ Additionally, airline passenger traffic is very sensitive to changes in the price of airline travel—studies show that a "[one]

⁵⁰ See *id.*

⁵¹ See Bell, *supra* note 43, at 98; AIRPORT DEVELOPMENT NEEDS, *supra* note 31, at 7.

⁵² See AIRPORT DEVELOPMENT NEEDS, *supra* note 31, at 7.

⁵³ See *id.*

⁵⁴ See *id.*

⁵⁵ See GENERAL ACCOUNTING OFFICE, AIRPORT PRIVATIZATION: ISSUES RELATED TO THE SALE OR LEASE OF U.S. COMMERCIAL AIRPORTS, Doc. No. T-RCED-96-82, 11 (1996) [hereinafter AIRPORT PRIVATIZATION].

⁵⁶ See *id.*

percent increase in ticket prices may lead to more than a [one] percent decline" in the volume of passengers.⁵⁷

2. *Airport Bonds*

Airport operators may raise capital with both *general obligation bonds*, backed by the taxing authority of the issuer, and *airport revenue bonds*, backed by the airport's own revenue streams.⁵⁸ Airport revenue bonds are now the primary method by which large, medium, and small hub⁵⁹ airports finance airport capital development.⁶⁰ In 1996, airport revenue bonds provided airports with approximately \$4 billion for airport capital development.⁶¹ Whether an airport can secure airport revenue bonds depends on a number of factors, including an airport's debt structure; its management, administration, and scope of operations; its revenue structure and financial operations; and its economic base and physical plant.⁶² Under current federal law, the federal government exempts holders of airport bonds from federal tax on interest income—providing "a 'tax expenditure' funded by the general taxpayer."⁶³ According to the FAA, "[t]he Federal tax exemption shaves almost two full percentage points off interest costs for airport borrowers of all sizes, an estimated saving of nearly \$1 billion per year for airports over the period 1985 to 1993."⁶⁴

3. *Airport Improvement Program Grants*

The federal government has provided monetary grants for airport capital development since 1946, originally from the general

⁵⁷ *Id.*

⁵⁸ See AIRPORT DEVELOPMENT NEEDS, *supra* note 31, at 7.

⁵⁹ For information on categories of airports in the United States, see ESTIMATING FUTURE COSTS, *supra* note 20, at 4; and FEDERAL AVIATION ADMIN., NATIONAL PLAN OF INTEGRATED AIRPORT SYSTEMS (NPIAS), 1993-1997 (1995) [hereinafter NATIONAL PLAN]. Of approximately 18,331 airports in the United States, 3,331 are part of the National Airport System. Of these airports, 564 are commercial service airports, handling "all regularly scheduled commercial . . . traffic and [having] at least 2,500 annual passenger enplanements." ESTIMATING FUTURE COSTS, *supra* note 20, at 4. Of commercial service airports, 421 are primary airports, of which there are 29 large hub airports, 40 medium hub airports, 71 small hub airports, and 281 non-hub airports. See *id.*

⁶⁰ See AIRPORT DEVELOPMENT NEEDS, *supra* note 31, at 7.

⁶¹ See *id.* at 9.

⁶² See *id.* at 7.

⁶³ INNOVATIVE APPROACHES, *supra* note 43, at ii.

⁶⁴ *Id.*

fund of the United States Treasury.⁶⁵ In 1970, Congress established the Airport and Airway Trust Fund (Aviation Trust Funds),⁶⁶ which funded federal grants with deposited revenues from specific aviation user taxes on passenger tickets, international departures, cargo weight, and aviation gasoline and jet fuel, rather than from the general treasury fund.⁶⁷ Congress renamed the federal grant program the Airport Improvement Program (AIP) in 1982.⁶⁸ "Between 1985 and 1995 the AIP financed 14% of all [airport] capital [development] at large commercial airports, 28% at medium . . . commercial airports[,] and 41% at small[er] airports."⁶⁹ Since 1992, Congress has reduced federal grants under the AIP from a high of \$1.9 billion to \$1.46 billion in 1997.⁷⁰

The FAA apportions AIP grants each year by two methods: first, according to a statutory formula to specific airports or categories of airports (called "statutory," "apportionment," or "entitlement" grants); and second, at the FAA's discretion as limited by statute (called "discretionary" grants).⁷¹ There is an extensive grant process for securing either type of AIP grant,⁷² and only airport projects listed in the FAA's National Plan of Integrated Airport Systems (NPIAS)⁷³ are eligible for AIP funding.⁷⁴ The FAA has modernized the AIP and now issues letters of intent (LOIs), which advise airports that the FAA intends to fund "approved, long-term, high-priority capacity projects as appropriations allow" and allow the FAA "to reimburse a sponsor for

⁶⁵ See FEDERAL AVIATION ADMIN., INTRODUCTION TO THE AIRPORT IMPROVEMENT PROGRAM, Doc. No. FAA-P-5100-1, 3 (1993) [hereinafter 1993 AIRPORT IMPROVEMENT PROGRAM].

⁶⁶ Airport and Airway Development Act of 1970, Pub. L. No. 91-258, § 208, 84 Stat. 219, 250 (1970) (codified at 26 U.S.C. § 9502).

⁶⁷ See 1993 AIRPORT IMPROVEMENT PROGRAM, *supra* note 65, at 3.

⁶⁸ See Airport and Airway Improvement Act of 1982, Pub. L. No. 97-248, § 505, 96 Stat. 671 (1982) (codified in scattered sections of 49 U.S.C.); see also 1993 AIRPORT IMPROVEMENT PROGRAM, *supra* note 65, at 3.

⁶⁹ INNOVATIVE APPROACHES, *supra* note 43, at ii.

⁷⁰ See AIRPORT DEVELOPMENT NEEDS, *supra* note 31, at 10.

⁷¹ See FEDERAL AVIATION ADMIN., FOURTEENTH ANNUAL REPORT OF ACCOMPLISHMENTS UNDER THE AIRPORT IMPROVEMENT PROGRAM, FISCAL YEAR 1995, at 10-13 (Nov. 1996) [hereinafter FOURTEENTH ANNUAL REPORT].

⁷² See 1993 AIRPORT IMPROVEMENT PROGRAM, *supra* note 65, at 12-15.

⁷³ The NPIAS, the plan for developing public use airports in the United States, published by the Secretary of Transportation every two years, estimates the cost of establishing an airport system adequate for the needs of civil aviation, the Department of Defense, and the Postal Service. See 49 U.S.C. § 47103 (1994); see also NATIONAL PLAN, *supra* note 59, at 3.

⁷⁴ See FOURTEENTH ANNUAL REPORT, *supra* note 71, at 3.

allowable costs for work, which was performed prior to a grant agreement, of a project contained in the LOI.”⁷⁵ The FAA also has experimented successfully with a State Block Grant Pilot Program, by which the FAA dispenses AIP funds directly to seven participating states, which themselves select and fund AIP eligible airport capital development projects at smaller airports.⁷⁶

4. *Passenger Facility Charges*

Prior to 1990, Federal law prohibited airports from charging a per passenger enplanement fee.⁷⁷ Congress finally authorized the FAA to allow public agencies owning or operating commercial service airports to collect and use Passenger Facility Charges (PFCs) with the Aviation Safety and Capacity Expansion Act of 1990.⁷⁸ Congress intended PFC revenue to finance airport capital development, specifically projects preserving or enhancing aviation safety, capacity, or security; reducing airport noise; or increasing competition among airlines.⁷⁹ Airports may also use PFCs for costs associated with securing and retiring debt from airport capital development projects.⁸⁰ PFC-authorized airports may collect a \$1, \$2, or maximum \$3 per passenger charge, the proceeds of which may be used for eligible projects.⁸¹ Airlines are responsible for collecting PFCs and distributing them to the appropriate airport.⁸² Airports must consult with airlines and other airport tenants regarding expenditure of PFC funds, but the airport ultimately controls their expenditure of PFC funds subject to FAA approval of each proposed project.⁸³ The PFC legislation allowed airport control of PFC expenditures with the belief that airports have greater incentive to make the long-term

⁷⁵ THIRTEENTH ANNUAL REPORT 1994, *supra* note 39, at 30.

⁷⁶ See GENERAL ACCOUNTING OFFICE, AIRPORT IMPROVEMENT PROGRAM: STATE BLOCK GRANT PILOT PROGRAM IS A SUCCESS, Doc. No. T-RCED-96-86, 1 (March 14, 1996); see also FOURTEENTH ANNUAL REPORT, *supra* note 71, at 25.

⁷⁷ See Airport Development Acceleration Act of 1973, Pub. L. No. 93-44, § 7(a), 87 Stat. 88 (1973) (prohibiting state taxation of persons traveling in air commerce), *repealed by* Act of July 5, 1994, Pub. L. No. 103-272, § 7(b), 108 Stat. 1094 (1994); AIRPORT DEVELOPMENT BACKGROUND PAPER, *supra* note 14, at 8.

⁷⁸ See Pub. L. No. 101-508, § 9110, 104 Stat. 2210 (1990) (authorizing the passenger facility charge); FOURTEENTH ANNUAL REPORT, *supra* note 71, at 34.

⁷⁹ See FOURTEENTH ANNUAL REPORT, *supra* note 71, at 34.

⁸⁰ See 1995 AIRPORT IMPROVEMENT PROGRAM, *supra* note 45, at 14.

⁸¹ See *id.*

⁸² See *id.*

⁸³ See AIRPORT DEVELOPMENT BACKGROUND PAPER, *supra* note 14, at 8; 1995 AIRPORT IMPROVEMENT PROGRAM, *supra* note 45, at 14.

investments in airport infrastructure, which airlines would be less likely to support.⁸⁴

Because primarily large and medium hub airports benefit from the collection of PFCs, those airports must return up to fifty percent of the AIP grants to which they would normally be entitled.⁸⁵ The FAA reallocates those AIP funds according to a statutory formula to smaller airports that cannot directly raise PFC revenue—small hub primary airports, non-hub primary airports, and non-commercial service airports.⁸⁶ The PFC's power as a financing tool is greatest for the nation's largest airports: according to the FAA "[f]ully one half of the total revenue generating potential of the PFC program is concentrated at the top ten enplaning airports in the country. This has the effect of concentrating PFC revenue at airports with the greatest capacity development and noise mitigation needs."⁸⁷ In 1996, commercial service airports collected approximately \$1.113 billion in PFC revenue, while they were authorized to collect \$1.35 billion.⁸⁸

5. *State and Local Grants*

State and local governments provide approximately \$500 million per year for airport capital development raised primarily from state-imposed fuel taxes.⁸⁹

II. SEEKING A SOLUTION: OPTIONS FOR OVERHAULING THE CURRENT FINANCING SYSTEM

A. FINANCING OPTIONS AVAILABLE TO THE NCARC

Various organizations involved in the airport capital development debate have proposed a wide range of options for financing that development. The Commission evaluates those options in its Airport Development Background Paper.⁹⁰ Following is a discussion of financing options that have been proposed or studied.

⁸⁴ See AIRPORT DEVELOPMENT BACKGROUND PAPER, *supra* note 14, at 8.

⁸⁵ See 1995 AIRPORT IMPROVEMENT PROGRAM, *supra* note 45, at 15.

⁸⁶ See *id.* at 16.

⁸⁷ INNOVATIVE APPROACHES, *supra* note 43, at ii-iii.

⁸⁸ See AIRPORT DEVELOPMENT BACKGROUND PAPER, *supra* note 14, at 8.

⁸⁹ See *id.*

⁹⁰ See *id.* at 11-21.

1. *FAA Study of Innovative Financing Options*

By congressional mandate⁹¹, the FAA identified and prioritized several innovative financing alternatives in its 1996 Study entitled *Innovative Approaches for Using Federal Funds to Finance Airport Capital Development* (FAA Study).⁹² The FAA Study focused on four financing options: (1) the use of AIP grants to fund debt repayment reserves of airport revenue bonds; (2) the authorization of a federal guarantee of airport loans, assuming retention of federal tax-exempt status; (3) using AIP funds to pay for commercial bond insurance; and (4) instituting an airport loan fund.⁹³ Of these options, the FAA concluded that using AIP funds to pay for commercial bond insurance for airports “offer[ed] the most promise,” considering the effectiveness, complexity and administrative cost of implementing the financing options.⁹⁴ Paying for commercial bond insurance would permit airports normally unable to afford or qualify for such insurance to purchase commercial bond insurance with AIP funds.⁹⁵ The FAA warned that “[t]his option would have to be implemented in a manner that ensures that the holders of such bonds would have no recourse to the Federal Government in the event of default by the issuer of the bond and insolvency of the bond insurer.”⁹⁶

The FAA also warned that the design of any innovative financing program would depend on AIP funding levels:

Under current AIP program levels, innovative financing mechanisms would need to be carefully targeted in order to avoid the substitution of Federal dollars for capital dollars available from non-Federal sources. Targeting might give special weight to small airports, which face growing state and local fiscal restraint in addition to limited access in the capital markets; yet some large and medium-sized airports also face constraints, albeit those imposed by the financial condition of major airlines.⁹⁷

On the other hand, if AIP funds were significantly reduced, “a more generally available innovative financing program would be

⁹¹ See Federal Aviation Admin. Authorization Act of 1994, Pub. L. No. 103-305, § 520, 108 Stat. 1569 (1994) (mandating FAA study of innovative financing techniques).

⁹² See generally *INNOVATIVE APPROACHES*, *supra* note 43.

⁹³ See *id.* at 3-1 to 3-2.

⁹⁴ See *id.* at 4-1.

⁹⁵ See *id.* at 3-3.

⁹⁶ *Id.*

⁹⁷ *Id.* at 5-1.

suitable and perhaps necessary to help sustain required airport development.”⁹⁸

The FAA Study made two follow-up proposals. First, it proposed a select panel to assess “the widest possible range of mechanisms to finance airport development, including modifications to the Passenger Facility Charge (PFC) program, public/private partnerships, and the creation of new financial institutions and techniques.”⁹⁹ Second, it proposed statutory authority for the FAA Administrator “to test and evaluate the effects on airport development of innovative financing proposals involving AIP funds.”¹⁰⁰ The 1996 Reauthorization Act instituted each of these proposals, creating the NCARC and providing for an innovative financing demonstration program which would issue up to ten AIP grants using three of the innovative financing techniques: (1) using AIP grants for the payment of interest; (2) using AIP grants to secure commercial bond insurance; or (3) flexible non-federal match to AIP grants.¹⁰¹ The Act prohibited the FAA from using AIP grants to directly or indirectly guarantee airport loans.¹⁰² The NCARC assessed the initial success of the demonstration program in its Airport Development Background Paper:

The FAA’s initial experience with the program suggests that all three techniques offer modest opportunities to leverage Federal funds. The experience also indicates that smaller airports are more likely to use AIP funds to pay interest or credit enhancements. Flexible non-federal match also provides the opportunity to achieve greater local participation in projects, particularly at general aviation and reliever airports.¹⁰³

2. PFC-Backed Bonds

In 1996, Little Rock National Airport and Chicago O’Hare International Airport completed the first bond issues secured by PFC revenue.¹⁰⁴ Airports believe the PFC-backed bond could

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ See FAA Reauthorization Act of 1996, *supra* note 8, § 148 (authorizing innovative financing demonstration program); AIRPORT DEVELOPMENT BACKGROUND PAPER, *supra* note 14, at 14.

¹⁰² See FAA Reauthorization Act of 1996, *supra* note 8; AIRPORT DEVELOPMENT BACKGROUND PAPER, *supra* note 14, at 15.

¹⁰³ AIRPORT DEVELOPMENT BACKGROUND PAPER, *supra* note 14, at 15.

¹⁰⁴ See Holly Arthur, *Innovative Airport Financing: Will the PFC-backed Bond Be a Savior?*, AIRPORT MAG., Sept.-Oct. 1996, at 15.

play a major role in financing airport capital development, supplementing the traditional use of tax-exempt bonds backed by airport revenues.

Until 1996, airports had not been able to use PFC revenue as leveraging potential in securing bond issues, primarily because investor's services such as Moody's, Standard & Poor's, and Fitch withheld investment grade ratings due to the "FAA's authority to terminate an airport's ability to collect PFC revenues, effectively leaving bondholder's without recourse."¹⁰⁵ The investor's services feared that the FAA's retention of termination provisions, despite its knowledge that the provisions hindered airport bond issues, indicated that the FAA might use them as a possible "regulatory hammer."¹⁰⁶ The investor's services also feared what might happen to PFC revenue in the event of an airline bankruptcy.¹⁰⁷ Airlines keep PFC revenue in the same accounts as ordinary revenue; and given unsettled law, it was possible that a court might treat PFC revenue as part of an airline's estate rather than as part of the airport's estate.¹⁰⁸

Only recently have these investor's services decided to assign investment grade ratings to PFC-backed bond issues.¹⁰⁹ The Department of Transportation (DOT) and the FAA finally began to lend support to the use of PFC revenue for bond leverage, stating that the "FAA is committed to working with the airport finance community to further increase the leverage potential for PFC revenues."¹¹⁰ The FAA further displayed its softening position with an FAA Record of Decision during the O'Hare bond issue, which contained an agreement that "significantly narrow[ed] the possibility of complete PFC authority termination as long as the bonds are outstanding."¹¹¹ Moody's viewed the agreement as a "major policy shift," and the service is now considering assigning investment grade ratings on long-term, stand-alone debt on a "case-by-case basis."¹¹² Likewise, a Standard & Poor's analyst told *Airport Magazine* that "[t]he PFC-backed bond should open up a large number of doors for airports It is

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ *See id.*

¹⁰⁸ *See id.*

¹⁰⁹ *See id.*

¹¹⁰ *Id.* at 14.

¹¹¹ *Id.* at 15.

¹¹² *Id.*

possibly the best and most innovative [airport financing] option in terms of moving forward.”¹¹³

3. *Authorizing Airports to Collect More Income from PFCs*

Another option for financing airport capital development, should federal funding continue to be reduced or eliminated, is to raise the \$3 per passenger enplanement limit on PFC collections. The NCARC analyzed this option (endorsed by the AAAE in 1996)¹¹⁴ in its Airport Development Background paper.¹¹⁵ According to the Commission, the impact of increasing PFC revenue by \$1 per passenger enplanement and decreasing AIP grant revenue would differ depending on the volume of passenger traffic at the airport. Large airports would likely experience an increase in revenue.¹¹⁶ For medium-size airports, one-half would experience a slight increase or no change in revenue, while the other half would experience a revenue loss unless Congress implemented a \$2 increase.¹¹⁷ For small airports, it would take a \$2 increase in the PFC limit for one quarter of small airports to experience a slight increase or no change in revenue, while another twenty-five percent would require a \$3 limit increase to experience a slight increase or no change in revenue.¹¹⁸ Fifty percent of small airports would lose revenue, even if Congress implemented a \$3 limit increase.¹¹⁹

Additionally, increasing the PFC limit would require Congress to address several significant policy issues.¹²⁰ First, the FAA uses the threat to withdraw federal AIP funds to enforce compliance with binding assurances that airports must execute in order to receive AIP grants: the assurance that airport facilities will be available on a non-discriminatory basis, and that rates and charges will be fair and reasonable.¹²¹ If the FAA grants airports a PFC increase that terminates AIP eligibility, airport users and the federal government will have to seek “new and equally persuasive means to achieve compliance.”¹²² Second, the FAA uses

¹¹³ *Id.* at 16.

¹¹⁴ See Barclay, *supra* note 20, at 13-14.

¹¹⁵ See AIRPORT DEVELOPMENT BACKGROUND PAPER, *supra* note 14, at 15-17.

¹¹⁶ See *id.* at 15.

¹¹⁷ See *id.*

¹¹⁸ See *id.*

¹¹⁹ See *id.*

¹²⁰ See *id.* at 15-17.

¹²¹ See *id.* at 15.

¹²² See *id.* at 15-16.

AIP grants to fund priority projects that benefit the national airport system as a whole.¹²³ Under the PFC legislation, projects funded by PFC revenue are not subject to the same AIP funding priorities.¹²⁴ The Commission states that “[i]f a PFC increase is intended as a substitute for AIP funds, then AIP funding priorities warrant consideration as prerequisites to future PFC approvals.”¹²⁵ Third, letters of intent (LOI)—indicating FAA intent to fund major airport capital development projects with AIP grants—have successfully allowed airports to attract non-federal funding sources for major development projects that the FAA has pledged to support.¹²⁶ To ensure that non-federal funding remains in place, it may be desirable to honor those LOI commitments.¹²⁷

4. *Airport Privatization*

a. Introduction to the Airport Privatization Debate

The challenge to find new ways to finance the nation’s aviation infrastructure has led many policymakers to propose privatizing United States commercial service airports—an idea that has ignited considerable debate. United States commercial airports, almost without exception, are owned and operated by the public sector—either states or municipalities.¹²⁸ Privatization involves the transfer of government responsibilities to the private sector.¹²⁹ Privatization plans vary in degree, ranging from allowing the public sector to contract for services with private entities to allowing the complete sale of government assets or operations to the private sector.¹³⁰

Supporters argue that privatization will make airports more commerce-oriented and self-sufficient—increasing the efficiency of publicly operated airports, infusing new capital into the aviation system, and providing local governments with greater revenue.¹³¹ Opponents argue that privatization merely

¹²³ See *id.* at 16.

¹²⁴ See *id.*

¹²⁵ *Id.*

¹²⁶ See *id.*

¹²⁷ See *id.*

¹²⁸ See AIRPORT PRIVATIZATION, *supra* note 55, at 1.

¹²⁹ See *id.* at 2.

¹³⁰ See *id.*

¹³¹ See AIRPORT PRIVATIZATION 1996, *supra* note 16, at 6; see also CAPITAL HILL HEARING TESTIMONY, TESTIMONY FEBRUARY 29, 1996, ALLEN H. ROTH, EXECUTIVE DIRECTOR, NEW YORK STATE RESEARCH COUNCIL, HOUSE TRANSPORTATION, AVIA-

allows local governments to “divert airport revenue intended for developing aviation infrastructure to other municipal purposes, resulting in increased costs for airlines and passengers.”¹³² The GAO summarized the increased interest in airport privatization as follows:

First, commercial airports generate significant revenues, in some cases exceeding \$100 million annually. Second, well-capitalized firms with experience in airport management and development have emerged in response to the demand created by privatizations worldwide. These firms believe that many U.S. airports possess considerable untapped profit potential and have aggressively sought greater opportunities in the United States. Third, funding levels for federal airport grants have dropped from \$1.9 billion in fiscal year 1992 to \$1.45 billion in fiscal year 1996. Accordingly, some airports are eager to tap alternative sources of revenue, according to airline industry representatives. Fourth, municipalities facing budget problems view their airports as a potential source of fiscal relief.¹³³

United States airports are already heavily reliant on the private sector, largely because “budget pressures on the federal government have reduced traditional sources of capital.”¹³⁴ Due to federal budget pressures and “intense competition in the airline industry,” there is great pressure on airports to reduce costs.¹³⁵ Many airports are reducing their costs and decreasing their reliance on revenue from airlines by increasing their revenue from non-airline revenue such as concessions.¹³⁶ In 1994, this non-airline revenue was fifty percent of total revenue for larger airports.¹³⁷ Fully ninety percent of all employees at the largest airports in the United States are employed by the private sector,¹³⁸ and the private sector provides the lion’s share of services like airline ticketing, baggage handling, cleaning, retail concession, and ground transportation to those airports.¹³⁹ These private sector services help airports “reduce costs and improve

TION, AIRPORT IMPROVEMENT PROGRAM; AIRPORT PRIVATIZATION, *supra* note 55, at 6.

¹³² AIRPORT PRIVATIZATION 1996, *supra* note 16, at 2.

¹³³ AIRPORT PRIVATIZATION, *supra* note 55, at 6.

¹³⁴ AIRPORT PRIVATIZATION 1996, *supra* note 16, at 22.

¹³⁵ *Id.*

¹³⁶ *See id.* at 24-25.

¹³⁷ *See id.* at 5.

¹³⁸ *See id.* at 4-5.

¹³⁹ *See id.*

the quality and the range of services offered.”¹⁴⁰ Some airports, such as Indianapolis International Airport, even contract with a private firm to manage the airport.¹⁴¹ GAO’s analysis of eighty-two commercial airports revealed that “only [twenty] percent of these airports’ total revenues are derived from landing fees charged to airlines, while over [forty] percent of total revenues are derived from concessions and parking, [twenty] percent from terminal leases, and [twenty] percent from other sources.”¹⁴²

b. Legal Obstacles to the Sale or Lease of Airports

Despite the potential promise of airport privatization as a solution to airport capital development funding problems, there are several legal obstacles to the sale or lease of commercial airports. In order to receive federal AIP grants, public airports must agree that all revenue generated by the airport will be used exclusively for airport capital and operating costs and will not be diverted for non-airport purposes (revenue diversion restrictions).¹⁴³ Under current FAA policy, this includes revenue generated by a sale or lease of the airport, thus, local and state governments can recover only unreimbursed capital and operating costs from the sale or lease of an airport.¹⁴⁴ This greatly diminishes the financial benefits a local or state government would receive from the privatization of a public airport, diminishing its incentive to privatize.¹⁴⁵

Additionally, privatized airports would not be eligible for apportioned grants under the AIP,¹⁴⁶ tax-exempt debt financing, or to collect passenger facility charges—an unsettling loss of funding sources.¹⁴⁷ These three financing mechanisms provide the largest portion of an airport’s capital base, and a privatized airport would have to find other means to replace these financing methods.¹⁴⁸

¹⁴⁰ *Id.* at 5.

¹⁴¹ *See id.*

¹⁴² AIRPORT PRIVATIZATION, *supra* note 55, at 4.

¹⁴³ *See* AIRPORT PRIVATIZATION 1996, *supra* note 16, at 6.

¹⁴⁴ *See id.*

¹⁴⁵ *See id.*

¹⁴⁶ A privatized airport would, however, be eligible for AIP discretionary grants. *See id.*

¹⁴⁷ *See id.*

¹⁴⁸ *See id.*

Since the FAA limits an airport's revenue from rates and charges on airlines, a privatized airport might also face severe constraints on this revenue.¹⁴⁹ Without a change in the law, it will be difficult to increase this revenue, since any change in this rate would require renegotiation of airport use agreements with the airlines, which would be reluctant to change the agreements if the result would be a cost increase.¹⁵⁰

c. Will Privatization Work?

Although it remains an open question whether airport privatization is a viable method for securing consistent funding for airport capital development, there have been several promising privatization ventures involving either the sale or lease of government-owned airports to private operators. In 1987, the United Kingdom sold the government corporation—the British Airports Authority—operating seven major commercial airports (including Heathrow and Gatwick) in a \$2.5 billion public-share offering.¹⁵¹ The British government used the proceeds to reduce its national debt.¹⁵² The government is still heavily involved with the airports through regulation of airline access, airport charges to airlines, safety, security and environmental protection.¹⁵³ Since the sale, the British Airports Authority has earned profits every year, and it earned \$455 million in profits for shareholders in 1995 “despite government-imposed caps on charges to airlines and \$782 million in infrastructure improvements”¹⁵⁴

Mexico has also begun the privatization of its airports, passing legislation in December 1995 to allow the long-term lease of fifty-eight government-owned airports to private operators.¹⁵⁵ The Mexican privatization plan places limits on participation by foreign companies and airlines.¹⁵⁶ Australia also is beginning privatization of twenty-two of its major airports through long-term leases to private operators.¹⁵⁷ The results of these privatization efforts are not yet available.

¹⁴⁹ *See id.*

¹⁵⁰ *See id.* at 6-7.

¹⁵¹ *See id.* at 30.

¹⁵² *See id.*

¹⁵³ *See id.*

¹⁵⁴ AIRPORT PRIVATIZATION, *supra* note 55, at 5-6.

¹⁵⁵ *See id.* at 5.

¹⁵⁶ *See id.*

¹⁵⁷ *See* AIRPORT PRIVATIZATION 1996, *supra* note 16, at 29.

In the United States, the city of Indianapolis has contracted with a private operator to manage the Indianapolis airport system, the private operator guaranteeing to reduce operating costs and increase revenue by \$140 million over ten years.¹⁵⁸ Proponents claim that these privatization efforts, particularly those in the United Kingdom, indicate that privatized airports are more efficient than publicly operated airports, and generate enough revenue to maintain sufficient airport capital development.¹⁵⁹

d. 1996 Reauthorization Act Privatization Pilot Program

Recognizing the need to explore privatization as a means to stabilize the system for financing airport capital development in the United States, Congress authorized a privatization pilot program in the 1996 Reauthorization Act.¹⁶⁰ 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."¹⁶¹ The Secretary of Transportation may authorize five airports (one general aviation airport and four commercial service airports) to participate in the program.¹⁶² The participating general aviation airport may be sold or leased, while the commercial service airports may only be leased.¹⁶³ Any privately leased commercial service airports would still be eligible to collect PFCs and receive AIP apportionment grants.¹⁶⁴ The Secretary is authorized to grant certain exemptions to the participants in the program, specifically from federal restrictions on revenue diversion, federal grant repayment and surplus property requirements.¹⁶⁵ It is unclear whether the airports would still have access to tax-exempt debt.¹⁶⁶ A private owner would clearly not have access to federal government tax-

¹⁵⁸ See *id.* at 33.

¹⁵⁹ See *id.* at 32-33.

¹⁶⁰ See FAA Reauthorization Act of 1996, *supra* note 8, § 47134.

¹⁶¹ AIRPORT PRIVATIZATION 1996, *supra* note 16, at 48.

¹⁶² See *id.*

¹⁶³ See *id.*

¹⁶⁴ See *id.*

¹⁶⁵ See *id.* "Under current law, when an airport's asset is sold and no longer used for its originally intended purpose, the federal government can seek reimbursement for its share in assets acquired through grants, while surplus federal property would automatically revert to the federal government." AIRPORT PRIVATIZATION, *supra* note 55, at 8.

¹⁶⁶ See AIRPORT PRIVATIZATION 1996, *supra* note 16, at 48 n.47.

exempt debt provisions, although for a privately leased airport, the public owner might have access to tax-exempt debt to fund airport capital development depending on the lease agreement.¹⁶⁷

Several airports have indicated interest in the privatization program, including Allegheny County Airport in Pennsylvania and Stewart International Airport in New York.¹⁶⁸ The FAA published privatization pilot program application procedures for public comment on April 22, 1997.¹⁶⁹ No airports have yet been selected for the program.

III. RECOMMENDATIONS OF THE NATIONAL CIVIL AVIATION REVIEW COMMISSION

A. NCARC FINAL REPORT AND RECOMMENDATIONS

The NCARC issued its final report and recommendations, accompanied by draft legislation, on December 11, 1997.¹⁷⁰ The report does not add to the substantive analysis of airport capital development issues presented in the NCARC's Airport Capital Development Background Paper¹⁷¹ or its Preliminary Funding Report.¹⁷² The NCARC Final Report presents three primary policy recommendations favored by a consensus of the twenty-one member National Civil Aviation Review Commission.¹⁷³

The NCARC's first recommendation is that the AIP should be funded at a minimum level of \$2 billion annually for the next five years, adjusted for growth, and that federal budget treatment of AIP should guarantee that AIP is a stable and predictable funding source.¹⁷⁴ In its discussion of this recommendation, the NCARC makes clear its belief that current airport revenue sources are insufficient to satisfy airport capital development requirements.¹⁷⁵ The NCARC advises that funding AIP at the \$2 billion level would preserve airport infrastructure at smaller airports, which rely on federal aid, fund more safety and security projects at airports of "all types and sizes," and fund

¹⁶⁷ See *id.*

¹⁶⁸ See *id.* at 49.

¹⁶⁹ See Airport Privatization Pilot Program: Application Procedures, 62 Fed. Reg. 19,638 (1997).

¹⁷⁰ See NCARC FINAL REPORT, *supra* note 13.

¹⁷¹ See AIRPORT DEVELOPMENT BACKGROUND PAPER, *supra* note 14.

¹⁷² See PRELIMINARY FUNDING REPORT, *supra* note 15.

¹⁷³ See NCARC FINAL REPORT, *supra* note 13, at *Funding Report*, Part VII.

¹⁷⁴ See *id.* at *Funding Report*, Part VI. A, B.

¹⁷⁵ See *id.* at *Funding Report*, Part VI.B.

more noise mitigation projects—all of which are heavily dependent on AIP.¹⁷⁶ Additionally, funding of AIP at the \$2 billion level will produce increased aviation system capacity—necessary to meet the forthcoming capacity demand.¹⁷⁷

The NCARC's second recommendation is that "the Congress look to AIP and Passenger Facility Charges (PFCs) as sources of additional revenues to finance future airport capital needs."¹⁷⁸ This finding, along with the recommendation regarding increased AIP funding, seems to indicate a policy determination by the NCARC that the federal government should continue to be involved in funding airport capital development, and that the most efficient and reliable vehicle for federal involvement is a combination of the Airport Improvement Program and the Passenger Facility Charge. The NCARC recommends that to meet future airport capital development requirements the PFC limit should be raised above the current three-dollar-per-passenger enplanement limit.¹⁷⁹

Finally, the NCARC recommends that "smaller airports receive funding at a higher level, so that their capital development needs can be met and thereby allowing them to continue serving as a critical element of the air transportation system."¹⁸⁰ The NCARC found that the "Airport Improvement Program is essential for capital development at smaller airports as they have less capability to draw in a meaningful way from other sources of capital funds."¹⁸¹

The NCARC also presented several other more minor findings and recommendations. The NCARC recognized the importance of airport revenue bonds to large and medium-sized airports, and recommended the "[p]reservation and potential enhancement of the tax-exempt status" of airport revenue bonds.¹⁸² However, the NCARC downplayed the potential of innovative financing options such as revolving loan programs, loan guarantees and credit enhancements, saying that they offered only "marginal and limited opportunities to leverage federal funds" because such options have already been

¹⁷⁶ See *id.*

¹⁷⁷ See *id.*

¹⁷⁸ *Id.* at *Funding Report*, Part VI.A.

¹⁷⁹ See *id.* at *Funding Report*, Part VI.C.

¹⁸⁰ *Id.* at *Funding Report*, Part VI.A.

¹⁸¹ *Id.*

¹⁸² *Id.* at *Funding Report*, Part VI.C.

institutionalized at airports capable of borrowing.¹⁸³ Finally, the NCARC chose to withhold any recommendation regarding airport privatization until completion of the privatization pilot program provided for in the 1996 Reauthorization Act.¹⁸⁴

B. CONCLUSION

After one of the most comprehensive reviews of the system for funding airport capital development in United States history, the NCARC consensus has recommended a funding system refocused on federal programs—the AIP and the PFC. This approach makes sense because the AIP and the PFC, compared to other funding options, offer the most promise for a reliable and predictable funding system. For instance, a plan for privatizing United States airports is not sufficiently mature to guarantee a reliable and predictable source of funding, and various proposals for innovative financing options, while helpful, would offer only marginal increases in the funds available to airports. Additionally, while there is potential for increasing funding through airport revenue bonds (i.e., by enhancing the PFC-backed bond), airport revenue bonds are already the most significant source of reliable and predictable airport capital development funding for airports capable of borrowing.

The NCARC uses one potentially haunting refrain throughout its Final Report: “Again, the Commission stresses that these recommendations are an integrated, comprehensive package. The consensus the Commission developed rests in large part on the recommendations being adopted in whole, not piecemeal.”¹⁸⁵ The NCARC reports, taken in conjunction with comprehensive FAA reform,¹⁸⁶ offer a well-reasoned, sensible approach to ensuring predictable and reliable funding for airport capital development in the United States. One hopes these recommendations do not suffer the abuse of meddling congressional hands.

¹⁸³ *Id.*

¹⁸⁴ *Id.*

¹⁸⁵ *Id.* at *Funding Report*, Part VII.

¹⁸⁶ See generally *id.* for the NCARC’s comprehensive assessment of the FAA and recommendations for reform.

